



EIOPA-13/428  
02 October 2013

**EIOPA Final Report  
on Public Consultation No. 13/008  
on the Proposal for Guidelines on the  
System of Governance  
to EIOPA Insurance and Reinsurance  
Stakeholders' Group (IRSG)**

## Table of Contents

<b>1. Scope</b> .....	<b>3</b>
<b>2. Purpose</b> .....	<b>4</b>
<b>3. Feedback Statement</b> .....	<b>5</b>
I. Introduction .....	5
II. Comments in general.....	5
III. Specific issues raised by respondents.....	11
IV. Comments from Insurance and Reinsurance Stakeholders’ Group (IRSG)..	19
<b>4. Revised Guidelines</b> .....	<b>26</b>
Introduction .....	26
Section I: General Provisions for preparatory Guidelines.....	29
Section II: System of Governance.....	29
Section III: Group governance specific requirements.....	45
Compliance and Reporting Rules .....	47
Final Provision on Review .....	47
<b>5. Revised Explanatory Text</b> .....	<b>48</b>
Section I: General Provisions for preparatory Guidelines.....	48
Section II: System of Governance.....	48
Section III: Group governance specific requirements.....	92
<b>6. Appendixes:</b> .....	<b>97</b>
Appendix 1: Revised Impact Assessment.....	97
Appendix 2: Resolution of comments: .....	110

## **1. Scope**

- 1.1. This Final Report sets out the feedback to the Consultation Paper (CP) No. 13/08, which provides an analysis of responses to the consultation to the comments made by the Insurance and Reinsurance Stakeholders Group (IRSG), describes any material changes to the CP (or confirms that there have been no material changes), and explains the reasons for this in the light of feedback received.
- 1.2. It includes a feedback statement with EIOPA's opinion on the main comments received during the Public Consultation and the revised Guidelines.

## 2. Purpose

- 2.1. EIOPA is issuing Guidelines addressed to National Competent Authorities (NCAs) on how they should prepare for the application of Solvency II. The Guidelines follow EIOPA's Opinion on interim measures regarding Solvency II published on the 20 December 2012<sup>1</sup> (hereafter 'the Opinion'), within which EIOPA:
  - a) Set out its expectations that NCAs, by way of preparing for the new system, put in place, starting on 1 January 2014, important aspects of the prospective and risk based supervisory approach to be introduced by Solvency II.
  - b) Stressed the importance of a consistent and convergent approach with respect to these preparations, notwithstanding the current status of the negotiations on the Omnibus II Directive (OMDII) and the further delay to the application of Solvency II.
  - c) Committed to publish Guidelines addressed to NCAs on how they should meet the expectations described in the Opinion.
- 2.2. The measures set out in the Guidelines are preparatory for Solvency II. In order to ensure effective and meaningful preparation, there needs to be a defined and demonstrable progression towards it. This means that during the preparatory phase, NCAs are expected to ensure that undertakings take steps towards implementing the relevant aspects of the regulatory framework addressed by these Guidelines. In addition this would also ensure that when Solvency II is applicable in their jurisdiction undertakings are better prepared to fully comply with Solvency II. In turn, NCAs will be expected to take the appropriate steps to promote industry's preparation towards Solvency II and to review and evaluate the quality of the information provided to them.
- 2.3. The package in this Final Report reflects EIOPA's position on the comments received and includes:
  - a) Feedback Statement;
  - b) Revised preparatory Guidelines;
  - c) Revised Explanatory Text; and
  - d) Appendixes:
    - Appendix I: Impact Assessment
    - Appendix II: Comments template of IRSG comments

---

<sup>1</sup> <https://eiopa.europa.eu/publications/eiopa-opinions/index.html>

## **3. Feedback Statement**

### **I. Introduction**

- 3.1. EIOPA would like to thank the IRSG for having provided comments on CP No. 13/008. These comments provided valuable suggestions for improving the requirements related to governance and helped to identify areas needing further clarification.
- 3.2. The amendments that have been made cover not only clarifications, including the acceptance of a number of rewording suggestions from respondents, but also some changes to the content of the Guidelines.
- 3.3. The feedback statement outlines the comments received from stakeholders and the IRSG to CP No. 13/08 and the responses by EIOPA to those comments along with resulting changes made to the governance package.
- 3.4. For a complete overview of all comments, responses and resulting changes made please refer also to the comments template (Appendix 2: Resolution of comments).

### **II. Comments in general**

- 3.5. Generally stakeholders supported a move towards a harmonised regime. Stakeholders also highlighted that a proliferation of national requirements should be avoided and a consistent approach adopted across all jurisdictions for the preparation of Solvency II was welcomed.
- 3.6. The following paragraphs address the main comments received and EIOPA's answer to those.
- 3.7. IRSG has raised similar comments during the consultation than other stakeholders. Therefore EIOPA would like to outline these general comments in this Report to the IRSG.

#### **Principle based approach and proportionality principle**

- 3.8. Stakeholders want to see a 'principles based' approach for the preparatory Guidelines. They believe that the Guidelines ought to be proportionate, focus on overall issues and should avoid granularity and not be lengthy.
- 3.9. The approach taken by EIOPA is that the Guidelines do not describe how the requirements are to be applied on a case by case basis, but that they try to be applicable to all possible examples.
- 3.10. EIOPA aims to ensure that the Guidelines are applied in a manner that is proportionate in the context of the preparatory phase, and allows for some flexibility in application of these Guidelines through provisions for 'phasing-in' (i.e. different expectations for 2014 and 2015) and for the use of thresholds. Since proportionality applies whenever there are different ways to achieve expected outcomes, the Guidelines per nature do not explicitly refer to the principle of proportionality at every opportunity but specific proportionality provisions are included such as

materiality thresholds and new recitals in submission of information. As they are generally not setting out how undertakings are supposed to comply with requirements, the Guidelines also do not and cannot give specific examples of what would be considered proportionate under certain circumstances.

- 3.11. EIOPA expects that NCAs ensure that the provisions described in the Opinion are applied 'in a manner which is proportionate to the nature, scale and complexity inherent in the business of the insurance and reinsurance undertaking'. The approach taken aims to ensure that this expectation can be met, and this is reflected in the drafting of the Guidelines in two principal ways:
- a) In most cases, the Guidelines are principle based or drafted with a view to the outcome and supervisory objective that should be met, taking into account the preparatory nature of Guidelines.
  - b) The scope and level of detail of the Guidelines reflects the fact that the Guidelines are issued in order to prepare for Solvency II and not for full Solvency II application from 1 January 2014. When implementing those Guidelines both NCAs and undertakings will be better prepared for Solvency II.

### **Purpose of the preparatory phase**

- 3.12. Stakeholders questioned whether the purpose of the Guidelines was preparation or early implementation of Solvency II.
- 3.13. EIOPA would like to stress that the measures set out in the Guidelines are preparatory for Solvency II. However, to ensure effective and meaningful preparation, there needs to be a defined and demonstrable progression towards Solvency II by both supervisors and undertakings.
- 3.14. This means that during the preparatory phase, NCAs are expected to ensure that undertakings take active steps towards implementing the relevant aspects of the regulatory framework addressed in these Guidelines, so that when Solvency II is applicable, its requirements can be fully complied with. In turn, NCAs will be expected to take the necessary steps to enable them to review and evaluate the quality of the information provided to them, and to discuss with undertakings the progress being made.
- 3.15. The Guidelines are drafted using the formula "national competent authorities should ensure that" which supports this approach. In fact the Opinion stated that NCAs 'should put in place, starting on 1 January 2014, certain important aspects of the prospective and risk based supervisory approach to be introduced'. It is for NCAs to decide how to integrate the preparatory Guidelines into their regulatory or supervisory frameworks. It is important to emphasise the starting and the expected phasing-in approach here: NCAs and undertakings are expected to progress in their preparedness for Solvency II during the course of the preparatory phase.
- 3.16. Undertakings are expected to achieve the outcomes expected, taking into account the preparatory nature of the Guidelines. EIOPA expects that

Guidelines are implemented by NCAs in a way that undertakings' Systems of Governance and processes for Forward Looking Assessment of Own Risks (FLAOR) as well as for Submission of Information are in place and aligned with the requirements in the preparatory Guidelines. This should allow undertakings to perform the FLAOR during 2014 and 2015, as defined in the respective Guidelines and to submit the information within the framework defined in 2015.

### **Enforcement measures and supervisory actions**

- 3.17. Stakeholders supported that the preparatory phase should enable NCA's to assess preparedness but that it should not lead to any enforcement measures, asking for this clarification to be explicitly dealt with in a Guideline rather than in the introductory text.
- 3.18. EIOPA clarifies that NCAs are expected to comply with the Guidelines by ensuring that undertakings meet the specified outcomes taking into consideration its preparatory nature.
- 3.19. EIOPA Guidelines do not give indications on enforcement measures in relation to the implementation by undertakings of the preparatory Guidelines or in the specific way of implementation itself.
- 3.20. The means by which each NCA incorporates EIOPA Guidelines into their supervisory or regulatory frameworks is left at their discretion and it is not an EIOPA competence. When considering the best appropriate way to incorporate EIOPA Guidelines NCAs may be affected by their competences and powers and specific tools used at national level to incorporate the Guidelines.
- 3.21. Regardless of how NCAs incorporate the Guidelines at national level, EIOPA expects as an active step a dialogue to take place between NCAs and undertakings during the preparatory phase in order to prepare for Solvency II.
- 3.22. The preparatory Guidelines in itself do not require supervisory actions, in particular regarding failures by undertakings to comply with Solvency II Pillar I requirement as a result of the information provided during the preparatory phase.
- 3.23. Nevertheless, the following two examples on supervisory action would be expected:
  - a) It is expected that undertakings take into consideration any information arising from the implementation of the system of governance or from the performance of the FLAOR in the performance of their business or future business planning. It is also expected that a dialogue between NCAs and undertakings would take place, when appropriate. Although the dialogue could take this arising information into consideration, the preparatory Guidelines do not require NCAs to require an increase of capital, if the received information suggests a failure with Solvency II Directive requirements.

- b) When NCAs receive information on the calculation of the SCR and the determination of Own Funds it is expected that NCAs review the quality of the information received and that they may take supervisory actions if the quality of the information raises concerns. But it is not expected from the preparatory Guidelines that NCAs would take any supervisory action if the Own Funds are lower than the SCR.

### **Status of Solvency II Directive and the Delegated Acts (Implementing measures and Technical Standards)**

- 3.24. Stakeholders asked for clarifications about the interaction between the preparatory Guidelines and the overall Solvency II negotiation process. They also asked that the associated timing of submission of information and the link to pillar I ought to be spelled out in different scenarios if the Omnibus II Directive has not been agreed or has not progressed sufficiently by the end of 2013.
- 3.25. The Guidelines provide direct references to the corresponding provisions set out in Solvency II Directive. EIOPA acknowledges that certain parts of Solvency II Directive are to be revised by the OMDII and that delegated acts proposal have not yet been finalised by the European Commission yet.
- 3.26. These direct references to Solvency II are made using the expression "In accordance with..." indicating the legal basis of the topic, without prejudice to the current revision of Solvency II Directive by OMDII.
- 3.27. Although the comply-or-explain replies are provided to the preparatory Guidelines only, it is anticipated that during the preparatory phase NCAs and undertakings are preparing for the implementation of all areas covered by Solvency II Directive and not only those covered by the preparatory Guidelines.
- 3.28. EIOPA highlights that the current working assumption for the preparatory Guidelines is that Solvency II will be applicable from 1 January 2016. Under this assumption, starting the preparatory phase from 2015, as requested by some stakeholders, would be too late, especially for the System of Governance including the Forward Looking Assessment of Own Risks and reporting processes.
- 3.29. Final Solvency II Directive requirements will be determined by the OMDII, and the delegated acts. EIOPA is working under the assumption that these measures will be available in time for NCAs and undertakings to prepare for the submission of the forward looking assessment during 2014 and 2015 and the quantitative and qualitative information in 2015. In which case, at that stage, EIOPA would prepare technical specifications on Pillar I quantitative issues, including on the valuation of technical provisions, assets and liabilities other than technical provisions, the SCR and the Underlying Assumptions of the SCR formula and provide guidance on the assumptions underlying the calculation of the standard formula calculation, which reflect the decision on OMDII.

- 3.30. However, as this assumption is based on the current agenda of OMDII negotiations, for the submission of information and the report on the Forward Looking Assessment the submission dates will be reviewed at the end of 2013 based on the latest developments with regard to Omnibus II. A revision clause will be introduced in the Guidelines accordingly.

### **Minimum or maximum harmonisation**

- 3.31. Stakeholders questioned the extent to which any Guidelines would be 'mandatory' or whether NCAs could go beyond them, i.e. whether 'minimum' or 'maximum' harmonisation is being sought. It is understood that NCAs could choose to go further than any Guidelines issued by EIOPA which, in the view of stakeholders, may not be desirable or practical.
- 3.32. In fact NCAs may have current legislation or regulation that already go beyond the provisions set by the Guidelines and may also do it in future, to the extent that it is consistent with Union law as Solvency II Directive entered into force on the 6 January 2010 (Article 311).

### **Status of the Explanatory Text**

- 3.33. Stakeholders commented on the status of the Explanatory Text. Stakeholders pointed out that the Explanatory Text should not provide a further layer of requirements, as it was not subject to public consultation.
- 3.34. EIOPA would like to clarify that the Explanatory Text is not subject to the comply-or-explain obligation. The aim of the Explanatory Text is to provide illustrations on how Guidelines or certain parts of them can work in practice, adding cross references, concrete applications or examples without creating new obligations that should be complied with. Its content is intended to offer support to the users of the Guidelines and therefore it does not need to be publicly consulted.
- 3.35. In the Explanatory Text, examples of good practices are given, i.e. it shows in more detail on case by case basis examples on how proportionality can be applied, and it presents as well tables in order to help visualise certain structures on an exemplary basis.

### **Application by third countries**

- 3.36. Stakeholder argued that it would be inappropriate any extra-territoriality to be applied on an interim basis. They believe that only EEA undertakings should be subjected, directly or indirectly, to requirements at this stage which require any degree of adaptation to the Solvency II regime.
- 3.37. EIOPA does not expect that supervisory authorities in third countries apply the preparatory Guidelines. The Guidelines are not subject to equivalence analysis nor do they pre-empt any decision taken in past or future by the European Commission regarding equivalence.

- 3.38. In the CP No. 13/010 and in the revised preparatory Guidelines it was clarified that “When the deduction and aggregation method is applied, insurance and reinsurance groups are allowed to use solvency capital requirements and eligible own funds of related third country undertakings calculated according to their local rules for the purposes of these Guidelines only, and without prejudice to any future European Commission equivalence determinations and any future decisions of group supervisors”, meaning that all third countries would be considered equivalent during the preparatory phase regardless of any equivalence analysis conducted or applied for.
- 3.39. Notwithstanding this, with regard to pillar II requirements as the preparatory System of Governance and the Forward Looking Assessment of Own Risks EIOPA assumes that third country supervisors have similar parts of risk management in their national requirements, as the preparatory Guidelines where these follow international standards.
- 3.40. When referring to group structures or group level the preparatory Guidelines apply to EEA groups only. They do not apply to branches of third country (re)insurance companies set up in the EEA.

### **Comply-or-explain mechanism**

- 3.41. Article 16 of the EIOPA Regulation sets out that NCAs have to report to EIOPA within 2 months from the publication of the Preparatory Guidelines whether they comply or intend to comply with each Guideline. In case NCAs do not comply with a guideline they need to provide an explanation about the reasons for non-compliance. Such obligation is set in Article 16 of the EIOPA Regulation.
- 3.42. The answers on comply-or-explain provided by NCAs will be made publicly available by EIOPA. In the cases of not compliance, the reasons will be kept confidential unless agreed otherwise by the Board of Supervisors.
- 3.43. The NCAs replies provided during the comply-or-explain will be updated later on after the submission of the progress report by NCAs to EIOPA.
- 3.44. EIOPA recognises that in a significant number of member states, the NCA does not have the legal competence to enact the relevant financial legislation and is dependent on the powers bestowed upon it.
- 3.45. If NCAs don't comply with the Guidelines then, by nature EIOPA expectations on NCAs actions need to be considered accordingly.

### **Progress report**

- 3.46. The progress report is a tool to facilitate communication between EIOPA and the NCAs but it is not part of the requirements for preparation towards Solvency II.
- 3.47. NCAs are required to submit a progress report to EIOPA by the end of February during two years after the application of the Guidelines. The first NCA's progress reports should be submitted by 28 February 2015, based on the period from 1 January 2014 to 31 December 2014.

- 3.48. It is up to the NCAs to decide how the level of detail of the information given to EIOPA in the progress reports and how this information has to be gathered at national level.

### **III. Specific issues raised by respondents**

#### **Decision-making**

- 3.49. Guideline 6 about decision-making is almost universally criticised although stakeholders have different concerns. There are also requests for providing a definition for “significant decision”.
- 3.50. EIOPA has carefully drafted this Guideline to be applicable for the different governance structures across the European Union. Some of these structures provide for one person, e.g. a CEO, to represent the undertaking and the intention is not to interfere with those existing national structures. “Persons who effectively run the undertaking” are not limited to the AMSB but may include senior management members. Effective controls, where a decision could potentially seriously affect the undertaking, need to be applied at all levels of the undertaking and even where one person represents an undertaking. There needs to be assurance that there is involvement of somebody with sufficient seniority who can effectively challenge such a decision.
- 3.51. What constitutes a significant decision is addressed in the Explanatory Text (see 1.22). This gives an explanation rather than a definition. In EIOPA’s view this is appropriate to ensure that the undertaking should not apply an approach to the Guideline that is too narrow, but meets the purpose of the requirement.

#### **Fit and proper requirements**

- 3.52. Respondents claim that EIOPA goes beyond the requirements of Solvency II Directive in calling for undertakings to apply the fit and proper requirements also to other personnel than the persons explicitly named in Article 42 of Solvency II Directive.
- 3.53. EIOPA acknowledges that the wording of the Guidelines was not sufficiently clear. Therefore, the text is changed to leave no doubts that although the undertaking is as well responsible for ensuring that personnel outside the scope of Article 42 are sufficiently qualified and reliable for the tasks and responsibilities entrusted to them this does not mean that they are subject to the same fit and proper requirements, which apply to persons who effectively run the undertaking or have other key functions.
- 3.54. The outsourcing of key functions is another issue that raises concerns by stakeholders. Requiring all persons performing the outsourced key function at the service provider to be fit and proper was seen as disproportionate and extending beyond the Directive and draft Implementing Measures. It is suggested that the requirements should only apply to the persons who effectively run the service provider or that it should be possible to delegate the responsibility for ensuring that

relevant personnel is fit and proper to the service provider via the outsourcing agreement.

- 3.55. The scope of the fit and proper requirements in case of outsourcing of key functions is determined by the Directive. According to Article 42 (1) of Solvency II Directive all persons who have other key functions, i.e. who perform key functions, need to be fit and proper. However, only the person responsible for a key function has to be notified to the supervisory authority<sup>2</sup>. The fit and proper requirement applies regardless of whether the key function is performed by employees of the undertaking or is outsourced to a service provider.
- 3.56. When a key function is outsourced, the undertaking is expected to explicitly address the fit and proper requirements for the persons performing the function at the service provider in the outsourcing agreement. However, it is not sufficient to rely on the contract with the service provider to ensure that requirements are met. Since, according to article 49 (1) of Solvency II Directive, the undertaking cannot delegate responsibility for the compliance with regulatory requirements in case of outsourcing, it has to ascertain that the requirements are observed. That does not necessarily mean that the undertaking itself has to assess whether the relevant personnel employed by the service provider is fit and proper but it has to be part of the general monitoring of the outsourcing agreement.

### **Key functions**

- 3.57. Stakeholders' comments about the role and responsibilities of the key functions are divided. While some stakeholders consider the preparatory Guidelines to be too prescriptive and not sufficiently principles-based, others expect more information about the division of tasks between key functions, in particular the risk management and the actuarial function.
- 3.58. EIOPA underlines that Solvency II Directive generally leaves it to undertakings to organise themselves and to decide on their internal structures. However, the Directive sets out which of the key function is responsible for which tasks and undertakings cannot deviate from this distribution of tasks. EIOPA has clarified and specified some of these requirements but has not drafted additional requirements, i.e. everything that respondents consider to be too prescriptive is already mandatory on account of Solvency II Directive and cannot be changed by EIOPA.
- 3.59. In order not to restrict undertaking's discretion in organising themselves EIOPA does not intend to elaborate further on the division of tasks and cooperation between the key functions. It is up to the undertakings to justify their organisational decisions and demonstrate how these structures do not conflict with the requirement. The requirements include appropriate segregation of responsibilities and the general principles underlying the decision of the Directive that certain tasks shall be carried out by a specific key function.

### **Risk management**

---

<sup>2</sup> Notification is not part of the Preparatory Guidelines but is required by Article 42(2) of Solvency II Directive.

- 3.60. The chapter on risk management is generally considered to be too prescriptive and detailed by stakeholders who especially object to the content of the risk management policy. Several respondents claim that the Guidelines introduce new requirements as compared to Solvency II Directive and draft Implementing Measures.
- 3.61. EIOPA believes the section is sufficiently principles based. The Guidelines generally do not prescribe how undertakings should manage their risks, but just mention obvious issues to be considered or the most basic tools and methods to be employed. EIOPA believes that the Guidelines comprise risk management standards which are considered to be matter-of-course and wide spread practices.
- 3.62. The Guidelines specify the Directive requirements but do not add any new requirement. In reviewing the Guideline EIOPA has assured again that the Guidelines do not go beyond Solvency II Directive. However, EIOPA has clarified the connection with Solvency II Directive in the Resolution Template.
- 3.63. Stakeholders also see the requirement for undertakings to have sub-policies of the risk management policy in place as disproportionate during the preparatory phase. The required regular stress-testing is another issue that respondents object to. Some stakeholders have pointed out that there should be no additional stress testing required on top of stress testing for solvency and capital needs in the framework of the ORSA.
- 3.64. EIOPA underlines that undertakings need to have all sub-policies in place at the start of Solvency II which implies that they should use the preparatory phase to draft these sub-policies and implement them step-by-step during this phase. Please refer to the general comments above on the purpose of the preparatory phase.
- 3.65. Stress tests and scenario analyses do in EIOPA's view not only help to establish solvency and capital needs but also to determine how exposed the undertaking is to certain risks. The Guidelines on the risk management policy only require the undertaking to consider the frequency and content of regular stress tests and the trigger for ad-hoc stress tests. It is up to the undertaking to decide how much stress testing is appropriate

### **Operational risk**

- 3.66. Regarding operational risk respondents object to the requirement to set risk tolerance limits, claiming that such limits are difficult to set for operational risk and therefore unsuitable. Most stakeholders further oppose the implementation of a system for collecting and monitoring operational risk events with the argument that this is disproportionate for small undertakings and goes beyond Solvency II Directive and draft Implementing Measures requirements.
- 3.67. EIOPA underlines that undertakings are required by Article 44 of Solvency II Directive to identify, measure, monitor, manage and report all risks to which they are or could be exposed. While EIOPA acknowledges that assessing operational risk is not an easy task, undertakings still need to address operational risk and to determine what measures they need to

take to reduce and mitigate operational risk to an acceptable and proportionate level.

- 3.68. From that requirement of the Directive also follows the need to systematically collect and monitor operational risk events. Guideline 19 in no way implies that this necessarily requires that undertakings implement an electronic data base for operational risks. Undertakings can choose whatever approach is seen as appropriate by them taking into account the proportionality principle.

### **Prudent Person Principle**

- 3.69. Stakeholders oppose the inclusion of the prudent person principle in the preparatory Guidelines claiming that it is not part of the system of governance requirements and introduces Pillar I requirements into the preparatory phase. Putting additional constraints on top of the existing investment regime was seen as impractical.
- 3.70. EIOPA does not agree that the prudent person principle is only part of the quantitative requirements of Pillar I and therefore does not belong to the system of governance requirements. There is a clear connection in Article 44(3) of Solvency II Directive to the prudent person principle which is qualitative not quantitative in nature. The undertaking's investment risk management has to comply with the prudent person principle.
- 3.71. As the investment risk management of undertakings is to be fully compliant with the prudent person principle at the start of Solvency II, undertakings have to consider during the preparatory phase what changes they need to introduce into their existing portfolio of assets to make the transition to a portfolio that is appropriate according to Solvency II requirements. This implies that undertakings are expected to take into account the Solvency II implications of investment decisions. Solvency I and Solvency II may lead to different decisions in some cases, which is the reason why the potential Solvency II impact of a decision under the current regime cannot be disregarded in the decision-making process during the preparatory phase.
- 3.72. Among the most opposed requirements under the prudent person principle is the development of an own set of key risk indicators by the undertaking and the requirement not to solely depend on the information provided by other financial institutions, asset managers and rating agencies (see Guideline 25). For some stakeholders the requirement for key risk indicators would be more appropriate as a general requirement over any material risks while others reject key risk indicators as outside the scope of the prudent person requirements.
- 3.73. In EIOPA's view Guideline 25 specifies the requirement of Article 132 of Solvency II Directive that undertakings are only allowed to invest in assets and take on board risks the undertaking can properly identify, measure, monitor, manage, control and report. Key risk indicators are an important monitoring tool that helps to ensure that undertakings are able to be compliant with this requirement.
- 3.74. In addition EIOPA believes that a second opinion on investment risk challenging the views of financial institutions, asset managers and rating agencies would increase overall risk management. Therefore, proper

monitoring and controlling of assets and investments requires that the undertaking does not blindly trust such information but also establishes sufficient expertise to form its own assessments. Guideline 25 does not imply that all undertakings should have rating agency expertise in-house. Rather undertakings should develop an approach that is proportionate taking into account the risks in their investments.

### **Governance of own funds**

- 3.75. With regard to the governance of own funds stakeholders claim that there is no direct link between these Guidelines and Article 41 of Solvency II Directive and that a capital management policy is neither required by Solvency II Directive nor the draft Implementing Measures. Some stakeholders are of the opinion that this policy should be covered by the ORSA. For the preparatory phase the majority of stakeholders want to see Guidelines 31 and 32 to be deleted.
- 3.76. EIOPA believes that both the governance requirements of Article 41 and the own funds requirements of Article 93 are relevant Solvency II Directive text. The point is that in order to comply with these requirements in the future there will need to be adequate governance over own funds and capital management. More generally, sound and prudent management of an undertaking subject to the Solvency II regime *inter alia* calls for a capital management policy setting out the procedures necessary to properly attend to the question of eligibility of own funds as well as a capital management plan. This plan should cover the business planning period and should ensure that the undertaking takes active steps towards providing for an adequate level of eligible own funds at any time.
- 3.77. Under the current Solvency I based system, some stakeholders seem to consider that the quality of own funds is not an important issue as it will be under the Solvency II regime and that Solvency I own funds require less monitoring by comparison. EIOPA is concerned that undertakings in preparing for the new regime may not therefore give enough attention to what processes and procedures are necessary to ensure the eligibility of own funds unless the topic is explicitly addressed in the preparatory Guidelines. Moreover, Guidelines 31 and 32 should be understood from a dynamic perspective. Hence, the governance of current own funds would need to increase the closer the Solvency II regime comes and to reflect the more complex own funds structure under Solvency II. This is fully in line with the future-oriented approach of the preparatory Guidelines. (Please also see the general comments above 'Purpose of the preparatory phase').
- 3.78. While EIOPA acknowledges that, with regard to the topic of capital management, it can be argued that the relevant Guidelines may perhaps be better placed in the Guidelines on the Forward-looking assessment of own risks, EIOPA considers policies and plans in general to be System of governance issues.

### **Compliance Function**

- 3.79. A number of stakeholders express the view that the Guidelines do not sufficiently address the compliance function and request that EIOPA should clarify the tasks and responsibilities of this key function during the preparatory phase.
- 3.80. EIOPA considers the Directive text to be sufficiently explicit on the compliance function's role. It is also clear what relevant input the function could provide during the preparatory phase. In particular, the compliance function will have an important role in ensuring that the preparatory measures taken by the undertaking are suitable for enabling it to be fully compliant with all requirements at the start of Solvency II.
- 3.81. Accordingly, in line with its general reticence about giving guidance as to how certain outcomes are to be achieved, EIOPA will leave it to the undertaking itself to decide on best way to organise the compliance function and its responsibilities.

### **Internal audit policy**

- 3.82. Stakeholders question whether the whistle-blowing to the supervisory authority and staff rotation should be required of the internal audit function (see Guideline 36). The objection is not only that there is no legal basis for either of these demands in Solvency II Directive and draft Implementing Measures, but also that some stakeholders consider that whistle-blowing and staff rotation would actually have a detrimental effect.
- 3.83. EIOPA has clarified that both issues should be considered for establishing the internal audit policy, bearing in mind proportionality, but that no mandatory whistle-blowing to the NCA or staff rotation requirement is intended.
- 3.84. However, EIOPA does not share stakeholders' view that these measures normally would have negative effects. Whistle-blowing to the NCA can be a suitable escalation measure where the internal audit function has identified major deficiencies that the AMSB fails to address appropriately. This does not affect the distribution of responsibilities between the internal audit function which reports its findings to the AMSB and the AMSB which decides what to do about them. But it could improve the governance of the undertaking if the AMSB knows that any decision not to act on major findings of the internal audit function could come to the attention of the NCA concerned.
- 3.85. Provided that the number of staff members in the internal audit function has a size that allows rotation to take place, changing responsibilities after a number of years can have a positive effect by increasing objectivity and avoiding potential conflicts of interest. However, this advantage has to be weighed against the need to develop and maintain specialist knowledge in the internal audit function and may make it inexpedient to rotate all staff.

### **Actuarial Function**

- 3.86. Several stakeholders argue that the tasks of the actuarial function are only relevant for the submission of preparatory information to the NCA as there is no framework for the valuation of technical provisions during the

preparatory phase due to the status of OMDII negotiations. They request that for this reason there should be fewer requirements regarding data quality, testing against experience and reporting to the AMSB.

- 3.87. The section about the actuarial function has been reviewed very carefully following the consultation and EIOPA introduces important changes on account of comments received. However, undertakings should not underestimate the work required to get the actuarial function ready for Solvency II during the preparatory phase. This is not limited to helping with the submission of information to the NCA. Undertakings need to take the necessary steps to ensure that they can apply the Solvency II valuation framework correctly as soon as Solvency II Directive applies in their jurisdiction. This is where the actuarial function has an important role. Waiting for the final framework to emerge before it effectively applies, carries the risk that the undertaking lacks sufficient time to prepare and to implement necessary internal steps and procedures.
- 3.88. Also the AMSB should not only concern itself with potential problems in the valuation of technical provisions once the requirements are applicable, but should be informed about the outcome of various tasks as appropriate in order to be able to react if necessary. Hence, already introducing internal reporting requirements on the technical provisions during the preparatory phase is seen by EIOPA as an appropriate step of preparation towards Solvency II.

### **Outsourcing of underwriting**

- 3.89. There is stakeholders' uncertainty with regard to the applicability of Guideline 49 to activities subject to Insurance Mediation Directive (IMD). The stakeholders are of the view that outsourcing requirements can only govern activities not covered by Insurance Mediation Directive (IMD).
- 3.90. EIOPA underlines that Guideline 49 aims to clarify that activities captured by the IMD can still fall under the outsourcing requirements where these activities meet the definition of outsourcing. Underwriting falls under that definition if the person mandated with the underwriting is not an employee and acts on behalf and on account of the undertaking, i.e. makes the final decision about the underwriting.

### **Scope of outsourcing**

- 3.91. Some stakeholders want EIOPA to limit the scope of the outsourcing requirements. They consider the scope as too wide generally or want it stressed that the outsourcing requirements only apply to critical or important activities of key functions or alternatively to critical or important functions and (re)insurance-specific activities. Respondents also ask EIOPA to clarify whether the outsourcing requirements are applicable during the preparatory phase.
- 3.92. EIOPA has amended the title of Guideline 48 towards critical or important activities. Outsourcing is defined by Solvency II Directive (Article 13. (28)) and EIOPA cannot deviate from that – fairly wide – definition. The Guidelines are based on Article 49(2) of Solvency II Directive. The requirements set out there apply to critical or important operational

functions or activities. The latter – in accordance with Article 49(2) - do not have to be insurance-specific.

- 3.93. All outsourcing arrangements concerning critical or important functions and activities have to be compliant with the aforementioned specific outsourcing requirements when Solvency II starts. This includes existing outsourcing arrangements as Solvency II Directive does not have any grandfathering clause on this. Therefore undertakings are expected to use the preparatory phase to bring those arrangements in line with these requirements.

### **Group specific part**

#### **Group level AMSB and individual AMSB interaction**

- 3.94. Many comments raise the issue that the respective roles of the Group AMSB and the AMSBs of undertakings in the group may be inconsistent and also asked some clarification about how the group AMSB and the AMSB of individual undertakings interact.
- 3.95. EIOPA considers that the role and responsibilities of the AMSB of an undertaking is not diminished because this undertaking is part of a group. Nevertheless, the AMSB of the responsible entity has the same type of role and responsibilities at the level of the group. It is very important that the AMSB of the responsible entity is in a situation to challenge the decisions of the AMSB of a related undertaking when these decisions have a material impact on the group (see Guideline 3). It is also important that the AMSB of the group does not impair the responsibilities of the AMSB of the related undertaking when setting up its own system of governance (see Guideline 53).

#### **Group key functions and individual key functions interaction**

- 3.96. Many stakeholder comments raise the issue that the respective roles of the group key functions and the key functions of related undertakings may be inconsistent, in particular for the actuarial function as the technical provisions are calculated at individually entity level. Stakeholders also ask for clarification about how the key functions at the level of the group and at the level of individual undertakings interact.
- 3.97. EIOPA considers that the role and responsibilities of the key functions of an undertaking are not diminished because this undertaking is part of a group. Nevertheless, the key functions of the individual entities within the group have the same role and responsibilities as the key functions at the level of the group.
- 3.98. It is important to consider that a key function of a group could also serve as a key function of an undertaking of a group and vice versa, these functions do not necessarily need to be separated. For example, the risk management of the undertaking may be a part of the risk management of the group. That is why EIOPA does not consider that there is an inconsistency in saying that the group actuarial function is coordinating the calculation of technical provision at the level of the group, while at the same time there is at the level of the individual undertaking an actuarial function in charge of coordination of the calculation of the undertaking's technical provisions.

### **Jurisdiction over the groups**

- 3.99. Many stakeholder comments raise the issue that it is not possible to have requirements on groups as there is no jurisdiction over groups.
- 3.100. EIOPA acknowledges the fact that in the Solvency I regime, apart from adjusted solvency margin calculation for groups and intra-group transactions, only the Helsinki protocol applies. Regardless of this fact, it is possible for EIOPA to issue Guidelines on the matter of group governance as a preparatory exercise for Solvency II. It is also possible because, as a result of the Helsinki protocol, Coordination Committees, which are now named colleges, are in place for European groups.
- 3.101. In each group there is an entity responsible for the fulfilment of the governance requirements at group level, the rules to be applied for the group will be defined by the jurisdiction where this entity is located.

## **IV. Comments from Insurance and Reinsurance Stakeholders' Group (IRSG)**

- 3.102. IRSG generally supports EIOPA's decision to provide preparatory Guidelines on the system of governance.
- 3.103. As mentioned in the IRSG Activity Report 2011 – 2013, in spring 2012 EIOPA shared a previous version of first draft Guidelines on the System of Governance, on which these preparatory Guidelines are based, with members of the IRSG in their personal capacity. The IRSG subgroup Governance discussed those draft Guidelines and gave informal feedback by mid-2012.
- 3.104. An on-going constructive dialogue continues between the IRSG subgroup and the corresponding EIOPA staff member, which lead to a substantially positive opinion by the IRSG on the consultation on those preparatory Guidelines.
- 3.105. EIOPA would like to thank IRSG for the constructive and effective cooperation during the public consultation.
- 3.106. Many issues, which IRSG raises in the public consultation, are already reflected upon in this Final Report. Please see the general comments and the specific comments above.

### **Inconsistencies with EBA Guidelines**

- 3.107. According to IRSG any differences between the Guidelines and corresponding texts by EBA should be justified or otherwise be eliminated.
- 3.108. EIOPA is fully aware of differences between the Guidelines (and corresponding Solvency II Directive) and governance texts by EBA (and the corresponding Directives for credit institutions and investment firms). However, EIOPA has to follow the terminology of Solvency II Directive as this Directive is the basis of the preparatory Guidelines. Therefore if the terminology used in Solvency II Directive deviates from the relevant Directives and regulations in the banking sector it is for the EU

Commission to address and align Directives and regulations as appropriate.

### **Reporting by the AMSB and internal review of the system of governance**

- 3.109. Since the Guidelines are silent on the subject of reporting by the AMSB, IRSG proposes that EIOPA should include an additional paragraph in Guideline 4 that requires that the AMSB reports at least annually on the discharge of its functions both publicly and to specifically interested classes of stakeholders.
- 3.110. In addition IRSG proposes that reporting of the scope, findings and conclusions of the review of the system of governance should not be limited to the AMSB of the undertaking but should be extended to specifically interested classes of public stakeholders as appropriate.
- 3.111. The reason the Guidelines are silent on reporting by the AMSB is that Solvency II Directive does not provide for corporate governance requirements. The Directive only deals with internal governance. Therefore, there is no basis for requiring the AMSB to report externally on how the AMSB has discharged its duties. Accordingly, while EIOPA does not deny that it might have a beneficial effect if AMSBs were to take responsibility for their actions and omissions in this way; such a requirement is seen as outside the scope of the preparatory Guidelines for Solvency II.
- 3.112. EIOPA would like to point out that the Solvency and Financial Condition Report based on Article 51 of Solvency II Directive includes information on the system of governance.

### **Conflicts of interest**

- 3.113. Acknowledging the importance of effective management of conflicts of interest IRSG suggests an amendment to Guideline 9 according to which procedures are to be established and communicated by the undertaking for the identification and management of potential conflicts of interest in relation to governance.
- 3.114. Potential conflicts of interest lie at the root of the requirement to ensure an appropriate segregation of duties according to Article 41(1) of Solvency II Directive. So undertakings already have to identify (potential) conflicts of interest and to avoid them or manage the conflicts of interest sufficiently if such recognized conflicts do not lead to the decision to segregate the different tasks. Accordingly, the preparatory Guidelines do not repeat the requirement of the Directive. Although Solvency II Directive covers public disclosure requirements through Article 51 on the Solvency and Financial Condition Report, which will include information on the system of governance, these public disclosure requirements are outside the scope of the preparatory Guidelines. As far as communication of the identification and management of potential conflicts of interest to the NCA is concerned, the NCA can ask an undertaking at any time on how it addresses the issue.

### **Key functions**

- 3.115. IRSG suggests that, according to the principle of proportionality, small and medium-sized undertakings should be explicitly allowed to have one individual performing more than one key function. The only exemption from this would be the internal audit function.
- 3.116. EIOPA would like to stress that proportionality is an underlying principle to all Guidelines, which is always linked to the nature, scale and complexity of the risks to which an undertaking is or may be exposed. The size of an undertaking alone can never be a reason to accept simpler solutions for the implementation of requirements. However, EIOPA does agree that for key functions other than the internal audit function smaller and less complex undertakings could be allowed to allocate more than one key function to one person. EIOPA would like to stress the fact that possible conflicts of interest need to be addressed accordingly.

### **Fit and proper for persons who effectively run the undertaking or have other key functions**

- 3.117. With regard to the fitness requirements IRSG proposes that Guideline 11 should include the consideration at the adequacy of training arrangements in support of diversity.
- 3.118. In addition IRSG is concerned about the use of the term “personal behaviour” in Guideline 12 on the proper requirements which is seen as potentially too open-ended and suggests that it should be deleted or at least changed to “personal conduct”.
- 3.119. EIOPA considers the terms “personal behaviour” and “personal conduct” to be interchangeable. Neither of the terms allows taking into account what a person does in their private sphere. Personal conduct is only relevant in so far as it reflects on whether the person presents an unacceptable moral hazard as a person having a key function in the undertaking.
- 3.120. Undertakings are required by Article 42 of Solvency II Directive to ensure that persons who effectively run the undertaking or have other key functions are continuously fit and proper. This includes, where necessary, that the persons concerned receive the training to keep their qualifications up to the required level. In EIOPA’s view adding the point to Guideline 11 as requested by IRSG does not enhance the clarity nor promote a better understanding of the Guideline. In addition, training as an issue for undertakings may have a longer time horizon than Solvency II. For this reason, EIOPA did not consider it appropriate to include this subject in the preparatory Guidelines.

### **Risk Management**

- 3.121. In Guideline 18 on underwriting and reserving risk IRSG suggests a reference to risk aggregation be added.
- 3.122. In addition IRSG considers paragraph 1.45 of Guideline 19 on operational risk to extend beyond the requirements of Article 44 of Solvency II Directive and proposes that it be either justified or deleted.
- 3.123. As a further request IRSG asks for Guideline 21 e) that the intention of that subparagraph is clarified in the Explanatory Text. IRSG does not

understand why the importance of adherence to originally communicated aims for unit-linked funds is specifically mentioned in the context of reinsurance or risk mitigation although it is not limited to the use of these tools.

- 3.124. According to Article 44 (1) of Solvency II Directive undertakings already have to take into account the risks of aggregation on an individual as well as on an aggregated level.
- 3.125. According to Article 44(1) of Solvency II Directive undertakings need to have in place strategies, processes and reporting procedures necessary to monitor, manage and report on the risks to which they are or could be exposed to. This includes operational risks. In EIOPA's view these requirements will be met, when identifying all operational risks that have crystallized and their near misses.

### **Prudent Person Principle**

- 3.126. IRSG requests that the preparatory Guidelines addressing derivatives be consolidated.
- 3.127. For Guideline 30 IRSG suggests that in line with the Explanatory Text sponsors' interests should also be taken into account in the wording of the Guideline.
- 3.128. Merging the Guidelines on derivatives is not possible as all paragraphs carry different and important messages. The aim of these Guidelines is not to specify the purpose(s) of the use of derivatives. Rather it is to require that undertakings actually show that in accordance with Article 132 (4) of Solvency II Directive the use of derivatives has actually served the purposes for which they were intended.
- 3.129. EIOPA has further added the word "sponsor" to the Guideline as proposed by IRSG to provide consistency between the Guideline and the Explanatory Text.

### **Governance of own funds**

- 3.130. IRSG does not object to the fact that two Guidelines on the governance of own funds are included in the preparatory Guidelines but points out that both Guidelines may require clarification that no detailed own funds requirements have been implemented.
- 3.131. While further specifications of the own funds requirements are expected from the Implementing Measures and Technical Standards, Solvency II Directive already provides important information about own funds requirements. Undertakings are expected to take first steps to comply with these requirements during the preparatory phase. Without further specifications undertakings may not be in a position to determine whether current own funds all meet future own funds requirements. Although full compliance with future requirements is not the aim of the preparatory Guidelines, undertakings should already consider to what extent they may need contingency plans when the detailed own funds requirements will be established.

### **Internal controls**

- 3.132. Concerning Guideline 34 on monitoring and reporting IRSG agrees with the Guideline in principle but considers the wording to be too general to be verifiable. In addition IRSG is of the opinion that the point made is already sufficiently covered by Guidelines 6 and 7.
- 3.133. While the Guideline 34 does not mention this explicitly, the monitoring and reporting mechanisms established as part of the internal control system are to be documented. Additionally, the documentation of decisions taken by the AMSB (Guideline 7) would be expected to show that information from the internal control system has been taken into account. Guidelines 6 and 7 both address decision-taking at the level of the AMSB but do not cover the same issues as Guideline 34. Guideline 6 does not concern the information basis for decision-taking at all, but relates to any significant decision regardless of the topic. Guideline 7 refers to the input from the risk management system only.

### **Internal audit**

- 3.134. IRSG is of the view that there should be procedures for the escalation of internal audit findings and the Group would usually expect this escalation to take place via an independent audit committee. In this context the IRSG asks for an explanation of the rationale and intention behind the part of the internal audit policy dealing with internal rules setting out the procedures, which the person responsible for the internal audit function needs to follow before informing the supervisory authority.
- 3.135. Through changes in the wording of the Guideline EIOPA has expressed more clearly that it expects undertakings to consider allowing and providing procedures for whistle-blowing to the NCA as an escalation measures where the AMSB fails to respond to the identification of material deficiencies. EIOPA considers such a measure to be potentially beneficial as it could incentivize the AMSB to react to serious problems in a timely manner. Please see above the section on 'Internal audit policy', too.

### **Actuarial Function**

- 3.136. With regard to the actuarial function IRSG considers Guideline 42 on valuation models of technical provisions to lack a relation to Article 48 of Solvency II Directive and to be unclear in its intent.
- 3.137. IRSG further asks for the deletion of Guideline 40 on the grounds that a combination of calculation and validation tasks in the actuarial function does not result in conflicts of interest.
- 3.138. Concerning Guideline 43 on data quality IRSG suggests that the second paragraph either should be more clearly worded – and makes a specific drafting proposal – or deleted.
- 3.139. The main responsibilities of the actuarial function revolve around the coordination of the calculation of the technical provisions. This coordination tasks includes the responsibility for valuation models. As the Guideline is more about what the actuarial function has to take into account in performing the task, EIOPA acknowledges that the Guideline may be more appropriately placed in the future Guidelines on the valuation of technical provisions. Accordingly, EIOPA has removed this

part of the Guideline from the preparatory Guidelines. However, one of the purposes of the Guideline is to ensure that the actuarial function does not employ valuation models with the intention to inappropriately “smooth” the valuation of technical provisions.

- 3.140. Guideline 40 has a wider application than the combination of the validation of the technical provisions with the task of calculating them. However, EIOPA disagrees that there seems to be no potential conflict of interests between those two tasks. Hence, an undertaking should avoid a combination of these tasks where possible, or address any potential conflict of interest where such tasks are being combined, to ensure that the methodology employed is completely validated independently otherwise.
- 3.141. EIOPA has taken up the suggestion to clarify the wording of the former paragraph 1.83, if not according to the specific drafting proposal of IRSG, and has moved the paragraph from Guideline 43 to Guideline 41 on the coordination of the calculation of technical provisions.

### **Outsourcing**

- 3.142. With respect to Guideline 48 on critical or important operational functions IRSG asks for clarification on whether it follows from the Guideline that some sort of contingency planning in case of a breakdown of critical or important outsourced functions is required.
- 3.143. In Guideline 48 EIOPA clarifies how undertakings should determine whether an operational function or activity is critical or important and thus subject to specific outsourcing requirements. Contingency planning in case that critical or important functions or activities, outsourced or not, suffer disruption may be expected, however, this does not follow from Guideline 48 specifically. Rather it will be a consequence of Articles 41(4) of Solvency II Directive. As the undertaking remains fully responsible for the critical or important outsourced operational function or activity it has to include this in its contingency planning.

### **Terminology**

- 3.144. In respect of the Impact Assessment, IRSG supports EIOPA’s decision not to define the terms risk tolerance and risk appetite. It suggests that EIOPA should consider using similar language as is used in the banking sector where the explanation of these terms includes the note that the terms are used interchangeably.
- 3.145. At the moment there are different interpretations of the terms risk tolerance and risk appetite leading to different definitions and EIOPA at this point in time does not want prescribe and pre-empt the outcome by a specific Guideline or binding certain definition. Building blocks of what should be considered when determining risk tolerance limits and risk appetite have been provided for in the Explanatory Text.

### **Notification of appointment for a key function**

- 3.146. Further regarding the Impact Assessment, IRSG agrees with the approach of EIOPA in not prescribing how persons with key functions should be notified to the NCA during the preparatory phase. However,

IRSG points out that there are potential risks arising from a subjective or inconsistent interpretation by both undertakings and NCAs which could pose a systemic risk for the sector.

- 3.147. EIOPA would like to point out that while it does not expect NCAs to conform to a prescribed form for the notification of key function holders, this does not mean that there is no common understanding as to what NCAs have to consider in their assessments. As in other areas EIOPA seeks convergence among NCAs in the assessments within the nature of Guidelines subject to Comply-or-Explain.

## 4. Revised Guidelines

### Introduction

- 4.1. According to Article 16 of Regulation (EU) 1094/2010 of 24 November 2010 (hereafter, EIOPA Regulation or the Regulation)<sup>3</sup> EIOPA is issuing Guidelines addressed to national competent authorities (NCAs) on how to proceed in the preparatory phase leading up to the applications of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II Directive)<sup>4</sup>.
- 4.2. These Guidelines are based on Articles 40 to 49, Article 93, Article 132 and Article 246 of Solvency II Directive.
- 4.3. In the absence of preparatory Guidelines, European national competent authorities may see the need to develop national solutions in order to ensure sound risk sensitive supervision. Instead of reaching consistent and convergent supervision in the EU, different national solutions may emerge to the detriment of a good functioning internal market.
- 4.4. It is of key importance that there will be a consistent and convergent approach with respect to the preparation of Solvency II. These Guidelines should be seen as preparatory work for Solvency II by fostering preparation with respect to key areas of Solvency II in order to ensure proper management of undertakings and to ensure that supervisors have sufficient information at hand. These areas are the system of governance, including risk management system and a forward looking assessment of the undertaking's own risks (based on the Own Risk and Solvency Assessment principles, known as ORSA), pre-application for internal models, and submission of information to national competent authorities.
- 4.5. Early preparation is key in order to ensure that when Solvency II is fully applicable undertakings and national competent authorities will be well prepared and able to apply the new system. For this, national competent authorities are expected to engage with undertakings in a close dialogue.
- 4.6. As part of the preparation for the implementation of Solvency II, national competent authorities should put in place from 1 January 2014 the Guidelines as set out in this document so that insurance and reinsurance undertakings take the appropriate steps to full implementation of Solvency II.

---

<sup>3</sup> OJ L 331, 15.12.2010, p. 48–83

<sup>4</sup> OJ L 335, 17.12.2009, p.1-155

- 4.7. National competent authorities should send to EIOPA, a progress report on the application of these Guidelines by the end of February following each relevant year, the first being by 28 February 2015 based on the period 1 January 2014 to 31 December 2014.
- 4.8. These Guidelines include Guidelines on the prudent person principle. National competent authorities are expected to ensure that undertakings during the preparatory period already take into account this principle on top of the system of regulatory quantitative limits applicable under the current supervisory regime. In addition national competent authorities are expected to ensure that progress is made by undertakings to make the necessary transition over the duration of the interim period towards having all the requisite governance surrounding investments in place. This does not imply that undertakings' investment portfolios already have to be changed to the extent undertakings would consider necessary when the Solvency II regime is fully applicable.
- 4.9. The Guidelines concerning the actuarial function contain references to capital requirements and technical provisions. These references are to be understood as references to Solvency II requirements. A majority of the tasks of the actuarial function concerns the coordination of Solvency II technical provisions. During the preparatory period these tasks are mainly relevant with regard to the submission of interim information to national competent authorities. There is no full framework for technical provisions valuation during this period. For the purpose of the preparatory reporting and only for that purpose the framework will be provided later.
- 4.10. According to Solvency II Directive, national competent authorities are expected to ensure that these Guidelines are applied in a manner which is proportionate to the nature, scale and complexity of the risks inherent in the business of the insurance and reinsurance undertaking. The Guidelines already reflect the application of the principles of proportionality by having the principle embedded.
- 4.11. The national competent authorities should apply the Guidelines to both individual insurance undertakings and mutatis mutandis at the level of the group. Additionally, for groups national competent authorities need to apply the group specific Guidelines.
- 4.12. For the purpose of these Guidelines, the following definition has been developed:
- "the responsible entity" which is used in the group specific Guidelines as "the entity responsible for fulfilling the governance requirements at group level".

4.13. The Guidelines shall apply from 1 January 2014.

## **Section I: General Provisions for preparatory Guidelines**

### **Guideline 1 – General provisions for Guidelines**

- 4.14. National competent authorities should take the appropriate steps in order to put in place from 1 January 2014 the present Guidelines on System of Governance.
- 4.15. National competent authorities should ensure that insurance and reinsurance undertakings and groups take the appropriate steps to:
- a. build an effective system of governance in accordance with Solvency II Directive which provides for sound and prudent management;
  - b. build an effective risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks, at an individual and at an aggregated level, to which they are or could be exposed, and their interdependencies; and
  - c. provide qualitative information that will allow national competent authorities to evaluate the quality of the system of governance.

### **Guideline 2 – Progress report to EIOPA**

- 4.16. National competent authorities should send to EIOPA, a progress report on the application of these Guidelines by the end of February following each relevant year, the first being by 28 February 2015 based on the period 1 January 2014 to 31 December 2014.

## **Section II: System of Governance**

### **Chapter I: General governance requirements**

#### **Guideline 3 – The administrative, management or supervisory body (AMSB)**

- 4.17. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the administrative, management or supervisory body of the undertaking has appropriate interaction with any committee it establishes as well as with senior management and with other key functions in the undertaking, proactively requesting information from them and challenging that information when necessary.
- 4.18. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that at group level, the administrative, management or supervisory body of the responsible entity has an appropriate interaction with the administrative, management or supervisory bodies of all entities within the group, requesting information

proactively and challenging the decisions in the matters that may affect the group.

#### **Guideline 4 – Organisational and operational structure**

- 4.19. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking has organisational and operational structures aimed at supporting the strategic objectives and operations of the undertaking. Such structures should be able to be adapted to changes in the strategic objectives, operations or in the business environment of the undertaking within an appropriate period of time.
- 4.20. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the administrative, management or supervisory body of the responsible entity assesses how changes to the group's structure impact on the sustainable financial position of the entities affected and makes the necessary adjustments in a timely manner.
- 4.21. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that, in order to take appropriate measures, the administrative, management or supervisory body of the responsible entity has an appropriate knowledge of the corporate organisation of the group, the business model of its different entities and the links and relationships between them and the risks arising from the group's structure.

#### **Guideline 5 – Key functions**

- 4.22. In accordance with Articles 44, 46, 47 and 48 of Solvency II Directive, national competent authorities should ensure that the undertaking appropriately implements the following key functions: risk management function, compliance function, internal audit function and actuarial function.
- 4.23. In accordance with Articles 44, 46, 47, 48 and 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity appropriately implements the following key functions: risk management function, compliance function, internal audit function and actuarial function at the level of the group.

#### **Guideline 6 – Decision-making**

- 4.24. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking ensures that at least two persons effectively run the undertaking. That implies that any significant

decision of the undertaking involves at least two persons who effectively run the undertaking before the decision is being implemented.

#### **Guideline 7 – Documentation of decisions taken at the level of the AMSB**

4.25. In accordance with Article 41 and Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking appropriately documents the decisions taken at the level of the administrative, management or supervisory body of the undertaking and how information from the risk management system has been taken into account.

#### **Guideline 8 – Internal review of the system of governance**

4.26. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the administrative, management or supervisory body of the undertaking determines the scope and frequency of the internal reviews of the system of governance, taking into account the nature, scale and complexity of the business both at individual and at group level, as well as the structure of the group.

4.27. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the scope, findings and conclusions of the review are properly documented and reported to the administrative, management or supervisory body of the undertaking. Suitable feedback loops are necessary to ensure follow-up actions are undertaken and recorded.

#### **Guideline 9 – Policies**

4.28. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking aligns all policies required as part of the system of governance with each other and with its business strategy. Each policy should clearly set out at least:

- a) the goals pursued by the policy;
- b) the tasks to be performed and the person or role responsible for them;
- c) the processes and reporting procedures to be applied; and
- d) the obligation of the relevant organisational units to inform the risk management, internal audit and the compliance and actuarial functions of any facts relevant for the performance of their duties.

4.29. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that in the policies that cover the key functions, the undertaking also addresses the position of these functions within the undertaking, their rights and powers.

## **Guideline 10 – Contingency plans**

4.30. In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking identifies risks to be addressed by contingency plans covering the areas where it considers itself to be vulnerable, and reviews, updates and tests these contingency plans on a regular basis.

## **Chapter II: Fit and Proper**

### **Guideline 11 – Fit requirements**

4.31. In accordance with Article 42 of Solvency II Directive, national competent authorities should ensure that the undertaking ensures that persons who effectively run the undertaking or have other key functions, including members of the administrative, supervisory or management body of the undertaking, are 'fit' and take account of the respective duties allocated to individual persons to ensure appropriate diversity of qualifications, knowledge and relevant experience so that the undertaking is managed and overseen in a professional manner.

4.32. In accordance with Article 42 of Solvency II Directive, national competent authorities should ensure that the undertaking ensures that the members of the administrative, management or supervisory body collectively possess appropriate qualification, experience and knowledge about at least:

- a) insurance and financial markets;
- b) business strategy and business model;
- c) system of governance;
- d) financial and actuarial analysis; and
- e) regulatory framework and requirements.

### **Guideline 12 – Proper requirements**

4.33. In accordance with Article 42 of Solvency II Directive, national competent authorities should ensure that the undertaking, when assessing whether a person is 'proper', includes an assessment of that person's honesty and financial soundness based on relevant evidence regarding their character, personal behaviour and business conduct including any criminal, financial, supervisory aspects regardless of jurisdiction. The period of limitation of the committed offence is judged based on national law or practice.

### **Guideline 13 – Fit and proper policies and procedures**

- 4.34. In accordance with Article 41 and 42 of Solvency II Directive, national competent authorities should ensure that the undertaking has a policy on the fit and proper requirements, which includes at least:
- a) a description of the procedure for assessing the fitness and propriety of the persons who effectively run the undertaking or have other key functions, both when being considered for the specific position and on an on-going basis;
  - b) a description of the situations that give rise to a re-assessment of the fit and proper requirements; and
  - c) a description of the fit and proper procedures for assessing other relevant personnel not subject to the requirements of Article 42 of Solvency II Directive according to internal standards, both when being considered for the specific position and on an on-going basis.

#### **Guideline 14 – Outsourcing of key functions**

- 4.35. In accordance with Article 42 and 49 of Solvency II Directive, national competent authorities should ensure that the undertaking applies the fit and proper procedures in assessing persons employed by the service provider or sub service provider to perform an outsourced key function.
- 4.36. In accordance with Article 42 and 49 of Solvency II Directive, national competent authorities should ensure that the undertaking designates a person within the undertaking with overall responsibility for the outsourced key function who is fit and proper and possesses sufficient knowledge and experience regarding the outsourced key function to be able to challenge the performance and results of the service provider.

### **Chapter III: Risk Management**

#### **Guideline 15 – Role of the administrative, management or supervisory body in the risk management system**

- 4.37. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the administrative, management or supervisory body of the undertaking is ultimately responsible for ensuring the effectiveness of the risk management system, setting the undertaking's risk appetite and overall risk tolerance limits as well as approving the main risk management strategies and policies.
- 4.38. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the administrative, management or supervisory body of the responsible entity is responsible for the effectiveness of the risk management system of the whole group. This risk management system should include at least:

- a) the strategic decisions and policies on risk management at group level;
  - b) the definition of group's risk appetite and overall risk tolerance limits; and
  - c) the identification, measurement, management, monitoring and reporting of risks at group level.
- 4.39. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that such strategic decisions and policies are consistent with the group's structure, size and the specificities of the entities in the group. It also ensures that the specific operations, which are material, and associated risks of each entity in the group are covered and in addition, it ensures that an integrated, consistent and efficient risk management of the group is put in place.

#### **Guideline 16 – Risk management policy**

- 4.40. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking establishes a risk management policy which at least:
- a) defines the risk categories and the methods to measure the risks;
  - b) outlines how the undertaking manages each relevant category, area of risks and any potential aggregation of risks;
  - c) describes the connection with the overall solvency needs assessment as identified in the forward looking assessment of the undertaking's own risks (based on the ORSA principles), the regulatory capital requirements and the undertaking's risk tolerance limits;
  - d) specifies risk tolerance limits within all relevant risk categories in line with the undertaking's overall risk appetite; and
  - e) describes the frequency and content of regular stress tests and the situations that would warrant ad-hoc stress tests.

#### **Guideline 17 – Risk management function: general tasks**

- 4.41. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the risk management function to report to the administrative, management or supervisory body on risks that have been identified as potentially material. The risk management function should also report on other specific areas of risks both on its own initiative and following requests from the administrative, management or supervisory body.

4.42. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that the risk policy is implemented consistently across the group.

### **Guideline 18 – Underwriting and reserving risk management policy**

4.43. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in its risk management policy, the undertaking covers at least the following with regard to underwriting and reserving risk:

- a) the types and characteristics of the insurance business, such as the type of insurance risk the undertaking is willing to accept;
- b) how the adequacy of premium income to cover expected claims and expenses is to be ensured;
- c) the identification of the risks arising from the undertaking's insurance obligations, including embedded options and guaranteed surrender values in its products;
- d) how, in the process of designing a new insurance product and the premium calculation, the undertaking takes account of the constraints related to investments; and
- e) how, in the process of designing a new insurance product and the premium calculation, the undertaking takes account of reinsurance or other risk mitigation techniques.

### **Guideline 19 – Operational risk management policy**

4.44. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in the risk management policy, the undertaking covers at least the following with regard to operational risk:

- a) identification of the operational risks it is or might be exposed to and assessment of the way to mitigate them;
- b) activities and internal processes for managing operational risks, including the IT system supporting them; and
- c) risk tolerance limits with respect to the undertaking's main operational risk areas.

4.45. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking has processes to identify, analyse and report on operational risk events. For this purpose, it should establish a process for collecting and monitoring operational risk events.

4.46. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that for the purposes of operational risk

management, the undertaking develops and analyses an appropriate set of operational risk scenarios based on at least the following approaches:

- a) the failure of a key process, personnel or system; and
- b) the occurrence of external events.

#### **Guideline 20 – Control and documentation of risk-mitigation techniques**

4.47. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that for the purposes of proper use of reinsurance and other risk mitigation techniques the undertaking analyses, assesses and documents the effectiveness of all risk mitigation techniques employed.

#### **Guideline 21 – Reinsurance and other risk-mitigation techniques – risk management policy**

4.48. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in the risk management policy the undertaking covers at least the following with regard to risk mitigation techniques:

- a) identification of the level of risk transfer appropriate to the undertaking's defined risk limits and which kind of reinsurance arrangements are most appropriate considering the undertaking's risk profile;
- b) principles for the selection of such risk mitigation counterparties and procedures for assessing and monitoring the creditworthiness and diversification of reinsurance counterparties;
- c) procedures for assessing the effective risk transfer and consideration of basis risk; and
- d) liquidity management to deal with any timing mismatch between claims' payments and reinsurance recoverable.

#### **Guideline 22 – Asset-liability management policy**

4.49. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in its risk management policy the undertaking covers at least the following information with regard to asset-liability management:

- a) a description of the procedure for identification and assessment of different natures of mismatches between assets and liabilities, at least with regard to terms and currency;

- b) a description of mitigation techniques to be used and the expected effect of relevant risk-mitigating techniques on asset-liability management;
- c) a description of deliberate mismatches permitted; and
- d) a description of the underlying methodology and frequency of stress tests and scenario tests to be carried out.

### **Guideline 23 – Investment risk management policy**

4.50. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that in its risk management policy, the undertaking covers at least the following with regard to investments:

- a) the level of security, quality, liquidity, profitability and availability the undertaking is aiming for with regard to the whole portfolio of assets and how it plans to achieve this;
- b) its quantitative limits on assets and exposures, including off-balance sheet exposures, that are to be established to help to ensure the undertaking achieves its desired level of security, quality, liquidity, profitability and availability for the portfolio;
- c) consideration of the financial market environment;
- d) the conditions under which the undertaking can pledge or lend assets;
- e) the link between market risk and other risks in adverse scenarios;
- f) the procedure for appropriately valuing and verifying the investment assets;
- g) the procedures to monitor the performance of the investments and review the policy when necessary; and
- h) how the assets are to be selected in the best interest of policyholders and beneficiaries.

### **Guideline 24 – Liquidity risk management policy**

4.51. In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in its risk management policy, the undertaking covers at least the following items with regard to liquidity risk:

- a) the procedure for determining the level of mismatch between the cash inflows and the cash outflows of both assets and liabilities, including expected cash flows of direct insurance and reinsurance such as claims, lapses or surrenders;

- b) consideration of total liquidity needs in the short and medium term, including an appropriate liquidity buffer to guard against a liquidity shortfall;
- c) consideration of the level and monitoring of liquid assets, including a quantification of potential costs or financial losses arising from an enforced realisation;
- d) identification and costs of alternative financing tools; and
- e) consideration of the effect on the liquidity situation of expected new business.

## **Chapter IV: The “prudent person” principle and the system of governance**

### **Guideline 25 – Investment risk management**

4.52. In accordance with Article 132 of Solvency II Directive, national competent authorities should ensure that the undertaking does not solely depend on the information provided by third parties, such as financial institutions, asset managers and rating agencies. In particular, the undertaking should develop its own set of key risk indicators in line with its investment risk management policy and business strategy.

4.53. In making its investment decisions, the undertaking should take into account the risks associated with the investments without relying only on the risk being adequately captured by the capital requirements.

### **Guideline 26 – Assessment of non-routine investment activities**

4.54. In accordance with Article 132 of Solvency II Directive, national competent authorities should ensure that before performing any investment or investment activity of a non-routine nature the undertaking carries out an assessment of at least:

- a) its ability to perform and manage the investment or the investment activity;
- b) the risks specifically related to the investment or the investment activity and the impact of the investment or the investment activity on the undertaking’s risk profile;
- c) the consistency of the investment or investment activity with the beneficiaries’ and policyholders’ interest, liability constraints set by the undertaking and efficient portfolio management; and
- d) the impact of this investment or investment activity on the quality, security, liquidity, profitability and availability of the whole portfolio.

4.55. In accordance with Article 132 of Solvency II Directive, national competent authorities should ensure that the undertaking has procedures that require that where such investment or investment activity entails a significant risk or change in the risk profile, the undertaking's risk management function communicates such a risk or change in the risk profile to the administrative, management or supervisory body of the undertaking.

#### **Guideline 27 – Unit-linked and index-linked contracts**

4.56. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the investments of unit-linked and index-linked contracts of the undertaking are selected in the best interest of policyholders and beneficiaries taking into account any disclosed policy objectives.

4.57. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that, in the case of unit-linked business, the undertaking takes into account and manages the constraints related to unit-linked contracts, in particular liquidity constraints.

#### **Guideline 28 – Assets not admitted for trading on a regulated financial market**

4.58. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking implements, manages, monitors and controls procedures in relation to investments that are not admitted to trading on a regulated financial market or to complex products, which are difficult to value.

4.59. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking treats assets admitted to trading, but not traded or traded on a non-regular basis, similarly to those assets not admitted to trading on a regulated financial market.

#### **Guideline 29 – Derivatives**

4.60. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking, when it uses derivatives, implements the procedures in line with its risk management policy on investments to monitor the performance of these derivatives.

4.61. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking demonstrates how the quality, security, liquidity or profitability of the portfolio is

improved without significant impairment of any of these features where derivatives are used to facilitate efficient portfolio management.

- 4.62. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking documents the rationale and demonstrates the effective risk transfer obtained by the use of the derivatives where derivatives are used to contribute to a reduction of risks or as a risk mitigation technique.

### **Guideline 30 – Securitised instruments**

- 4.63. In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that, where the undertaking invests in securitised instruments, it ensures that its interests and the interests of the originator or sponsor concerning the securitised assets are well understood and aligned.

## **Chapter V: Own fund requirements and the system of governance**

### **Guideline 31 – Capital Management Policy**

- 4.64. In accordance with Article 41 and 93 of Solvency II Directive, national competent authorities should ensure that the undertaking should be developing a capital management policy which includes:
- a. a description of the procedure to ensure that own fund items, both at issue and subsequently, meet the requirements of the applicable capital and distribution regime and are classified correctly where the applicable regime requires;
  - b. a description of the procedure to monitor the issuance of own fund items according to the medium term capital management plan;
  - c. a description of the procedure to ensure that the terms and conditions of any own fund item are clear and unambiguous in relation to the criteria of the applicable capital regime; and
  - d. a description of the procedures to
    - i. ensure that any policy or statement in respect of ordinary share dividends is taken into account in consideration of the capital position; and
    - ii. identify and document instances in which distributions on an own funds item are expected to be deferred or cancelled.

### **Guideline 32 – Medium-term Capital Management Plan**

- 4.65. In accordance with Article 41 and 93 of Solvency II Directive, national competent authorities should ensure that the undertaking is developing a medium-term capital management plan which is to be monitored by the

administrative, management or supervisory body of the undertaking and which includes at least considerations of:

- a. any planned capital issuance;
- b. the maturity, incorporating both the contractual maturity and any earlier opportunity to repay or redeem, relating to the undertaking's own fund items;
- c. how any issuance, redemption or repayment of, or other variation in the valuation of, an own funds item affects the application of any limits in the applicable capital regime; and
- d. the application of the distribution policy.

4.66. In accordance with Article 41 and 93 of Solvency II Directive, national competent authorities should ensure that the undertaking takes into account in the capital management plan the output from the risk management system and the forward looking assessment of own risks (based on the ORSA principles).

## **Chapter VI: Internal Controls**

### **Guideline 33 – Internal Control environment**

4.67. In accordance with Article 46 of Solvency II Directive, national competent authorities should ensure that the undertaking promotes the importance of performing appropriate internal controls by ensuring that all personnel are aware of their role in the internal control system. The control activities should be commensurate to the risks arising from the activities and processes to be controlled.

4.68. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures a consistent implementation of the internal control systems across the group.

### **Guideline 34 – Monitoring and reporting**

4.69. In accordance with Article 46 of Solvency II Directive, national competent authorities should ensure that the undertaking establishes that the monitoring and reporting mechanisms within the internal control system provide the administrative, management or supervisory body with the relevant information for the decision-making processes.

## **Chapter VII: Internal audit function**

### **Guideline 35 – Independence**

4.70. In accordance with Article 47 of Solvency II Directive, national competent authorities should ensure that the undertaking provides that when performing an audit and when evaluating and reporting the audit results,

the internal audit function is not subject to influence from the administrative, management or supervisory body that can impair its independence and impartiality.

### **Guideline 36 – Internal audit policy**

- 4.71. In accordance with Articles 41 and 47 of Solvency II Directive, national competent authorities should ensure that the undertaking has an internal audit policy which covers at least the following areas:
- a. the terms and conditions according to which the internal audit function can be called upon to give its opinion or assistance or to carry out other special tasks;
  - b. where appropriate, internal rules setting out the procedures the person responsible for the internal audit function needs to follow before informing the supervisory authority; and
  - c. where appropriate, the criteria for the rotation of staff assignments.
- 4.72. In accordance with Articles 41 and 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that the audit policy at the level of the group describes how the internal audit function:
- a. coordinates the internal audit activity across the group; and
  - b. ensures compliance with the internal audit requirements at the group level.

### **Guideline 37 – Internal audit function tasks**

- 4.73. In accordance with Article 47 of Solvency II Directive, national competent authorities should ensure that the undertaking requires that the internal audit function, at least:
- a. to establish, implement and maintain an audit plan setting out the audit work to be undertaken in the upcoming years, taking into account all activities and the complete system of governance of the undertaking;
  - b. to take a risk-based approach in deciding its priorities;
  - c. to report the audit plan to the administrative, management or supervisory body of the undertaking;
  - d. to issue an internal audit report to the AMSB based on the result of work carried out in accordance with point (a), which includes findings and recommendations, including the envisaged period of time to remedy the shortcomings and the persons responsible for doing so, and information on the achievement of audit recommendations;

- e. to submit the internal audit report to the administrative, management or supervisory body on at least an annual basis; and
- f. to verify compliance with the decisions taken by the administrative, management or supervisory body on the basis of those recommendations referred to in point (d).

4.74. In accordance with Article 47 of Solvency II Directive, national competent authorities should ensure that where necessary, the undertaking provides that the internal audit function may carry out audits which are not included in the audit plan.

## **Chapter VIII: Actuarial Function**

### **Guideline 38 – Tasks of the actuarial function**

4.75. In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking takes appropriate measures to address the potential conflicts of interests, if the undertaking decides to add additional tasks or activities to the tasks and activities of the actuarial function.

4.76. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity requires that the actuarial function gives an opinion on the reinsurance policy and the reinsurance program for the group as a whole.

### **Guideline 39 – Coordination of the calculation of technical provisions**

4.77. In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to identify any inconsistency with the requirements set out in Articles 76 to Article 85 of Solvency II Directive for the calculation of technical provisions and propose corrections as appropriate.

4.78. In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to explain any material effect of changes in data, methodologies or assumptions between valuation dates on the amount of technical provisions if already calculated on a Solvency II basis.

### **Guideline 40 – Data quality**

4.79. In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to assess the consistency of the internal and external data used

in the calculation of technical provisions against the data quality standards as set in Solvency II Directive. Where relevant, the actuarial function provides recommendations on internal procedures to improve data quality so as to ensure that the undertaking is in a position to comply with the related Solvency II requirement when implemented.

#### **Guideline 41 – Underwriting policy and reinsurance arrangements**

4.80. In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function, when providing its opinion on the underwriting policy and the reinsurance arrangements, to take into consideration the interrelations between these and the technical provisions.

#### **Guideline 42 – The actuarial function of an undertaking with an internal model under pre-application**

4.81. In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that, during the pre-application process, the undertaking requires the actuarial function to contribute to specifying which risks within their domain of expertise are covered by the internal model. The actuarial function should also contribute to how dependencies between these risks and dependencies between these risks and other risks are derived. This contribution is based on a technical analysis and should reflect the experience and expertise of the function.

#### **Guideline 43 - Actuarial reporting to the administrative, management or supervisory body**

4.82. In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to report in writing at least annually to the administrative, management or supervisory body. The reporting should document all material tasks that have been undertaken by the actuarial functions, their results, clearly identifying any deficiencies and giving recommendations as to how such deficiencies could be remedied.

### **Chapter IX: Outsourcing**

#### **Guideline 44 – Critical or important operational functions and activities**

4.83. In accordance with Article 49 of Solvency II Directive, national competent authorities should ensure that the undertaking determines and documents whether the outsourced function or activity is a critical or important function or activity on the basis of whether this function or activity is

essential to the operation of the undertaking as it would be unable to deliver its services to policyholders without the function or activity.

#### **Guideline 45 – Underwriting**

4.84. In accordance with Article 49 of Solvency II Directive, national competent authorities should ensure that, when an insurance intermediary, who is not an employee of the undertaking, is given authority to underwrite business or settle claims in the name and on account of an insurance undertaking, the undertaking ensures that the activity of this intermediary is subject to the outsourcing requirements.

#### **Guideline 46 – Intra-group outsourcing**

4.85. In accordance with Article 49 of Solvency II, national competent authorities should ensure that, if key functions are outsourced within the group, the responsible entity documents which functions relate to which legal entity and ensures that the performance of the key functions at the level of the undertaking is not impaired by such arrangements.

#### **Guideline 47 – Outsourcing written policy**

4.86. In accordance with Article 49 and Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking that outsources or considers outsourcing covers in its policy the undertaking's approach and processes for outsourcing from the inception to the end of the contract. This in particular includes:

- a. the criteria for determining whether a function or activity is critical or important;
- b. how a service provider of suitable quality is selected and how and how often his performance and results are assessed;
- c. the details to be included in the written agreement with the service provider; and
- d. business contingency plans, including exit strategies for outsourced critical or important functions or activities.

### **Section III: Group governance specific requirements**

#### **Guideline 48 – Responsible entity**

4.87. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the parent insurance or reinsurance undertaking or insurance holding company identifies the responsible entity and reports it to the group supervisor.

#### **Guideline 49 – Responsibilities for setting internal governance requirements**

- 4.88. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity sets adequate internal governance requirements across the group appropriate to the structure, business and risks of the group and of its related entities, and considers the appropriate structure and organization for risk management at group level, setting a clear allocation of responsibilities between all entities of the group.
- 4.89. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity does not impair the responsibilities of the administrative, management or supervisory body of each entity in the group when setting up its own system of governance.

#### **Guideline 50 – System of Governance at group level**

- 4.90. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity:
- a. has in place appropriate and effective tools, procedures and lines of responsibility and accountability enabling it to oversee and steer the functioning of the risk management and internal control systems at individual level;
  - b. has in place reporting lines within the group and effective systems for ensuring information flows in the group bottom up and top-down as well;
  - c. documents and informs all the entities in the group about the tools used to identify, measure, monitor, manage and report all risks to which the group is exposed; and
  - d. takes into account the interests of all the entities belonging to the group and how these interests contribute to the common purpose of the group as a whole over the long term.

#### **Guideline 51 – Risks with significant impact at group level**

- 4.91. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity considers in its risk management system the risks both at individual and group level and their interdependencies, in particular:
- a. reputational risk and risks arising from intra-group transactions and risk concentrations, including contagion risk, at the group level;
  - b. interdependencies between risks stemming from conducting business through different entities and in different jurisdictions;

- c. risks arising from third-country entities;
- d. risks arising from non-regulated entities; and
- e. risks arising from other regulated entities.

### **Guideline 52 – Group risk management**

- 4.92. In accordance with Article 246 of Solvency I Directive I, national competent authorities should ensure that the responsible entity supports in its risk management at the level of the group by appropriate processes and procedures to identify, measure, manage, monitor and report the risks that the group and each individual entity are or might be exposed to.
- 4.93. In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that the structure and organization of the group risk management do not impair the undertaking's legal ability to fulfil its legal, regulatory and contractual obligations.

### **Compliance and Reporting Rules**

- 4.94. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, Competent Authorities shall make every effort to comply with guidelines and recommendations.
- 4.95. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 4.96. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within 2 months after the publication.
- 4.97. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting.

### **Final Provision on Review**

- 4.98. These Guidelines shall be subject to a review by EIOPA.

## **5. Revised Explanatory Text**

### **Section I: General Provisions for preparatory Guidelines**

#### **Guideline 1 – General provisions for Guidelines**

**National competent authorities should take the appropriate steps in order to put in place from 1 January 2014 the present Guidelines on System of Governance.**

**National competent authorities should ensure that insurance and reinsurance undertakings and groups take the appropriate steps to:**

- a. build an effective system of governance in accordance with Solvency II Directive which provides for sound and prudent management;**
- b. build an effective risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks, at an individual and at an aggregated level, to which they are or could be exposed, and their interdependencies; and**
- c. provide qualitative information that will allow national competent authorities to evaluate the quality of the system of governance.**

#### **Guideline 2 – Progress report to EIOPA**

**National competent authorities should send to EIOPA, a progress report on the application of these Guidelines by the end of February following each relevant year, the first being by 28 February 2015 based on the period 1 January 2014 to 31 December 2014.**

### **Section II: System of Governance**

#### **Chapter I: General governance requirements**

#### **Guideline 3 – The administrative, management or supervisory body (AMSB)**

**In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the administrative,**

**management or supervisory body of the undertaking has appropriate interaction with any committee it establishes as well as with senior management and with other key functions in the undertaking, proactively requesting information from them and challenging that information when necessary.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that at group level, the administrative, management or supervisory body of the responsible entity has an appropriate interaction with the administrative, management or supervisory bodies of all entities within the group, requesting information proactively and challenging the decisions in the matters that may affect the group.**

- 5.1. The focal point of the governance system is the administrative, management or supervisory body. The term “administrative, management or supervisory body” used in Solvency II – which in these Guidelines is shortened to the term “AMSB” - covers the single board in a one-tier system and either the management or the supervisory board of a two-tier board system depending on their responsibilities and duties. When transposing Solvency II, each Member State considers its own specificities and attributes responsibilities and duties to the appropriate board, if necessary.
- 5.2. An undertaking’s AMSB is expected to consider whether a committee structure is appropriate and, if so, what its mandate and reporting lines should be. For example, it could consider forming audit, risk, investment or remuneration committees etc.

#### **Guideline 4 – Organisational and operational structure**

**In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking has organisational and operational structures aimed at supporting the strategic objectives and operations of the undertaking. Such structures should be able to be adapted to changes in the strategic objectives, operations or in the business environment of the undertaking within an appropriate period of time.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the administrative, management or supervisory body of the responsible entity assesses how changes to the group’s structure impact on the sustainable financial position of the entities affected and makes the necessary adjustments in a timely manner.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that, in order to take**

**appropriate measures, the administrative, management or supervisory body of the responsible entity has an appropriate knowledge of the corporate organisation of the group, the business model of its different entities and the links and relationships between them and the risks arising from the group's structure.**

- 5.3. Sound and prudent management of the business implies among other things a consistent application of risk management and internal control practices throughout the entire organisational structure of the undertaking. In order to support this goal, consideration ought to be given to drawing up and implementing a code of conduct for all staff, including the AMSB and senior management. Apart from the general code of conduct, everybody in the undertaking also has to be familiar with more detailed codes applicable to their own areas of expertise.
- 5.4. It is important that the undertaking ensures that it has an organisational culture that enables and supports the effective operation of its system of governance. This requires an appropriate "tone at the top" with the AMSB and senior management providing appropriate organisational values and priorities.
- 5.5. The undertaking needs to ensure that each key function has an appropriate standing within the organisational structure. This requires that their responsibilities and the authority they have to exercise their tasks are clearly set out.
- 5.6. The operational structure supports the main functions of the organisational structure. It identifies the business processes involving material risks and sets out how they should be executed, including responsibilities and information flows, to ensure that these processes are adequately monitored and controlled.
- 5.7. The undertaking has to document its internal organisational and operational structures and keep this documentation up to date and keep them for an appropriate time frame, taking into account prescribed record retention periods.
- 5.8. The assessment of the appropriateness of the organisational and operational structure is required both at individual and group level. Inquiries addressed by the group supervisor, in cooperation with the college of supervisors, on the appropriateness of the organizational and operational structure may be expected where changes occur in the group's structures, as well as on interconnections and significant transactions between group entities.

#### **Guideline 5 – Key functions**

**In accordance with Articles 44, 46, 47 and 48 of Solvency II Directive, national competent authorities should ensure that the undertaking appropriately implements the following key**

**functions: risk management function, compliance function, internal audit function and actuarial function.**

**In accordance with Articles 44, 46, 47, 48 and 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity appropriately implements the following key functions: risk management function, compliance function, internal audit function and actuarial function at the level of the group.**

#### **Guideline 6 – Decision-making**

**In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking ensures that at least two persons effectively run the undertaking. That implies that any significant decision of the undertaking involves at least two persons who effectively run the undertaking before the decision is being implemented.**

- 5.9. Significant decisions as opposed to day-to-day decisions do not concern the spate of usual decisions to be taken at the top level of the undertaking in the running of the business but are rather decisions that are unusual or that will or could have a material impact on the undertaking. This could be e.g. decisions that affect the strategy of the undertaking, its business activities or its business conduct, that could have serious legal or regulatory consequences, that could have major financial effects or major implications for staff or policyholders or that could potentially result in repercussions for the undertaking's reputation.
- 5.10. Persons who effectively run the undertaking are not limited to executive directors but include senior management and may include non-executive directors, provided these can be said to effectively run the undertaking.

#### **Guideline 7 – Documentation of decisions taken at the level of the AMSB**

**In accordance with Article 41 and Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking appropriately documents the decisions taken at the level of the administrative, management or supervisory body of the undertaking and how information from the risk management system has been taken into account.**

#### **Guideline 8 – Internal review of the system of governance**

**In accordance with Article 41 of Solvency II Directive, national**

**competent authorities should ensure that the administrative, management or supervisory body of the undertaking determines the scope and frequency of the internal reviews of the system of governance, taking into account the nature, scale and complexity of the business both at individual and at group level, as well as the structure of the group.**

**In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the scope, findings and conclusions of the review are properly documented and reported to the administrative, management or supervisory body of the undertaking. Suitable feedback loops are necessary to ensure follow-up actions are undertaken and recorded.**

- 5.11. The AMSB has to ensure that the system of governance is internally reviewed on a regular basis. The review undertaken by the internal audit function on the system of governance as part of its responsibilities can provide input to this internal review.
- 5.12. The feedback procedures need to encompass at least all key functions and include a review of the system of governance with recommendations for revisions where necessary. After the feedback reports are presented to the AMSB, discussions on any challenge provided or improvements suggested by the AMSB have to be appropriately documented.

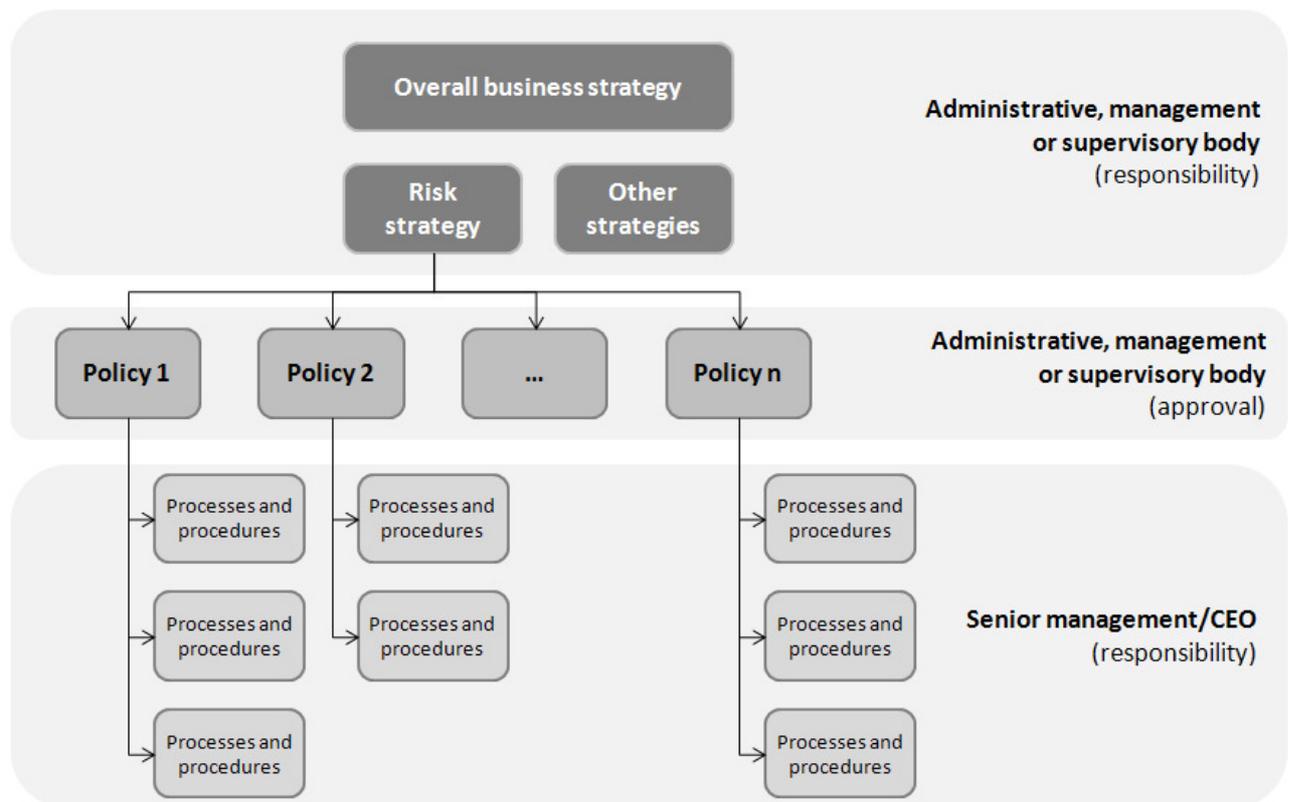
#### **Guideline 9 – Policies**

**In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking aligns all policies required as part of the system of governance with each other and with its business strategy. Each policy should clearly set out at least:**

- a) the goals pursued by the policy;**
- b) the tasks to be performed and the person or role responsible for them;**
- c) the processes and reporting procedures to be applied;**  
**and**
- d) the obligation of the relevant organisational units to inform the risk management, internal audit and the compliance and actuarial functions of any facts relevant for the performance of their duties.**

**In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that in the policies that cover the key functions, the undertaking also addresses the position of these functions within the undertaking, their rights and powers.**

5.13. The AMSB is responsible for the development and setting of the business strategy. It also has to approve written policies in order to materialise that strategy. This idea is summarised as an example in the following chart:



5.14. The undertaking may combine the written policies required by Solvency II as it sees fit in line with its organisational structure and processes.

5.15. Written policies are subject to prior approval by the AMSB not only for the original policy proposal but also for any subsequent changes, unless these are minor.

5.16. A proper implementation of the written policies requires ensuring that all relevant staff members are familiar with and observe the policies for their respective area of activities. It also requires that any changes to the policies are promptly communicated to them.

5.17. The review requirement applies to all written policies undertakings have to implement in order to comply with Solvency II, i.e. it not only covers the policies explicitly referred to in Article 41(3) but also e.g. the “sub-policies” according to Article 44(2) and the model change policy.

5.18. Any review of the written policies has to be appropriately documented. The documentation needs to record who conducted the review and to include any suggested recommendations and the decisions subsequently taken by the AMSB in respect of those recommendations as well as the reasons for them.

**Guideline 10 – Contingency plans**

**In accordance with Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking identifies risks to be addressed by contingency plans covering the areas where it considers itself to be vulnerable, and reviews, updates and tests these contingency plans on a regular basis.**

- 5.19. The undertakings has to develop and document contingency plans to ensure that business disruption or possible losses are limited if there is an unforeseen interruption to its systems and procedures. These might for example arise from natural catastrophes such as floods or earthquakes, from terrorist attacks, serious fires, a breakdown of the IT systems or a pandemic that affects a large number of employees. The aim of contingency planning is to enable the undertaking to continue its business activity at a predetermined minimum level to protect individuals and tangible property as well as assets.
- 5.20. While it is not necessary that contingency planning includes every activity of the undertaking, it has to take into consideration all significant activities. Test runs provide assurance that the plans will actually work effectively should an emergency arise. The plans have to be made available to all relevant management and personnel so that every person involved knows their role in advance of any emergency situation.
- 5.21. The undertaking also has to give proper consideration to determining communication channels in case of emergencies.

## **Chapter II: Fit and Proper**

- 5.22. The undertaking has to assess the fitness and propriety as set out in these Guidelines regarding all persons who effectively run the undertaking as well as all persons working within a key function.

### **Guideline 11 – Fit requirements**

**In accordance with Article 42 of Solvency II Directive, national competent authorities should ensure that the undertaking ensures that persons who effectively run the undertaking or have other key functions, including members of the administrative, supervisory or management body of the undertaking, are 'fit' and take account of the respective duties allocated to individual persons to ensure appropriate diversity of qualifications, knowledge and relevant experience so that the undertaking is managed and overseen in a professional manner.**

**In accordance with Article 42 of Solvency II Directive, national competent authorities should ensure that the undertaking ensures**

**that the members of the administrative, management or supervisory body collectively possess appropriate qualification, experience and knowledge about at least:**

- a) insurance and financial markets;**
- b) business strategy and business model;**
- c) system of governance;**
- d) financial and actuarial analysis; and**
- e) regulatory framework and requirements.**

- 5.23. When assessing the knowledge, competence and experience required for the performance of a particular role within the AMSB, the qualifications and experience of other employees within the undertaking could be taken into account as a relevant factor.
- 5.24. The fitness assessment is not limited to the moment of employment but includes arranging for further professional training as necessary, so that staff is also able to meet changing or increasing requirements of their particular responsibilities.
- 5.25. The members of the AMSB are not each expected to possess expert knowledge, competence and experience within all areas of the undertaking. However, the collective knowledge, competence and experience of the AMSB as a whole have to provide for a sound and prudent management of the undertaking.
- 5.26. When changes occur within the AMSB, e.g. replacement of one of the members of the AMSB, the undertaking is expected to be able to demonstrate at all times that the collective knowledge of the members of the AMSB is maintained at an adequate level.
- 5.27. 'Insurance and Financial Markets knowledge' means an awareness and understanding of the wider business, economic and market environment in which the undertaking operates and an awareness of the level of knowledge of and needs of policyholders.
- 5.28. 'Business strategy and business model knowledge' refers to a detailed understanding of the undertaking's business strategy and model.
- 5.29. 'System of Governance knowledge' means the awareness and understanding of the risks the undertaking is facing and the capability of managing them. Furthermore, it includes the ability to assess the effectiveness of the undertaking's arrangements to deliver effective governance, oversight and controls in the business and, if necessary, oversee changes in these areas.
- 5.30. 'Financial and actuarial analysis knowledge' means the ability to interpret the undertaking's financial and actuarial information, identify key issues,

put in place appropriate controls and take necessary measures based on this information.

- 5.31. 'Regulatory framework and requirements knowledge' means awareness and understanding of the regulatory framework in which the undertaking operates, in terms of both the regulatory requirements and expectations, and the capacity to adapt to changes to the regulatory framework without delay.

**Guideline 12 – Proper requirements**

**In accordance with Article 42 of Solvency II Directive, national competent authorities should ensure that the undertaking, when assessing whether a person is 'proper', includes an assessment of that person's honesty and financial soundness based on relevant evidence regarding their character, personal behaviour and business conduct including any criminal, financial, supervisory aspects regardless of jurisdiction. The period of limitation of the committed offence is judged based on national law or practice.**

- 5.32. Relevant criminal offences include any offence under the laws governing banking, financial, securities or insurance activity, or concerning securities markets or securities or payment instruments, including, but not limited, to laws on money laundering, market manipulation, or insider dealing and usury as well as any offences of dishonesty such as fraud or financial crime. They also include any other criminal offences under legislation relating to companies, bankruptcy, insolvency, or consumer protection.
- 5.33. Any other criminal offences currently being tried or having been tried in the past may also be relevant, as they can cast doubt on the integrity of the person.
- 5.34. Relevant disciplinary or administrative offences include any offences made under an activity of the financial sector, including offences under legislation relating to companies, bankruptcy, insolvency, or consumer protection.
- 5.35. When assessing the propriety of the person other circumstances than court decisions and on-going judicial proceedings, which may cast doubt on the repute and integrity of the person, may also be considered. These could include current investigations or enforcement actions, the imposition of administrative sanctions for non-compliance with provisions governing banking, financial, securities or insurance activity, securities markets, securities or payment instruments or any financial services legislation.
- 5.36. Further, current investigations or enforcement actions by any relevant regulatory or professional body for non-compliance with any relevant provisions could be taken into account.
- 5.37. Notwithstanding what has been written, having previous infringements does not automatically result in the person not being assessed as proper

for the duties he/she is to perform. It is recognised that, while criminal, disciplinary or administrative convictions or past misconduct are significant factors, the assessment of the fit and proper requirements is to be done on a case-by-case basis. Hence, consideration needs to be given to the type of misconduct or conviction, the level of appeal (definitive vs. non-definitive convictions), the lapse of time since the misconduct or conviction, and its severity, as well as the person's subsequent conduct.

- 5.38. All persons are expected to avoid, to the extent possible, activities that could create conflicts of interest or the appearance of conflicts of interest.
- 5.39. The proportionality principle does not result in different standards in the case of the propriety requirement, for persons who effectively run the undertaking or have other key functions, since the reputability and integrity of the persons should always be on the same adequate level irrespective of the nature, scale and complexity of the risks inherent to the business or of the undertaking's risk profile.
- 5.40. Proper considerations are relevant for all employees of an undertaking. However, any assessment needs to take into account their level of responsibility within the undertaking and will differ proportionately, according to whether or not, for example, they are persons who effectively run the undertaking or have other key functions.

**Guideline 13 – Fit and proper policies and procedures**

**In accordance with Article 41 and 42 of Solvency II Directive, national competent authorities should ensure that the undertaking has a policy on the fit and proper requirements, which includes at least:**

- a) a description of the procedure for assessing the fitness and propriety of the persons who effectively run the undertaking or have other key functions, both when being considered for the specific position and on an on-going basis;**
- b) a description of the situations that give rise to a re-assessment of the fit and proper requirements; and**
- c) a description of the fit and proper procedures for assessing other relevant personnel not subject to the requirements of Article 42 of Solvency II Directive according to internal standards, both when being considered for the specific position and on an on-going basis.**

- 5.41. The policy establishes which situations would imply a review of whether a person should still be regarded as fit and proper. At least the following situations are considered:

- a) when there are reasons to believe that a person will discourage the undertaking from pursuing the business in a way that is consistent with applicable legislation;
- b) when there are reasons to believe that a person will increase the risk of financial crime, e.g. money laundering or financing of terrorism; and
- c) when there are reasons to believe that sound and prudent management of the business of the undertaking is at risk.

**Guideline 14 – Outsourcing of key functions**

**In accordance with Article 42 and 49 of Solvency II Directive, national competent authorities should ensure that the undertaking applies the fit and proper procedures in assessing persons employed by the service provider or sub service provider to perform an outsourced key function.**

**In accordance with Article 42 and 49 of Solvency II Directive, national competent authorities should ensure that the undertaking designates a person within the undertaking with overall responsibility for the outsourced key function who is fit and proper and possesses sufficient knowledge and experience regarding the outsourced key function to be able to challenge the performance and results of the service provider.**

- 5.42. If an undertaking outsources a key function, the undertaking also needs to ensure the service provider has checked the fitness and propriety of all persons working on that function.
- 5.43. The fitness of the person with overall responsibility for the outsourced key function at the undertaking is assessed taking into account that, while the oversight role carries ultimate responsibility for the key function, the level of knowledge required would not need to be as in depth as that of the relevant person(s) at the service provider. But at a minimum the person with overall responsibility for the outsourced key function at the undertaking has to possess enough knowledge and experience regarding the outsourced key function to be able to challenge the performance and results of the service provider.
- 5.44. When outsourcing a key function, an undertaking also needs to consider all the other issues mentioned in the outsourcing Guidelines.

**Chapter II: Risk Management**

**Guideline 15 – Role of the administrative, management or supervisory body in the risk management system**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the administrative,**

**management or supervisory body of the undertaking is ultimately responsible for ensuring the effectiveness of the risk management system, setting the undertaking's risk appetite and overall risk tolerance limits as well as approving the main risk management strategies and policies.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the administrative, management or supervisory body of the responsible entity is responsible for the effectiveness of the risk management system of the whole group. This risk management system should include at least:**

- a) the strategic decisions and policies on risk management at group level;**
- b) the definition of group's risk appetite and overall risk tolerance limits; and**
- c) the identification, measurement, management, monitoring and reporting of risks at group level.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that such strategic decisions and policies are consistent with the group's structure, size and the specificities of the entities in the group. It also ensures that the specific operations, which are material, and associated risks of each entity in the group are covered and in addition, it ensures that an integrated, consistent and efficient risk management of the group is put in place.**

- 5.45. While risk management is the responsibility of the undertaking's AMSB as a whole, the undertaking is expected to designate at least one member of the administrative, management or supervisory body to oversee the risk management system on its behalf.
- 5.46. Risk management is a continuous process that is used in the implementation of the undertaking's business strategy and allows for an appropriate understanding of the nature and significance of the risks to which it is exposed, including its sensitivity to those risks and its ability to mitigate them.
- 5.47. Within an undertaking there has to be a coordinated and integrated approach to risk management and a common "risk language" across the organisation.
- 5.48. It is the responsibility of the undertaking to choose the way it defines and describe its risk appetite and overall risk tolerance limits. Nevertheless risk appetite and overall risk tolerance limits have to reflect the following characteristics:
- a) Risk appetite addresses the attitude of the AMSB toward the main categories of risks. It needs to be clear and detailed enough to

express and reflect the strategic high level objectives of the AMSB. It may include a quantitative assessment in terms of risk and capital. The AMSB will give appropriate directions concerning the definition of risk appetite.

- b) "Overall risk tolerance limits" expresses the restrictions the undertaking imposes on itself when taking risks. It takes into account:
  - i. the relevant constraints that effectively limit the capacity to take risks. These constraints can go beyond the framework of solvency as defined in Solvency II;
  - ii. the risk appetite; and
  - iii. other relevant information (e.g. current risk profile of the undertaking, interrelationship between risks).

5.49. The definition of overall risk tolerance limits is understood and endorsed by the AMSB.

5.50. The risk tolerance limits defined for all relevant risk categories are in line with the overall risk tolerance and limits to guide day-to-day business operations.

5.51. The AMSB is also responsible for the approval of any periodic revision of the main strategies and business policies of the undertaking in terms of risk management.

5.52. The embedding of the risk management system in the organisational structure is demonstrated by adequate risk management processes and procedures across the undertaking and adequate consideration of the risks involved in all major decisions.

5.53. The interplay between individual and group levels is addressed in [Title II]. The risk management system of entities belonging to groups is necessarily linked to the group's business strategy and operations. The risk management strategy is underpinned by an integrated framework of responsibilities and functions driven from group level down to individual levels. The administrative, management or supervisory bodies of the entities within the group, each within the scope of its duties, are responsible for implementing the risk management strategies and policies established by the administrative, management or supervisory body of the entity responsible for fulfilling the requirements at group level.

5.54. The identification and measurement or assessment of risks is to be documented.

5.55. Internal risk reporting is required to be a continuous process within all levels of the undertaking. The frequency and content of reporting to the AMSB ensures that it has all necessary current information for its decision-taking with an appropriate level of detail.

### **Guideline 16 – Risk management policy**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking establishes a risk management policy which at least:**

- a) defines the risk categories and the methods to measure the risks;**
- b) outlines how the undertaking manages each relevant category, area of risks and any potential aggregation of risks;**
- c) describes the connection with the overall solvency needs assessment as identified in the forward looking assessment of the undertaking's own risks (based on the ORSA principles), the regulatory capital requirements and the undertaking's risk tolerance limits;**
- d) specifies risk tolerance limits within all relevant risk categories in line with the undertaking's overall risk appetite; and**
- e) describes the frequency and content of regular stress tests and the situations that would warrant ad-hoc stress tests.**

- 5.56. The risk management policy covers all material risks, including emerging risks<sup>5</sup>, quantifiable or non-quantifiable and reputational and strategic risks where relevant.
- 5.57. The risk management policy has to consider not only each relevant category and area of risks but also potential accumulation and interactions of risks. Where relevant, the risk management policy will also consider indirect effects of risks (e.g. indirect exposure to liquidity risks with regard to gearing, margin calls on derivatives or stock lending positions).
- 5.58. In addition to specific stress tests prescribed under the supervisory regime, the undertaking is expected to employ stress tests as tools in its risk assessment process. The risk management policy sets out the frequency and content of these stress tests.
- 5.59. The regular risk-specific stress tests are tailored by the undertaking to its risk profile. To this purpose the undertaking has to identify possible short and long term risks and possible events or future changes in economic conditions that could have an unfavourable effect on its overall financial standing and determine their capital impact.

---

<sup>5</sup>Emerging risks are newly developing or changing risks which are difficult to quantify and which may have a major impact on the undertaking.

- 5.60. An undertaking may also make use of reverse stress testing, which identifies circumstances and that would threaten the viability of the undertaking, and describe the precautions it is taking.
- 5.61. The undertaking will have to choose adequate scenarios to serve as basis for its risk assessment process. The scenario analyses are based on an analysis of the worst (i.e. most severe but plausible) cases the undertaking could face and take into account any material second order effect that may arise. The risk management policy sets out the frequency and content of these stress tests and scenario analyses.
- 5.62. Although each individual undertaking within a group is responsible for its risk management policy, a general steer is expected to be provided by the entity responsible for the fulfilment of the governance requirements at group level [(see Title II)]. In providing its steering, the entity responsible is expected to take into consideration the impact on and the compatibility with the individual undertaking's risk management strategies and policies bearing in mind possible discrepancies between the group perspective and local market specificities.

**Guideline 17 – Risk management function: general tasks**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the risk management function to report to the administrative, management or supervisory body on risks that have been identified as potentially material. The risk management function should also report on other specific areas of risks both on its own initiative and following requests from the administrative, management or supervisory body.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that the risk policy is implemented consistently across the group.**

**Guideline 18 – Underwriting and reserving risk management policy**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in its risk management policy, the undertaking covers at least the following with regard to underwriting and reserving risk:**

**the types and characteristics of the insurance business, such as the type of insurance risk the undertaking is willing to accept;**

**how the adequacy of premium income to cover expected claims and expenses is to be ensured;**

**the identification of the risks arising from the undertaking's insurance obligations, including embedded options and guaranteed surrender values in its products;**

**how, in the process of designing a new insurance product and the premium calculation, the undertaking takes account of the constraints related to investments; and**

**how, in the process of designing a new insurance product and the premium calculation, the undertaking takes account of reinsurance or other risk mitigation techniques.**

5.63. Where appropriate, the policy for underwriting and reserving risk may also include:

- a) the maximum acceptable exposure to specific risk concentrations;
- b) internal underwriting limits for the various products or classes; and
- c) considerations regarding reinsurance and other risk mitigation strategies and their effectiveness.

- 5.64. The undertaking ensures that all policies and procedures established for underwriting are applied by all distribution channels of the undertaking.
- 5.65. The undertaking needs to take into account the constraints related to investments in the design of new products. For example:
- a) an undertaking planning to sell a new life product with a minimum guaranteed rate has to take into account the return available on the market.
  - b) an undertaking planning to sell a new Property and Casualty contract has to take into account the liquidity constraints that could be linked to the contract.

**Guideline 19 – Operational risk management policy**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in the risk management policy, the undertaking covers at least the following with regard to operational risk:**

- a) Identification of the operational risks it is or might be exposed to and assessment of the way to mitigate them;**
- b) activities and internal processes for managing operational risks, including the IT system supporting them; and**
- c) risk tolerance limits with respect to the undertaking's main operational risk areas.**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that the undertaking has processes to identify, analyse and report on operational risk events. For this purpose, it should establish a process for collecting and monitoring operational risk events.**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that for the purposes of operational risk management, the undertaking develops and analyses an appropriate set of operational risk scenarios based on at least the following approaches:**

- a) the failure of a key process, personnel or system; and**
- b) the occurrence of external events.**

- 5.66. As operational risk is typically harder to identify and assess than other types of risks, it is even more important for the undertaking to have a conscious approach to it in its overall risk management. As some of the risk comes from the undertaking itself (e.g. inadequate or failed internal processes, personnel or systems), the undertaking plays a role in the occurrence and unfolding of operational risks. This is also partly true for operational risks having an external event for a cause.

- 5.67. It is important to note that because operational risks tend to interact with the other risk types they will not be assessed in isolation, but rather be considered alongside the assessment of the other risk types.
- 5.68. Operational risk may materialize through personnel execution errors, frauds, and processing failures as well as through the direct and indirect consequences of natural or man-made disasters such as terrorist attacks, fire, flood, earthquake and pandemics. These natural or man-made disasters are the high impact-low frequency type of operational risks which need to be considered when looking at scenario analysis. As their impact may be potentially catastrophic, the undertaking pays particular attention to them and develops early warning systems that allow for an effective and timely intervention.
- 5.69. For the development of scenarios, the undertaking takes into account that the different types of operational risk that are defined in article 13(33) of Solvency II are not strictly separated and that using the two starting points (start from a failure of internal process, system or personnel on one hand or external causes on the other hand) to develop the scenario set will give better chances to have a more comprehensive list of relevant scenarios. Very severe and unlikely but not impossible scenarios must also be considered.
- 5.70. To perform this analysis the undertaking can use pre-defined categories of operational risks and lists of its key processes. However, each undertaking is free to define a categorisation that better suits its specificities.
- 5.71. The analysis of stress tests and scenarios for the operational risk framework might differ from other types of stress or scenario analysis (e.g. financial), as the definition of the different stages of the scenario (cause, failure of process, impacts) will be a key element of the analysis and monitoring of the risks. The main reason for this is that the controls and corrective measures that the undertaking will put in place will have an effect on the scenario itself.
- 5.72. In the case of operational risk, prevention and corrective actions take precedence over the precise measure. Identifying operational risks is very closely linked to prevention, mitigation and corrective measures.
- 5.73. The continuous monitoring and control of operational risks implies that all personnel are aware of the importance of this type of risk.
- 5.74. The controls and mitigation actions need to be reviewed periodically taking into account the evolution of the operational risk and knowledge of operational risk evolutions.
- 5.75. Examples of mitigation actions are:
- a) insurance (liability insurance, key person insurance, fire insurance, etc.);
  - b) automation of processes; and

c) back up of data.

5.76. The undertaking is also expected to put in place key risk indicators.

5.77. For the purposes of operational risk events analysis, an undertaking may also consider how external data could supplement its collection of internal operational risk events data to produce more reliable estimates of operational risk events.

5.78. On each concerned event, at least the following information is needed:

- a) The cause of the event;
- b) The consequences of the event; and
- c) The actions taken or not on account of the event.

5.79. When defining the perimeter (e.g. materiality threshold) of the events that will be collected, the undertaking would have to keep in mind that:

- a) Operational risk can be both related to high frequency/low severity events or to low frequency/high impact events; and
- b) Some events that have had no negative impact (e.g. near misses) may be very useful to be analysed to monitor more material operational risks.

**Guideline 20 – Control and documentation of risk-mitigation techniques**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that for the purposes of proper use of reinsurance and other risk mitigation techniques the undertaking analyses, assesses and documents the effectiveness of all risk mitigation techniques employed.**

**Guideline 21 – Reinsurance and other risk-mitigation techniques – risk management policy**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in the risk management policy the undertaking covers at least the following with regard to risk mitigation techniques:**

- a) **identification of the level of risk transfer appropriate to the undertaking's defined risk limits and which kind of reinsurance arrangements are most appropriate considering the undertaking's risk profile;**
- b) **principles for the selection of such risk mitigation counterparties and procedures for assessing and**

**monitoring the creditworthiness and diversification of reinsurance counterparties;**

**c) procedures for assessing the effective risk transfer and consideration of basis risk; and**

**d) liquidity management to deal with any timing mismatch between claims' payments and reinsurance recoverable.**

5.80. The use of reinsurance and similar risk mitigation techniques constitute an ongoing process that may be used to keep the undertaking's risks within the scope of the approved risk tolerance limits. In using these techniques the undertaking has to consider the potential new risks they carry, such as the risk of counterparty default.

5.81. The undertaking develops a written analysis of the functioning and inherent material risks of the risk mitigation used. In particular, subject to the principle of proportionality, it will document the risks that can derive from the risk mitigation, the actions adopted to face such risks and the potential consequences of the risks (i.e. in a worst-case scenario).

#### **Guideline 22 – Asset-liability management policy**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in its risk management policy the undertaking covers at least the following information with regard to asset-liability management:**

**a) a description of the procedure for identification and assessment of different natures of mismatches between assets and liabilities, at least with regard to terms and currency;**

**b) a description of mitigation techniques to be used and the expected effect of relevant risk-mitigating techniques on asset-liability management;**

**c) a description of deliberate mismatches permitted; and**

**d) a description of the underlying methodology and frequency of stress tests and scenario tests to be carried out.**

5.82. Asset-liability management (ALM) is the management of a business in such a way that decisions on assets and liabilities are coordinated in order to manage the exposure to the risk associated with the variation of their economic values.

5.83. Along with the investment strategy, an ALM strategy describes how financial and insurance risks will be managed in an asset-liability framework in the short, medium and long term. Where appropriate the

investment strategy and the ALM-strategy could be integrated in a combined investment/ALM-strategy.

- 5.84. When choosing from the different ALM techniques available for measuring risk exposure, an undertaking relies on measurement tools that are consistent with the risk characteristics of the lines of business and its overall risk tolerance limits.
- 5.85. In order to provide for the effective management of assets and liabilities, the undertaking needs to ensure appropriate and continuing liaison between the different areas within its business involved in the ALM, such as off-balance sheet exposures or introduction of new products.
- 5.86. The management of the term structure of the portfolio is mainly done according to the term structure of the liabilities. A range of more or less sophisticated techniques can be used, e.g. duration, convexity, maturity buckets, according to the nature, size and complexity of the portfolio. Size is the factor that most limits the leeway on the management of term structure.

**Guideline 23 – Investment risk management policy**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that in its risk management policy, the undertaking covers at least the following with regard to investments:**

- a) the level of security, quality, liquidity, profitability and availability the undertaking is aiming for with regard to the whole portfolio of assets and how it plans to achieve this;**
- b) its quantitative limits on assets and exposures, including off-balance sheet exposures, that are to be established to help to ensure the undertaking achieves its desired level of security, quality, liquidity, profitability and availability for the portfolio;**
- c) consideration of the financial market environment;**
- d) the conditions under which the undertaking can pledge or lend assets;**
- e) the link between market risk and other risks in adverse scenarios;**
- f) the procedure for appropriately valuing and verifying the investment assets;**
- g) the procedures to monitor the performance of the investments and review the policy when necessary; and**
- h) how the assets are to be selected in the best interest of policyholders and beneficiaries.**

- 5.87. The risk management function evaluates whether the internal investment limits are appropriate in view of the undertaking's obligation to meet its liabilities and to comply with the requirements of Article 132(4) of Solvency II. For such purpose an appropriate number of stress tests are carried out on a regular basis.
- 5.88. The identification, measurement, monitoring, management and control of the investment risks inherent in the respective investment categories are carried out using suitable and acknowledged methods.
- 5.89. The undertaking has adequate internal control procedures in order to safeguard that the investment activity is properly reviewed and that transactions are always made under consideration of the investment principles and procedures approved by the AMSB; these control procedures must be aligned with the risks arising from investment activities. Such risks may include, but are not limited to, those risks involving coordination between front and back office, compliance with authorisations and trading limits, agreement of parties involved in a transaction, timely documentation of transactions, verification of quoted prices, traceability and tractability.
- 5.90. The risk management system has to put in place and monitor internal quantitative limits for each type of assets, including off-balance sheet exposures, considered eligible by the undertakings, per counterparty, geographical area or industry with the aim of managing risks in an appropriate manner and protecting the interests of policyholders.

**Guideline 24 – Liquidity risk management policy**

**In accordance with Article 44 of Solvency II Directive, national competent authorities should ensure that in its risk management policy, the undertaking covers at least the following items with regard to liquidity risk:**

- a) the procedure for determining the level of mismatch between the cash inflows and the cash outflows of both assets and liabilities, including expected cash flows of direct insurance and reinsurance such as claims, lapses or surrenders;**
- b) consideration of total liquidity needs in the short and medium term, including an appropriate liquidity buffer to guard against a liquidity shortfall;**
- c) consideration of the level and monitoring of liquid assets, including a quantification of potential costs or financial losses arising from an enforced realisation;**
- d) identification and costs of alternative financing tools; and**
- e) consideration of the effect on the liquidity situation of expected new business.**

- 5.91. The purpose of liquidity risk management is to ensure that obligations to policyholders can be met whenever they fall due. The required degree of liquidity in the investment portfolio can differ amongst undertakings according to the nature of the insurance business, especially the possibility to foresee the amount and the time of the insurance payments.
- 5.92. An appropriate buffer for liquidity shortfalls is understood as having enough liquid assets and not as holding additional capital.
- 5.93. Short term liquidity, or cash management, includes the day-to-day cash requirements under normal business conditions. Liquidity considerations over the long term need to be assessed in a way which takes into consideration the possibility of various unexpected and potentially adverse business conditions where asset values may not be realised for current market values, including situations where accelerated sales of assets reduce expected returns. There are also liquidity considerations that arise from policyholder behaviour, such as unexpected or accelerated payments to policyholders as a result of surrenders, large claims, or the exercise of policy options.
- 5.94. At group level, the management of liquidity risk needs to be adequately supported by clear agreements governing the usage of excess funds, supervision of each entity's financial position and regular stress and transferability testing.

### **Chapter III: The "prudent person" principle and the system of governance**

#### **Guideline 25 – Investment risk management**

**In accordance with Article 132 of Solvency II Directive, national competent authorities should ensure that the undertaking does not solely depend on the information provided by third parties, such as financial institutions, asset managers and rating agencies. In particular, the undertaking should develop its own set of key risk indicators in line with its investment risk management policy and business strategy.**

**In making its investment decisions, the undertaking should take into account the risks associated with the investments without relying only on the risk being adequately captured by the capital requirements.**

- 5.95. The Guideline basically refers to the underlying prudent person principle for managing investments. This principle has the following characteristics:
- a) Due diligence and process: The prudent person principle is as much a behavioural standard as an assessment of judgments and investment decisions. Prudence is to be found in the process by which investment strategies are developed, adopted, implemented, and monitored in

light of the purposes for which funds are managed, as well as in the outcomes.

- b) Care, skill and delegation: The undertaking, while performing investment management must have an adequate understanding of the risks associated with its investments, its risk management policy, the necessary level of “familiarity” with the liability and regulatory constraints to appropriately carry out its responsibilities. Similarly, the undertaking must have or acquire the care and skill sufficient to the tasks of investment management for which it is responsible. To obtain a sufficient level of skills satisfying the prudent person principle, the undertaking may obtain advice from relevant experts and delegate various activities to those with the requisite skill. When employing an expert,
  - i) the undertaking is responsible for assuring that the expert actually has the skills for which he or she is being employed and, therefore, will adequately investigate the expert’s qualifications and experience.
  - ii) the undertaking also ensures that employed experts acquire sufficient familiarity with the specific nature and needs of the managed portfolios by providing them with complete, accurate and sufficient information so that they can appropriately formulate requested advice or carry out delegated tasks.
  - iii) the undertaking assesses whether the hired parties have any conflicts of interest that could provide inappropriate incentives to act contrary to its interests.
- c) Duty to monitor: Even when delegating tasks, the undertaking remains responsible for monitoring and reviewing the activities delegated to assure that they have been appropriately and prudently carried out. This would include the monitoring and reviewing of investment managers based upon the investment risk section of the risk management policy and review procedure.
- d) Duty to protect policy holders and beneficiaries interest: The undertaking protects the policy holders’ and beneficiaries’ interests considering that risks such as legal risk, reputation risks, commercial risks, and operational risks resulting from a lack of care may also impair its solvency. A special emphasis on this point is made on unit-linked business.
- e) Principle of diversification: The investments in portfolios managed by the undertakings are suitably diversified. It requires both diversification among appropriate asset classes and within each asset classification, in order to avoid the unwarranted concentration of investment and the associated accumulation of risk in the portfolios.

5.96. Each portfolio contains investment related risks which can endanger the solvency position. The undertaking must be able to identify measure, monitor, manage and control these risks. The composition of the pool of

investment assets is at any time the result of a well-structured, disciplined and transparent investment process which consists of the following components:

- a) the implementation of the investment risk section of the risk management policy by an investment management with the appropriate skills and resources;
- b) continuous independent control of the investment activity by the employees entrusted with this task by comprehensive and, precise systems for identifying, measuring, monitoring, managing and controlling the investment risks and their aggregation on different levels;
- c) appropriate procedures for the measurement and evaluation of the investment result; and
- d) appropriate reporting procedures.

5.97. The qualitative features of security, quality, liquidity and profitability apply to the portfolio as a whole and not to individual investments. Hence, undertakings may have individual investments that do not fulfil every qualitative feature even if they will finally contribute to the security, quality, liquidity and profitability of the portfolio as a whole.

5.98. In order for these qualitative features to provide a real benchmark against which compliance can be assessed, it needs to be specified to what extent individual investments do not necessarily have to meet all these qualitative features. Assets that do not fulfil every qualitative feature must be kept at prudent levels.

**Guideline 26 – Assessment of non-routine investment activities**

**In accordance with Article 132 of Solvency II Directive, national competent authorities should ensure that before performing any investment or investment activity of a non-routine nature the undertaking carries out an assessment of at least:**

- a) its ability to perform and manage the investment or the investment activity;**
- b) the risks specifically related to the investment or the investment activity and the impact of the investment or the investment activity on the undertaking's risk profile;**
- c) the consistency of the investment or investment activity with the beneficiaries' and policyholders' interest, liability constraints set by the undertaking and efficient portfolio management; and**
- d) the impact of this investment or investment activity on the quality, security, liquidity, profitability and availability of the whole portfolio.**

**In accordance with Article 132 of Solvency II Directive, national**

**competent authorities should ensure that the undertaking has procedures that require that where such investment or investment activity entails a significant risk or change in the risk profile, the undertaking's risk management function communicates such a risk or change in the risk profile to the administrative, management or supervisory body of the undertaking.**

- 5.99. A not routinely employed investment or investment activity, such as a large or complex investment, is one that the undertaking does not perform on a regular basis and which is therefore out of the ordinary. The use of derivatives may not be exceptional as such but is considered non-regular as derivatives have to be tailored in each case to serve a specific purpose.
- 5.100. Investment activity means any action related to investment management (e.g.: sale of call options, security lending, issuance of an instrument).
- 5.101. The impact on the quality, security, liquidity profitability and availability of the whole portfolio has to be such that it improves the characteristics of the portfolio and does not deteriorate significantly one characteristic.
- 5.102. Where the investment or investment activity entails a significant risk or change in the risk profile, this will lead to the requirement to perform a new forward looking assessment of the undertaking's own risk (based on the ORSA principles).

**Guideline 27 – Unit-linked and index-linked contracts**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the investments of unit-linked and index-linked contracts of the undertaking are selected in the best interest of policyholders and beneficiaries taking into account any disclosed policy objectives.**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that, in the case of unit-linked business, the undertaking takes into account and manages the constraints related to unit-linked contracts, in particular liquidity constraints.**

- 5.103. In relation to unit-linked contracts, the undertaking is expected to consider the liquidity risk with reference to its liabilities arising from the obligations and representations to policyholders and beneficiaries. In particular this includes the assessment of the ability for policyholders and beneficiaries to redeem their unit-linked investments, taking into account the immediacy with which they must discharge their obligations (i.e. the notice period).

- 5.104. The operation of unit-linked and index-linked contracts requires for ALM reasons that the underlying assets of the contracts are sufficiently liquid that the purchase and sales of those assets can be realised consistently with the premium payment and redemptions on the contracts.
- 5.105. If it is not possible to sell particular assets in time or at a fair price to meet surrender payments, the undertaking needs to consider the interests of the remaining unit holders and whether there is a need to sell other liquid assets. A consequential risk is that the residual investment portfolio of the fund becomes unbalanced, in a way that it no longer conforms to the investment mandate and/or the risk profile disclosed to policyholders. The undertaking therefore needs to take into account the broader impact on the linked fund or portfolio.
- 5.106. The undertaking needs to ensure that no additional risk results from the unit-linked contracts in a way that could hurt other policyholders and beneficiaries, e.g. when the undertaking uses derivatives to limit the maximum possible loss.

**Guideline 28 – Assets not admitted for trading on a regulated financial market**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking implements, manages, monitors and controls procedures in relation to investments that are not admitted to trading on a regulated financial market or to complex products, which are difficult to value.**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking treats assets admitted to trading, but not traded or traded on a non-regular basis, similarly to those assets not admitted to trading on a regulated financial market.**

- 5.107. Where mark-to-model valuation is applied, the risk management function is responsible for model sign-off and review, independent price verification and stress-testing, as well as for internal control processes. On a regular basis, the undertaking is expected to assess the need to develop back-up valuation models for complex or potentially illiquid instruments. These methods and models have to be benchmarked, extrapolated or otherwise calculated as far as possible from market inputs. The undertaking is expected to maximise the use of relevant observable inputs and minimise the use of unobservable inputs.
- 5.108. The undertaking is expected to have access to appropriate expertise in order to understand, manage and monitor structured products and their embedded risks. Also, the undertaking needs procedures to evaluate the specific risks associated with these products, especially new concentration risks that may not be obvious.

### **Guideline 29 – Derivatives**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking, when it uses derivatives, implements the procedures in line with its risk management policy on investments to monitor the performance of these derivatives.**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking demonstrates how the quality, security, liquidity or profitability of the portfolio is improved without significant impairment of any of these features where derivatives are used to facilitate efficient portfolio management.**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that the undertaking documents the rationale and demonstrates the effective risk transfer obtained by the use of the derivatives where derivatives are used to contribute to a reduction of risks or as a risk mitigation technique.**

- 5.109. With respect to assets other than those covered by Article 132 paragraph 3 of Solvency II, derivatives are only allowed for the purposes of efficient portfolio management or the reduction of risks.
- 5.110. When the undertaking uses derivative products or any other financial instrument with similar characteristics or effects, it needs to put in place procedures to evaluate the strategy to use these types of products and the principles of risk management to be applied to them.
- 5.111. Where the undertaking uses derivatives that can generate losses significantly above the amount initially committed, such as the sale of a call, it is expected to assess the resulting structure of the whole portfolio whether it does create a situation where the possible loss could be unlimited or excessive with regard to the portfolio constraints.
- 5.112. The use of derivative as a hedging tool is expected to be done in a way that does not create any additional risks that have not been assessed previously.
- 5.113. Examples where derivatives are used for hedging and would create new risks:
- a) If the undertaking invests in a mutual fund in which the foreign currency risk is hedged (in the mutual fund) by a derivative with a margin call and the covered assets are not liquid, it can create a liquidity risk in the mutual fund even though economically the risk is hedged;

- b) If the undertaking wants to hedge a security with a negative value using a collar, it can create risks in the income statement even though economically the risk of an asset impairing is hedged; and
- c) If the undertaking wants to hedge against a rise in interest rates, it may buy caps from investment banks, which can create an increased counterparty risk even though economically the risk is hedged.

5.114. With respect to assets covered by Article 132 paragraph 3 of Solvency II, derivatives may also be used as an investment strategy.

**Guideline 30 – Securitised instruments**

**In accordance with Articles 44 and 132 of Solvency II Directive, national competent authorities should ensure that, where the undertaking invests in securitised instruments, it ensures that its interests and the interests of the originator or sponsor concerning the securitised assets are well understood and aligned.**

- 5.115. The undertaking ensures that the originator does not conclude deals solely because it expects to have essentially a brokerage activity on these deals.
- 5.116. The undertaking has a clear vision of the purpose followed by the originator, in particular the undertaking ensures that, at least, the assets are not securitised because the conditions on the market have become more risky for these assets.
- 5.117. Below are possible actions the undertaking could take to ensure that the alignment is in place, it could:
- a) perform due diligence including a risk analysis of the proposed securitised investments;
  - b) ensure that the originator has explicitly provided the undertaking with the documentation governing the investment that the originator will retain, on an ongoing basis a net economic interest which, in any event, should not be less than a relevant and pre-determined share;
  - c) ensure that the originator meets the following criteria: the originator or, where appropriate, the sponsor finances the transaction, based on sound and well-defined criteria, and clearly establishes the process for approving, amending, renewing and refinancing assets securitised to exposures to be securitised if they apply to exposures which are not currently securitised;
  - d) check that the originator or, where appropriate, the sponsor has in place effective systems to manage the on-going administration and monitoring of its assets, risk-bearing portfolios and exposures;

- e) check that the originator or, where appropriate, the sponsor adequately diversifies each asset portfolio based on its target market and overall credit strategy;
- f) ensure that the originator or, where appropriate, the sponsor makes readily available access to all relevant data necessary for the undertaking to comply with any legal requirements set;
- g) check that the originator or, where appropriate, the sponsor has a written policy on asset risk that includes its risk appetite and provisioning policy and how it measures, monitors and controls that risk;
- h) ensure that the originator or, where appropriate, the sponsor discloses the level of its retained net economic interest as well as any matters that could undermine the maintenance of the minimum required net economic interest.

## **Chapter IV: Own fund requirements and the system of governance**

### **Guideline 31 – Capital Management Policy**

**In accordance with Article 41 and 93 of Solvency II Directive, national competent authorities should ensure that the undertaking should be developing a capital management policy which includes:**

- a. a description of the procedure to ensure that own fund items, both at issue and subsequently, meet the requirements of the applicable capital and distribution regime and are classified correctly where the applicable regime requires;
- b. a description of the procedure to monitor the issuance of own fund items according to the medium term capital management plan;
- c. a description of the procedure to ensure that the terms and conditions of any own fund item are clear and unambiguous in relation to the criteria of the applicable capital regime; and
- d. a description of the procedures to
  - i. ensure that any policy or statement in respect of ordinary share dividends is taken into account in consideration of the capital position; and
  - ii. identify and document instances in which distributions on an own funds item are expected to be deferred or cancelled.

### **Guideline 32 – Medium-term Capital Management Plan**

**In accordance with Article 41 and 93 of Solvency II Directive,**

**national competent authorities should ensure that the undertaking is developing a medium-term capital management plan which is to be monitored by the administrative, management or supervisory body of the undertaking and which includes at least considerations of:**

- a. any planned capital issuance;**
- b. the maturity, incorporating both the contractual maturity and any earlier opportunity to repay or redeem, relating to the undertaking's own fund items;**
- c. how any issuance, redemption or repayment of, or other variation in the valuation of, an own funds item affects the application of any limits in the applicable capital regime; and**
- d. the application of the distribution policy.**

**In accordance with Article 41 and 93 of Solvency II Directive, national competent authorities should ensure that the undertaking takes into account in the capital management plan the output from the risk management system and the forward looking assessment of own risks (based on the ORSA principles).**

## **Chapter V: Internal Controls**

### **Guideline 33 – Internal Control environment**

**In accordance with Article 46 of Solvency II Directive, national competent authorities should ensure that the undertaking promotes the importance of performing appropriate internal controls by ensuring that all personnel are aware of their role in the internal control system. The control activities should be commensurate to the risks arising from the activities and processes to be controlled.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures a consistent implementation of the internal control systems across the group.**

5.118. Internal control combines the following aspects:

- a) internal control environment
- b) internal control activities
- c) communication
- d) monitoring

- 5.119. A high level of integrity is an essential part of the control environment. In reinforcing integrity, the undertaking needs to avoid policies and practices that may provide incentives for inappropriate activities. The undertaking needs to ensure staff are not only fully aware of the internal control system but that they understand their role within it. This ensures the system is fully embedded within the undertaking's culture.

**Guideline 34 – Monitoring and reporting**

**In accordance with Article 46 of Solvency II Directive, national competent authorities should ensure that the undertaking establishes that the monitoring and reporting mechanisms within the internal control system provide the administrative, management or supervisory body with the relevant information for the decision-making processes.**

- 5.120. The reporting of the achievement of the main goals and material risks inherent in the business is predefined.
- 5.121. Quality reports, timely reporting, accuracy, completeness and suggestions for improvements are encouraged.
- 5.122. Internal communication lines need to encourage the reporting of negative news, particularly when communicated to superiors, to avoid employees suppressing negative information and permit short cut across reporting lines in case the situation calls for such action.
- 5.123. Monitoring mechanisms include procedures to detect deficiencies.
- 5.124. Regular monitoring occurs in the course of normal operations and includes on-going management activities and actions taken by all personnel when performing their duties.

**Chapter VI: Internal audit function**

**Guideline 35 – Independence**

**In accordance with Article 47 of Solvency II Directive, national competent authorities should ensure that the undertaking provides that when performing an audit and when evaluating and reporting the audit results, the internal audit function is not subject to influence from the administrative, management or supervisory body that can impair its independence and impartiality.**

- 5.125. Internal audit is an independent function established within the undertaking to examine and evaluate the functioning, effectiveness and efficiency of the internal control system and all other elements of the system of governance. Internal audit assists members of the AMSB in their duty to have an adequate and effective internal control system in

place. Internal audit provides the AMSB with analysis, appraisals, recommendations and information concerning the activities reviewed.

- 5.126. Certain undertakings have established separate functions in charge of controlling or monitoring a specific activity or entity of the undertaking. Such functions are part of the internal control system and therefore do not release the internal audit from examining those specific activities or entities. However, for the sake of efficiency, the internal audit may, in carrying out its tasks, use the information reported by the various functions. The independence of the internal audit function implies that it is given an appropriate standing within the organization and carries out its assignments without undue interferences and with impartiality.
- 5.127. The AMSB can request that specific areas are included in the internal audit without impairing the independence of the internal audit function.

**Guideline 36 – Internal audit policy**

**In accordance with Articles 41 and 47 of Solvency II Directive, national competent authorities should ensure that the undertaking has an internal audit policy which covers at least the following areas:**

- a. the terms and conditions according to which the internal audit function can be called upon to give its opinion or assistance or to carry out other special tasks;**
- b. where appropriate, internal rules setting out the procedures the person responsible for the internal audit function needs to follow before informing the supervisory authority; and**
- c. where appropriate, the criteria for the rotation of staff assignments.**

**In accordance with Articles 41 and 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that the audit policy at the level of the group describes how the internal audit function:**

- a. coordinates the internal audit activity across the group; and**
- b. ensures compliance with the internal audit requirements at the group level.**

- 5.128. The policy is drawn up by the internal audit function and approved by the AMSB.

**Guideline 37 – Internal audit function tasks**

**In accordance with Article 47 of Solvency II Directive, national competent authorities should ensure that the undertaking requires that the internal audit function, at least:**

- a. to establish, implement and maintain an audit plan setting out the audit work to be undertaken in the upcoming years, taking into account all activities and the complete system of governance of the undertaking;
- b. to take a risk-based approach in deciding its priorities;
- c. to report the audit plan to the administrative, management or supervisory body of the undertaking;
- d. to issue an internal audit report to the AMSB based on the result of work carried out in accordance with point (a), which includes findings and recommendations, including the envisaged period of time to remedy the shortcomings and the persons responsible for doing so, and information on the achievement of audit recommendations;
- e. to submit the internal audit report to the administrative, management or supervisory body on at least an annual basis; and
- f. to verify compliance with the decisions taken by the administrative, management or supervisory body on the basis of those recommendations referred to in point (d).

**In accordance with Article 47 of Solvency II Directive, national competent authorities should ensure that where necessary, the undertaking provides that the internal audit function may carry out audits which are not included in the audit plan.**

- 5.129. Each assignment is adequately prepared. Its objectives as well as an outline of the work that is considered necessary to attain is described in an audit program.
- 5.130. A written report of each assignment is issued as quickly as possible.
- 5.131. It is transmitted to the auditee and the auditee's hierarchy and - possibly as an executive summary - to the AMSB.
- 5.132. The internal audit function indicates the relative importance of the deficiencies found or recommendations made.
- 5.133. The report covers at least any deficiencies with regard to the efficiency and suitability of the internal control system, as well as major shortcomings with regard to the compliance with internal policies, procedures and processes. It includes recommendations on how to remedy inadequacies and also specifically addresses how past points of criticism and past recommendations have been followed up.
- 5.134. The internal audit function develops appropriate procedures to verify the manner how the recommendations are implemented.

- 5.135. As part of its supervisory task, the AMSB body is expected to regularly discuss the organisation, audit plan, audit programme, adequacy of resources to ensure the proper performance of the activities of the internal audit function and summary of recommendations and their implementation.

## Chapter VI: Actuarial Function

### **Guideline 38 – Tasks of the actuarial function**

**In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking takes appropriate measures to address the potential conflicts of interests, if the undertaking decides to add additional tasks or activities to the tasks and activities of the actuarial function.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity requires that the actuarial function gives an opinion on the reinsurance policy and the reinsurance program for the group as a whole.**

- 5.136. One of the tasks of the actuarial function is the coordination of the calculation of technical provisions. This task, as defined in Solvency II, does not explicitly include the actual calculations of the technical provisions. Who should perform the calculation of the technical provisions is left to each undertaking to decide, provided that there is a clear allocation and appropriate segregation of responsibilities to ensure independent scrutiny and validation of the calculation. In cases where both calculation and validation of technical provisions is done by the actuarial function, the undertaking should have in place processes and procedures in order to avoid conflicts of interest and ensure appropriate independence. The degree of segregation of duties needs to be proportionate to the nature, scale and complexity of the risks inherent in the calculation of the technical provisions.
- 5.137. The undertaking needs to ensure and demonstrate that the processes of calculation and of validation of the technical provisions are independently performed.
- 5.138. The group actuarial function provides advice and an actuarial opinion on: underwriting risks of the group, asset-liability aspects, the group's solvency position, the groups prospective solvency position, such as stress tests and scenario tests in the area of technical provisions and ALM, distribution of dividends in relation to discretionary benefits, underwriting policies, reinsurance arrangements and other forms of risk transfer or risk mitigation techniques for insurance risks. Also advice is given on the adequacy, fairness of premiums and discretionary benefits,

or the methodology to determine the same, by the group actuarial function.

**Guideline 39 – Coordination of the calculation of technical provisions**

**In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to identify any inconsistency with the requirements set out in Articles 76 to Article 85 of Solvency II Directive for the calculation of technical provisions and propose corrections as appropriate.**

**In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to explain any material effect of changes in data, methodologies or assumptions between valuation dates on the amount of technical provisions if already calculated on a Solvency II basis.**

- 5.139. Both the task of ensuring the appropriateness of the methodologies and of the underlying models used, including the assumptions made in the calculation of technical provisions, and the assessment of the sufficiency and quality of the data used in the calculation of technical provisions are requirements of the coordination of the calculation.
- 5.140. In order to carry out this task, the actuarial function uses methodologies that allow for a complete analysis regarding those requirements.
- 5.141. The methodologies used to calculate the technical provisions should be validated, by validation tools such as back-testing against past experience, giving due considerations to changes over time.
- 5.142. The work required to ensure that an assumption is appropriate has to be proportionate to the impact of a variation in the assumption on the best estimate and to the materiality of the impact for the undertaking.

**Guideline 40 – Data quality**

**In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to assess the consistency of the internal and external data used in the calculation of technical provisions against the data quality standards as set in Solvency II Directive. Where relevant, the actuarial function provides recommendations on internal procedures to improve data quality so as to ensure that the undertaking is in a position to comply with the related Solvency II requirement when implemented.**

- 5.143. When assessing the appropriateness of the undertaking's segmentation of its insurance obligations into homogeneous risk groups, the actuarial function needs to take any data limitations into account. Limitations may include insufficient granularity and quantity of data.
- 5.144. The appropriate level of granularity is the level that allows the identification of trends affecting the different drivers of risk and ensures that there is sufficient data to enable the implementation of the methodologies and any statistical analysis.
- 5.145. The actuarial function has the task of consulting any relevant market data to perform the modelling of these liabilities and ensuring that these data are appropriately integrated into the model.
- 5.146. The actuarial function performs a process of comparison and validation of technical provisions based on experience and identifies solutions on how to deal with any material differences detected, which may imply revisions of assumptions and methodologies.

**Guideline 41 – Underwriting policy and reinsurance arrangements**  
**In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function, when providing its opinion on the underwriting policy and the reinsurance arrangements, to take into consideration the interrelations between these and the technical provisions.**

- 5.147. Underwriting policy, reinsurance arrangements and technical provisions are interdependent actions according to the nature of an undertaking's business. Changes in underwriting policy and practice, for example, may not only affect the calculation of technical provisions, but also the adequacy of reinsurance arrangements. Consequently, the actuarial function is expected to identify any important interrelationships between underwriting policy, reinsurance and technical provisions when carrying out its responsibilities as described in Article 48 of Solvency II.
- 5.148. The skills and experience of the actuarial function can provide a different perspective from the underwriters' or reinsurance teams' perspectives. This perspective, when communicated to the administrative, management or supervisory body, will help to ensure that it is fully informed. The opinions on the underwriting policy and reinsurance arrangements include, when necessary, recommendations regarding appropriate strategies to be followed by the undertaking in this matter.
- 5.149. The opinion on the overall underwriting policy may include amongst others the following issues:

- a) whether the product pricing is consistent with the underwriting policy for acceptance of risks;
- b) an opinion on the principal risk factors influencing the profitability of business to be written during the next year, including the potential impact on future profitability of external factors such as inflation, legal risk, changes in business volumes and changes in the market environment;
- c) an opinion on the likely financial impact of any material planned changes in terms and conditions of contracts;
- d) the degree of variability surrounding the estimate of expected profitability; and
- e) the consistency of this degree of variability with the risk appetite of the undertaking.

5.150. Commenting on the overall underwriting policy does not require expressing views on every single policy, but rather on the undertaking's underwriting in general. The scope of the view expressed is determined by what is relevant information for the administrative, management or supervisory body in reviewing the undertaking's underwriting policies.

5.151. The opinion on the adequacy of the undertaking's reinsurance arrangements may include amongst others the following issues:

- a) the consistency of the undertaking's reinsurance arrangements with its risk appetite;
- b) the effect of reinsurance on the estimation of technical provisions net of reinsurance recoverables; and
- c) an indication of the effectiveness of the undertaking's reinsurance arrangements in mitigating the volatility of its own funds.

5.152. The opinion on the adequacy of reinsurance arrangements needs to include an assessment of how the reinsurance coverage could respond under a number of stressed scenarios. These scenarios may include situations such as the following: exposure of the undertaking's portfolio of business to catastrophic claims experience, aggregations of risks, reinsurance defaults and potential reinsurance exhaustion.

5.153. The actuarial function provides information to the administrative, management or supervisory body to enable it to take decisions concerning the underwriting policy and reinsurance arrangements. The opinions of the actuarial function on the overall underwriting policy and reinsurance arrangements need to include descriptions and examinations of other possible options.

**Guideline 42 – The actuarial function of an undertaking with an internal model under pre-application**

**In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that, during the pre-application process, the undertaking requires the actuarial function to contribute to specifying which risks within their domain of expertise are covered by the internal model. The actuarial function should also contribute to how dependencies between these risks and dependencies between these risks and other risks are derived. This contribution is based on a technical analysis and should reflect the experience and expertise of the function.**

- 5.154. Article 44 (5) of Solvency II sets out that the risk management function is responsible for a number of areas of the internal model. Despite the fact that the risk management function is responsible for the design, implementation, testing and validation of the internal model, it is expected that the actuarial function assists in these tasks. The assistance of the actuarial function in the internal modelling is desirable also because of the close connection and consistency between the valuation of the assets, liabilities and the calculation of the loss Probability Distribution Forecast (PDF). During the calculation of the SCR, amongst others, the uncertainties of the technical provisions are measured, via life underwriting risk module, non-life underwriting risk module.
- 5.155. The design of the internal model is a task that is performed with the contribution provided by the actuarial function, for instance, regarding the scope of the internal model and the complexity of the model.
- 5.156. The level of data quality that is required to perform the modelling of the different risks is a particular factor that needs to be taken into consideration. The actuarial function, as responsible for the analysis of the sufficiency and the quality of the internal and external data to be used in the calculation of technical provisions, is in a position to express an opinion on whether it is appropriate to explore a specific area of modelling in the framework of the internal model, regarding the limitations of data that may apply.
- 5.157. The actuarial function, following its task of coordination of the calculation of technical provisions, assists the risk management function in defining the level of technical complexity that should be associated with the model. The level of complexity will depend, for instance, on the level of completeness of the data, the nature and complexity of the risks and its importance among the other risks.
- 5.158. The assistance of the actuarial function to risk management is particularly important in the modelling of underwriting risks and it is necessary to ensure consistency between the assumptions set to calculate technical provisions and the assumptions inherent to the calculation of the solvency capital requirement.
- 5.159. The actuarial function also has a role in the implementation of the internal model and may also be a user of it. The outputs of the internal

model are used by the actuarial function to support the analyses carried out by the function.

- 5.160. In the process of the internal model's implementation, the mutual communication between the actuarial function and the risk management function is needed that both functions insights in the internal model gained by the two functions are shared between them. This feedback could lead to the detection of shortcomings and to proposals on how to improve the model.
- 5.161. Parts of the validation tasks may include collecting and analysing information, for example providing an analysis of the actual experience against expected experience. It may be that there are systems in place within the sphere of responsibility of the actuarial function which have already been set up to collect this information.
- 5.162. In this case it may be sensible for the actuarial function to be involved in performing some of the tasks in the validation process so the undertaking can streamline processes and facilitate an efficient allocation of tasks.

**Guideline 43 – Actuarial reporting to the administrative, management or supervisory body**

**In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires the actuarial function to report in writing at least annually to the administrative, management or supervisory body. The reporting should document all material tasks that have been undertaken by the actuarial functions, their results, clearly identifying any deficiencies and giving recommendations as to how such deficiencies could be remedied.**

- 5.163. There may be deficiencies in the specific tasks carried out by the actuarial function, as set out in Article 48 of Solvency II. Such deficiencies identified may relate to data, technical procedures, methodologies or to knowledge or expertise.
- 5.164. Reporting to the AMSB does not require that all material tasks and their results are addressed in one written report. The actuarial function can cover the topics it needs to address in different written reports and submit them to the AMSB at different times as long as each relevant topic is dealt with at least annually.
- 5.165. If there is any material uncertainty about the accuracy of the data, the actuarial function report needs to:
- a) describe the uncertainty; and
  - b) explain any approach taken in light of the uncertainty in the calculation of technical provisions.

5.166. In some specific areas, which usually require a higher complexity of the modelling, shortcomings of knowledge or expertise of the personnel may be experienced. This may also be a consequence of the development of new complex products, some for instance with embedded options and guarantees, where difficulties may arise with regard to understanding and predicting the behaviour of assets and liabilities affected by a wide set of risk drivers as well as their interdependencies.

## **Chapter VII: Outsourcing**

5.167. A service provider is a third party and may be a supervised entity, an entity from the same group as the undertaking or not and it may be located inside the EU as well as outside.

5.168. In principle, any functions and activities of an undertaking can be outsourced, but the AMSB retains ultimate responsibility for discharging its obligations.

5.169. While an outsourcing arrangement may be performed directly by the service provider, the service provider may sub-outsource to another provider if this is permitted by the contract agreed with the undertaking. While an undertaking will not be a party to the sub-outsourcing agreement, it ensures that it is informed by the service provider of any sub-outsourcing, because the undertaking remains fully responsible for the activity or function outsourced and must ensure the service provided is satisfactorily performed.

5.170. An undertaking needs to decide whether an arrangement falls within the definition of outsourcing. Generally, for example, where an undertaking provides insurance services to its policyholders and certain elements of the delivery of those services are contracted to a third party, the arrangement is likely to be an outsourcing unless the policyholder has a direct contractual relationship with the third party for the delivery of those services. Any reliance on a third party for functions enabling the undertaking to provide those insurance services is also likely to be outsourcing.

5.171. However, not every provision of a function or service to an undertaking by a service provider will fall within the definition of outsourcing. Hiring a specialist consultant, for example, to provide one-off technical advice or one-off support for an undertaking's compliance, internal audit, accounting, risk management or actuarial functions does not normally constitute outsourcing. However, it may become outsourcing if an undertaking subsequently relies on that consultant to manage an internal function or service, e.g. when it is installed or becomes fully operational.

5.172. While it is not possible to determine a bright line it can be expected that, in broad terms, the more substantial or frequent the advice or service provided by a third party for an undertaking is, the more likely it is to fall within the definition of outsourcing.

**Guideline 44 – Critical or important operational functions and activities**

**In accordance with Article 49 of Solvency II Directive, national competent authorities should ensure that the undertaking determines and documents whether the outsourced function or activity is a critical or important function or activity on the basis of whether this function or activity is essential to the operation of the undertaking as it would be unable to deliver its services to policyholders without the function or activity.**

5.173. In determining whether an outsourced function or activity is critical or important the undertaking has to take into account any definition or list of such functions or activities provided under national law or national administrative interpretation. Where functions or activities are partially outsourced it is relevant whether these outsourced parts are per se critical or important.

5.174. Examples of critical or important functions or activities include:

- a) the design and pricing of insurance products;
- b) the investment of assets or portfolio management;
- c) claims handling;
- d) the provision of regular or constant compliance, internal audit, accounting, risk management or actuarial support;
- e) the provision of data storage;
- f) the provision of on-going, day-to-day systems maintenance or support; and
- g) the ORSA process.

5.175. The following activities cannot be considered critical or important operational functions or activities:

- a) the provision of advisory services to the undertaking, and other services which do not form part of the undertaking's insurance or reinsurance activities, such as legal advice, the training of personnel and the security of premises and personnel;
- b) the purchase of standardised services, including market information services and the provision of price feeds;
- c) the provision of logistical support, such as cleaning or catering; and
- d) the provision of elements of human resources support, such as recruiting temporary employees and processing the payroll.

#### **Guideline 45 – Underwriting**

**In accordance with Article 49 of Solvency II Directive, national competent authorities should ensure that, when an insurance intermediary, who is not an employee of the undertaking, is given authority to underwrite business or settle claims in the name and on account of an insurance undertaking, the undertaking ensures that the activity of this intermediary is subject to the outsourcing requirements.**

- 5.176. Underwriting is a main activity of any insurance undertaking. As such, underwriting is a critical or important operational function or activity. It is common in most Member States to have insurance intermediaries involved in the underwriting process. These are subject to [Insurance Intermediaries Directive<sup>6</sup> (IMD)]. However, where an insurance intermediary is mandated to write insurance business or to settle claims on behalf of the insurance undertaking, this is an outsourced service and, as such, the arrangement is caught by the Solvency II outsourcing requirements.
- 5.177. The typical intermediation activities of an insurance intermediary, i.e. introducing, proposing or carrying out other preparatory work for the conclusion of insurance contracts, or concluding such contracts, or assisting in the administration and performance of such contracts, in particular in the event of a claim, as set out in the IMD, these activities are not subject to the outsourcing requirements.
- 5.178. In the case of outsourcing of underwriting activities, the application of the outsourcing requirements needs to be analysed taking into consideration the specific requirements applicable under the IMD.

#### **Guideline 46 – Intra-group outsourcing**

**In accordance with Article 49 of Solvency II Directive, national competent authorities should ensure that, if key functions are outsourced within the group, the responsible entity documents which functions relate to which legal entity and ensures that the performance of the key functions at the level of the undertaking is not impaired by such arrangements.**

- 5.179. In case of intra-group outsourcing, the degree of flexibility may vary according to whether the service provider is, for example, in the same country as the undertaking or in a different geographical region.
- 5.180. Nevertheless, the undertaking needs to assess whether and to what extent it should rely on functions and activities provided by a service provider in its group.

---

<sup>6</sup> *Official Journal L 009 , 15/01/2003 P. 0003*

- 5.181. A written agreement must always exist, stipulating the duties and responsibilities of both parties. However, this could assume the form of a service level agreement since the arrangement is probably not subject to formal negotiations (unlike an outsourcing to an external service provider).
- 5.182. While the supervisory review process may take into account a group as a whole and the extent to which an entity within the group provides a service or function for other undertakings in the same group, the obligations remain with the individual undertaking as it is the authorised entity. While an undertaking may assign to another group member the carrying out of services or functions, it cannot absolve itself of responsibility for them and still has to manage the outsourcing arrangement robustly with, for example, suitable business contingency plans.

**Guideline 47 – Outsourcing written policy**

**In accordance with Article 49 and Article 41 of Solvency II Directive, national competent authorities should ensure that the undertaking that outsources or considers outsourcing covers in its policy the undertaking’s approach and processes for outsourcing from the inception to the end of the contract. This in particular includes:**

- a. the criteria for determining whether a function or activity is critical or important;**
- b. how a service provider of suitable quality is selected and how and how often his performance and results are assessed;**
- c. the details to be included in the written agreement with the service provider; and**
- d. business contingency plans, including exit strategies for outsourced critical or important functions or activities.**

- 5.183. On (a), the policy sets out the due diligence process to be carried out prior to deciding on an outsourcing arrangement. The matters to be covered include the financial and technical ability of the service provider and its capacity to perform the outsourcing; its control framework; and any conflict of interests, e.g. between service provider and undertaking or arrangements with competitors.
- 5.184. On (b), the policy also needs to address the conditions under which sub-outsourcing by a service provider is possible. In any case, if the sub-outsourced function is critical or important for the undertaking the sub-outsourced service needs to be approved by the undertaking.

- 5.185. The examination of an applicant service provider allows the undertaking to understand the main risks that might arise from the outsourcing, to identify the most suitable strategies for the mitigation or management of these risks and to ensure that the service provider has the ability, capacity and any authorisation required by law to perform the outsourced activities reliably and professionally. The conclusions are to be documented and reviewed by the undertaking at any time it considers relevant.
- 5.186. On (c), irrespective of the service provider's governance obligation to establish suitable contingency plans for the function outsourced by the undertaking, the undertaking needs to consider in its own contingency planning how, if needed, the outsourced can be taken over by a new service provider, or bring it back in-house, as appropriate.
- 5.187. The undertaking's AMSB approves all outsourced services of critical or important functions or relevant activities and regularly receives review reports on the performance of these outsourcing arrangements when they are operational.
- 5.188. An undertaking remains fully responsible for all outsourced functions and activities so needs to include in its system of governance a process for monitoring and reviewing the quality of the service provided. It is not sufficient for the service provider itself to have internal controls and a risk management system that covers the services performed. In order to ensure effective control of outsourced activities and manage the risks associated with the outsourcing, the undertaking needs to maintain the competence and ability within the undertaking to assess whether the service provider delivers according to contract.
- 5.189. As part of good management practice, an undertaking is expected to effectively monitor whether its service provider is in compliance with all the terms of their written agreement. If the service provider does not effectively carry out the functions or activities in compliance with the terms of the outsourcing agreement, appropriate actions must be taken. If, for example, a service provider is unwilling to cooperate with the undertaking's supervisory authorities, the undertaking will have to terminate the outsourcing agreement. In this context, where a service provider is located outside the EU, the undertaking needs to pay particular attention to whether the service provider's regulator or local laws and regulations might restrict access to information about the outsourced activity or function or to the service provider's premises.

### **Section III: Group governance specific requirements**

#### **Guideline 48 – Responsible entity**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the parent insurance or reinsurance undertaking or insurance holding company identifies the responsible entity and reports it to the group supervisor.**

- 5.190. The entity responsible for the fulfilment requirement at group level is usually the parent undertaking, but depending on the structure and organization of the group this entity may be other than the parent undertaking.

**Guideline 49 – Responsibilities for setting internal governance requirements**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity sets adequate internal governance requirements across the group appropriate to the structure, business and risks of the group and of its related entities, and considers the appropriate structure and organization for risk management at group level, setting a clear allocation of responsibilities between all entities of the group.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity does not impair the responsibilities of the administrative, management or supervisory body of each entity in the group when setting up its own system of governance.**

- 5.191. The entity responsible for fulfilling the governance requirements at group level is expected to verify that there is a clear allocation of responsibilities among all entities of the group to support an effective risk management process at group level.
- 5.192. Even if some or all of the governance requirements do not apply at the individual level for some entities belonging to an insurance group, namely holdings and other non-regulated entities, all governance requirements are applied to the coherent economic entity that in a holistic way aggregates all entities in the group (group level).

**Guideline 50 – System of Governance at group level**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity:**

- a. has in place appropriate and effective tools, procedures and lines of responsibility and accountability enabling it to oversee and steer the functioning of the risk management and internal control systems at individual level;**
- b. has in place reporting lines within the group and effective systems for ensuring information flows in the group bottom up and top-down as well;**
- c. documents and informs all the entities in the group about the tools used to identify, measure, monitor,**

**manage and report all risks to which the group is exposed; and**

- d. takes into account the interests of all the entities belonging to the group and how these interests contribute to the common purpose of the group as a whole over the long term.**

5.193. The AMSB of the entity responsible for fulfilling the governance requirements at group level assumes responsibility in terms of the establishment of group policies, review of the overall business activities, group strategies and policies. It understands not only the corporate organisation of the group but also the purpose of the group's different entities and the links and relationships among them. This includes understanding group-specific risks, intra-group transactions and how the group's funding, capital and risk profiles could be affected under normal and adverse circumstances.

5.194. The AMSB of the entity responsible for fulfilling the governance requirements at group level ensures that the different group entities, including the responsible entity, receive enough information for all of them to get a clear perception of the general aims and risks of the group. Any flow of significant information between entities relevant to the groups operational functioning should be documented and made accessible promptly, when requested, to the AMSB at group level, to the control functions and supervisors, as appropriate.

5.195. The AMSB of the entity responsible for fulfilling the governance requirements at group level ensures it keeps itself informed about the risks the groups' structure causes. This includes:

- a) information on major risk drivers; and
- b) regular reports assessing the group's overall structure and evaluating individual entity's activities compliance with the approved strategy.

5.196. In discharging its corporate governance responsibilities, the administrative, management or supervisory body of the entity responsible for fulfilling the governance requirements at group level:

- a) establishes a governance structure that contributes to the effective oversight of the entities in the group, taking into account the nature, the scale and complexity of the different risks to which the group and its components are exposed;
- b) ensures the overall consistency of the group's governance structure taking into account the structures, activities and of the different entities of the group;
- c) sets and reviews the general strategies and policies of the group;

- d) has appropriate means to control that each entities in the group complies with all applicable corporate governance requirements;
- e) ensures that reporting system in the group are clear, transparent and appropriate in order to guarantee adequate and timely communications within the group.

**Guideline 51 – Risks with significant impact at group level**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity considers in its risk management system the risks both at individual and group level and their interdependencies, in particular:**

- a. reputational risk and risks arising from intra-group transactions and risk concentrations, including contagion risk, at the group level;**
- b. interdependencies between risks stemming from conducting business through different entities and in different jurisdictions;**
- c. risks arising from third-country entities;**
- d. risks arising from non-regulated entities; and**
- e. risks arising from other regulated entities.**

5.197. The group is expected to have in place a process to identify the group's material risks, a comprehensive measurement system, a system of limits to manage exposures and other risk concentrations, and processes of stress testing and scenario and correlation analysis. Proper information systems and management reporting systems are essential for a sound risk management approach.

**Guideline 52 – Group risk management**

**In accordance with Article 246 of Solvency I Directive I, national competent authorities should ensure that the responsible entity supports in its risk management at the level of the group by appropriate processes and procedures to identify, measure, manage, monitor and report the risks that the group and each individual entity are or might be exposed to.**

**In accordance with Article 246 of Solvency II Directive, national competent authorities should ensure that the responsible entity ensures that the structure and organization of the group risk management do not impair the undertaking's legal ability to fulfil its legal, regulatory and contractual obligations.**

- 5.198. This guideline needs to be read in conjunction with guideline 14 Role of the administrative, management or supervisory body in the risk management system.
- 5.199. The entity responsible for fulfilling the governance requirements at group level is expected to assess how and to what extent all risks within the group are effectively identified, measured, managed and monitored. This assessment will be supported by appropriate documentation on the structure, organization and centralization of the group risk management system.

## 6. Appendixes:

### Appendix 1: Revised Impact Assessment

#### **Preliminary analysis of the opportunity of issuing preparatory Guidelines**

- 6.1. Before analysing pros and cons of the proposed groups of Guidelines with respect to the baseline, it is necessary, on a logical basis, to justify the choice of issuing preparatory Guidelines now or not doing anything and wait till the application of Solvency II. Directive
- 6.2. For this null option it is possible to identify the following costs and benefits:

#### **Option 0, not issuing preparatory Guidelines:**

- 6.3. With regard to costs on the side of undertakings:
  - a) Potential compliance costs may arise in case undertakings start doing investments, purchasing systems and implementing processes, which may need to be changed later due to changes in the on-going political negotiations;
  - b) In the absence of Guidelines, practices may evolve differently with respect to other financial market sectors, provoking adjustment costs later (EBA issued guidelines in 2012 and IAIS have issued "Core Principles on Governance");
  - c) Another source of costs could be the final rushing to set up systems right before the implementation date of Solvency II Directive. During the rushing errors are also easier to happen.
- 6.4. With regard to costs on the side of national competent authorities:
  - a) Some member states have started implementing parts of good governance; this bears the risks of future costs in order to be consistent with European requirements in the future;
  - b) In the absence of Guidelines, supervisory practices may evolve differently with respect to other financial market sectors, provoking adjustment costs later (EBA issued guidelines in 2012 and IAIS have issued "Core Principles on Governance");
  - c) Another source of costs could be the necessity to supervise undertaking during the final rushing right before the implementation date of Solvency II Directive. During the rushing errors are also easier to happen.
  - d) The national competent authorities need to have enough resources and knowledge available for supervising (re-)insurance undertakings with regard to their system of governance. The preparatory period is a good opportunity for NCA, to build up this competence.
- 6.5. With regard to benefits on the side of undertakings:
  - a) The advantage for the industry could be that, in structuring its system of governance, undertakings have not to take into account any new aspects or further elements encompassed by these Guidelines.

- b) In fact some member states might not have required fulfilling any measures with regard to governance.
  - c) However, one can argue if that (not having guiding principles) is really an advantage.
- 6.6. With regard to benefits on the side of national competent authorities:
- a) The advantage for NCAs could be that they do not have to take into account new aspects or further elements in the process of supervision the compliance by undertakings.
  - b) However, one can argue if that (not having guiding principles) is really an advantage.
- 6.7. For consumers:
- a) No immediate advantage as any costs that may be reflected on policyholders would also happen with full preparation of Solvency II.
  - b) The financial crisis in 2008 has shown that some risks with negative consequences for policyholders had their source in bad and insufficient governance structures within (re-)insurance undertakings. Therefore, an enhanced system in the undertaking protects policyholders, which is a good reason for issuing preparatory Guidelines.
- 6.8. The balancing between cons and pros led to the final evaluation that is beneficial for all providing now preparatory Guidelines, to help undertakings and national competent authorities in taking decisions and organising during the preparation phase.

### **1: Procedural issues and consultation of interested parties**

- 6.9. The Impact assessment was prepared in the course of the policy drafting process, with the contribution of experts on system of governance from different national competent authorities and EIOPA.
- 6.10. Selected stakeholders were pre-consulted in the preparation of the Guidelines.

### **2: Problem definition**

- 6.11. Existing Supervisory requirements with regard to the system of governance vary widely across Member States. These differing requirements do not provide a level playing field for undertakings that are parts of cross-border groups or have cross-border branches. Therefore, new requirements should harmonise and streamline supervisory requirements with regard to the system of governance in order to enhance transparency across borders.
- 6.12. Based on the economic crises it became evident that there was a need to strengthen and improve the requirements for the system of governance to ensure a more consistent and harmonised approach and to raise governance standards. Focus will be on how undertakings should manage their processes and procedures, including systems and controls to ensure continuous compliance with legislation and capital requirements.
- 6.13. The "Opinion of EIOPA on interim guidelines regarding Solvency II", issued on the 20th December 2012, stresses the importance of having a

consistent and convergent approach with respect to the preparation of Solvency II. In the run-up of the new system, some key areas of Solvency II need to be addressed in order to ensure proper management of undertakings and to ensure that supervisors have sufficient information at hand. The system of governance is among these key areas. This area of Guidelines aims at guiding undertakings in their preparation for the future phasing in of Solvency II.

### **Proportionality**

- 6.14. National competent authorities are expected to ensure that the provisions described in the Opinion are applied 'in a manner which is proportionate to the nature, scale and complexity inherent in the business of the insurance and reinsurance undertaking'. The approach taken aims to ensure that this expectation can be met, and this is reflected in the drafting of the Guidelines in two principal ways:
- 6.15. In most cases, the Guidelines are principle based or drafted with a view to the outcome or supervisory objective that should be met;
- 6.16. The level of detail and scope of the Guidelines reflects the fact that the Guidelines are issued in order to prepare for Solvency II and not for its full application.
- 6.17. For the overall approach to proportionality on the guidelines under consultation, please see the "Cover note for the Consultation Paper on Guidelines on preparing for Solvency II".

### **Baseline Scenario**

- 6.18. When analysing the impact from policies, the methodology foresees that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered. The aim of the baseline scenario is to explain how the current situation would evolve without additional public intervention. For the analysis of the potential related costs and benefits of the proposed guidelines, EIOPA has applied as a baseline the current practice, that means Solvency I requirements plus any national legislation on top of it (including any possible preparation that has already been made for implementing Solvency II Directive, as well as some provisions set out in the CEIOPS' Level 3 Guidance).

### **3: Objective pursued**

- 6.19. The aim of the preparatory Guidelines on the system of governance is to provide guidance to undertakings to prepare for the phasing of requirements about the system of governance stated in the future Solvency II regime.
- 6.20. In the "Opinion of EIOPA on interim guidelines regarding Solvency II", system of governance is cited among the key areas in the preparation for future Solvency II. Moreover, the Opinion asks national competent authorities to start preparing appropriate procedures and tools to ensure that undertakings have in place an effective system of governance which provides for sound and prudent management.
- 6.21. When assessing the merits of the various policy options and approaches the aim is to deliver a system that addresses the weaknesses of the

current regime, in particular with respect to removing obstacles to the proper functioning of the single market, whilst achieving an appropriate balance between the objectives of enhancing the protection of policyholders and beneficiaries and improving the international competitiveness of EU insurers and reinsurers.

### **3: Policy options**

- 6.22. In the light of the specific characteristics of these Guidelines, it was agreed to describe policy options not Guideline by Guideline neither group by group of Guidelines, but to proceed by themes. In fact, the Guidelines are all strictly linked and interrelated, and analysing them one by one would have ended up in a too fragmented and partial description. After discussion, it has been judged more appropriate to present directly policy options EIOPA considered, and then offer motivations about the preferred final choice. This way of constructing the reasoning appeared more adherent to the goals at the basis of system of governance.
- 6.23. EIOPA has identified five options that were considered in the development of the preparatory Guidelines. The identified options are based on what EIOPA believes could have the most significant impact on undertakings and the level of protection of policyholders as well as beneficiaries. The focal point of the options identified is how an underlying problem could evolve, all things being equal, if such options were not decided upon.
- 6.24. It is also worth highlighting that against the baseline the proposed preparatory Guidelines should not create material new requirements for undertakings in general. Instead, they give guidance as well as steering on what would be expected from the undertakings by national supervisors. Hence, for undertakings to comply with the preparatory Guidelines no additional costs are envisaged in comparison to those costs for implementing final Solvency II requirements in the future.

#### **Whether to specify the difference between, and terminology of, risk tolerance and risk appetite**

- 6.25. EIOPA discussed whether to neither define nor clarify the terminology of risk tolerance and risk appetite at all since the terms are widely used and are understood differently within the financial sector or perhaps just to define characteristics of the terms used but not give definitions to ensure some basis for a common understanding. Finally it was discussed whether to prescribe a Solvency II definition of the terms to ensure a harmonised understanding between members and to ensure a common approach when reading the preparatory Guidelines.

#### **Whether to develop Guidelines on Prudent Person Principle as part of the System of Governance for the interim period**

- 6.26. Based on Article 132 of Solvency II Directive, EIOPA discussed whether to develop Guidelines on the Prudent Person Principle (PPP) as part of the System of Governance on account of the reference to PPP in Article 44 of Solvency II Directive, or to leave it out for the preparatory period.

#### **Whether to include minimum requirements on the use of derivatives in the preparatory Guidelines**

- 6.27. Article 44 of Solvency II Directive requires that the risk management system of an undertaking cover among other things investments, in particular derivatives and similar commitments. The prudent person principle in Article 132 of Solvency II Directive requires that undertakings only invest in assets whose risks can be properly identified, measured, monitored, managed and reported. Paragraph 4 of that Article also sets out some specific requirements on the use of derivatives. EIOPA discussed whether the requirements within Solvency II Directive addressing the use of investments, including the above articles, should be complemented by further guidelines that specifically addressed requirements relevant to the use of derivatives by undertakings.

**Whether to require combined annual information from the Actuarial Function to the AMSB or leave it up to the undertaking to decide how and when the information is to be provided**

- 6.28. According to Article 48(1) of Solvency II Directive the Actuarial Function has to inform the AMSB about several subjects regarding the coordination or calculation of technical provisions. However, this does not include requirements on how this should be conducted. Hence, it was discussed whether the Actuarial Function has to provide to the AMSB combined information on an annual basis on all relevant issues or if the information should be provided whenever deemed necessary.

**Whether or not to have extended notification requirements during the preparatory period**

- 6.29. According to Article 42(2) of Solvency II Directive the notification requirements for persons subject to fit & proper requirements will apply to persons effectively running the undertaking and persons responsible for a key function. Existing notification requirements on national level usually apply to persons belonging to the AMSB or parts of it. Hence, the question was raised whether to require that additional persons, e.g. person responsible for key functions, should be notified to the supervisory authority during the preparatory period.

**4: Analysis of impacts**

- 6.30. As a consequence of the choice of describing options not Guideline by Guideline, nor group by group of Guidelines, but by theme, it was agreed to give to this chapter a structure symmetric to the structure of the previous chapter. For each option, arguments are constructed to prepare the selection of the preferred one. In the next chapter, these pros and cons are compared in order to arrive to the final choice. For each preferred option, the next chapter will summarise pros and cons for all actors involved, with the breakdown for undertakings, supervisors and policy holders.
- 6.31. In the Solvency II project, policy-makers have already considered, analysed and compared a number of policy options. Based on the impact assessment already done for the requirements set in Solvency II Directive EIOPA has considered a wide range of policy options referring to the preparatory Guidelines. In this section EIOPA would like to show alternative options which were considered and preferred options that have been analysed seriously, and to explain why they were not pursued.

- 6.32. During the analysis, the principle of proportionality was always taken into account, as the Community actions should not go beyond what is necessary to achieve satisfactorily the objectives which have been set. Due to their size and scarce resources, small and medium sized undertakings (SMEs) can be affected by the costs of regulations more than their bigger competitors. At the same time, the benefits of regulations tend to be more evenly distributed over entities of different sizes. SMEs may have limited scope for benefiting from economies of scale. SMEs in general find it more difficult to access capital and as a result the cost of capital for them is often higher than for larger businesses. Therefore, the principle of proportionality was always taken into account while considering different options.

### **Whether to specify the difference between and terminology of risk tolerance and risk appetite**

- 6.33. When drafting the risk management section of the preparatory Guidelines on the system of governance, it was extensively discussed whether to specify the difference between risk tolerance and risk appetite.
- 6.34. The use of the terms is very diverse, and EIOPA discussed whether a Solvency II definition would ensure a common understanding of the meaning of the terms for the purpose of compliance with requirements and ensure a harmonised approach between supervisors. However, the Solvency II terminology could diverge from the undertaking's view of how the terms are to be understood. Furthermore use of the terms with different meanings within the undertaking for internal and regulatory purposes could lead to mistakes and unnecessary risk exposure.
- 6.35. Another option discussed was for EIOPA to respect the use of the terms as currently employed by undertakings while ensuring that for the purpose of compliance with regulatory requirements there is no ambiguity as to what is meant by the terms. This would still require the necessity for discussions between undertakings and supervisors to verify that the terms are used as understood under Solvency II and not as internally used and defined by the undertaking itself.
- 6.36. The last option discussed was for EIOPA not to try and define the terms nor clarify the terminologies at all which would give the undertakings the possibility of not changing their current definitions of risk tolerance and risk appetite. This option though, would give the undertakings considerable uncertainties with regard to compliance with requirements as set out in Solvency II Directive or the preparatory Guidelines. Additionally, it would also entail lack of harmonisation between national competent authorities in understanding the terms and could make the communication between undertakings and supervisors more difficult as there is not necessarily a common understanding as to the meaning and usage of the terms.

### **Whether to develop Guidelines on Prudent Person Principle as part of the System of Governance for the preparatory period**

- 6.37. The Prudent Person Principle (PPP) is defined in Article 132 of Solvency II Directive but it is closely linked and explicitly mentioned in Article 44, it was discussed whether preparatory Guidelines were needed to specify the requirements and supervisory expectations of this Article and whether

the development of preparatory Guidelines should be a part of the system of governance.

- 6.38. The reasoning for choosing the option to include PPP in the interim period, although Article 132 of Solvency II Directive is relative to Pillar I requirements, is that its application has to be firmly embedded within the undertaking's system of governance. EIOPA believes that undertakings could use the preparatory period to put in place a risk framework in which to test the application of PPP in respect of the undertakings investment policy taking into account the fact that the regulatory quantitative limits will no longer apply under Solvency II. Moreover, the definition and regulation of PPP in Solvency II is fairly short and high-level and being aware of, that these requirements encompass substantial responsibilities for undertakings, the lack of guidance would be particularly challenging for undertakings and supervisors alike.
- 6.39. If EIOPA did not develop preparatory Guidelines this would give undertakings more flexibility in how to interpret Article 132 of Solvency II Directive. Furthermore, the principle as such - as opposed to its application to insurance undertakings - is not new. Undertakings could fall back on general explanations and understandings of the principle and hence, might not need guidance beyond what is already written. This would also limit the compliance costs, but could give more uncertainty on how to apply the PPP.

#### **Whether to include minimum requirements on derivatives as part of the preparatory Guidelines**

- 6.40. Derivatives pose a substantial risk to the solvency of undertakings when they are mismanaged and embody particular risks which to a large extent are unique in relation to other asset categories, such as the exposure that goes beyond the principal (amount) invested.
- 6.41. If EIOPA were not to specifically address requirements relevant to the governance of derivatives within these Guidelines, it would provide undertakings with greater discretion to determine what governance practices were necessary for the use of such instruments in relation to their risk profile. Conversely, by EIOPA developing preparatory Guidelines undertakings would get more information on the minimum requirements national competent authorities would expect them to comply with in the use of such instruments. Hence, the Guidelines would also encompass descriptions of some specific, but important aspects to ensure compliance with governance requirements when investing in derivatives.
- 6.42. Article 44 of Solvency II Directive requires the risk-management system to at least cover the governance/control of investments and in particular derivatives and other commitments since these are not fully included in the calculation of the solvency capital requirement. Furthermore, Article 132 of Solvency II Directive already states that an undertaking need to identify, measure, monitor, manage, control and report all risks adherent to assets. Thus, knowing that undertakings would be assessed according to certain expectations whether they are set out in Guidelines or not, while still keeping in mind those minimum requirements specifically for certain investments, could put obstacles in the way of using derivatives. Consequently, this could create additional costs for undertakings with

regard to organisation of processes and procedures (internal controls and documentation).

### **Whether to require combined annual information from the actuarial function to the AMSB or leave it up to the undertaking to decide how and when the information is to be provided**

- 6.43. When discussing the actuarial function and the level of information to be provided to the AMSB that should be expected it was further discussed whether to require combined annual information from the actuarial function or leave it up to the undertaking to decide how and when the information is to be provided on annual basis.
- 6.44. If the actuarial function has to prepare combined annual information covering all the issues to be reported to the AMSB this would ensure a higher level of harmonization among Member States concerning the frequency and the content of the information likely to be achieved. Furthermore, having a single document covering all the relevant issues concerning the tasks the actuarial function is responsible for, implies that all the relevant information is concentrated, but comprehensive.
- 6.45. Hence, there is less risk of missing information in this reporting process. It is also easier for the AMSB to identify the main problems and have the full picture of the different tasks performed and conclusions obtained as well as allowing for an easier way to see how technical provisions affect the assessment of the overall underwriting policy and the adequacy of the reinsurance arrangements. A consequence of the AMSB only receiving combined annual information is that it does not necessarily get the most critical information when the information is needed in order to take this into account in its decision-making process.
- 6.46. Alternatively, consideration was given to the fact that the actuarial function could report during the year and encompass all relevant issues when they arise. This would enhance the possibility of having a more continuous reporting process along the year, making it easier to identify the problems at an earlier stage and give the undertaking a higher level of flexibility in the reporting process.
- 6.47. Additionally, this could more effectively involve the AMSB during the process of calculation and validation of technical provisions. Therefore, it gives the AMSB the option of challenging the analysis carried out. Hence, the reporting can be done nearer to the performance of the task and may be of better quality on this account (more details and better pros and cons when an assessment is fresh in mind).
- 6.48. A drawback to the annual separate reporting is the risk that providing parts of the information at different points in time could make it more difficult to see the entire picture for the AMSB and other potential recipients and lead to bad decision-making based on a deficient/inadequate basis.

### **Whether or not to have extended notification requirements during the preparatory period**

- 6.49. As these Guidelines are based on the assumption that the qualitative requirements set out in Solvency II Directive are already applicable, EIOPA could have proceeded with giving guidance on notification of

persons effectively running the undertaking and responsible for key functions. While this would introduce better scrutiny it would however add considerable administrative burdens on both undertakings and supervisory authorities.

- 6.50. Having a postponement of the notification requirement could give an undertaking more leeway in testing whether a person really has the right qualifications for being a person appointed responsible for a key function. Furthermore, the undertaking would be able to more clearly define the tasks and responsibilities for the person responsible for the key function considering the undertaking's specific business model and clearly define in its processes and procedures what is expected of the key function and the person responsible for the key function.
- 6.51. On the other hand not having the notification requirement in place during the preparatory period, could make both supervisory authorities and undertakings less familiar with the notification process. Additionally, there could be a risk that the undertaking within the preparatory period has appointed a person that does not fulfil the fit and proper requirements from the time when Solvency II Directive is fully implemented.
- 6.52. The requirement set out in Article 42(3) of Solvency II Directive will only apply during the preparatory period for persons already subject to notification requirements on national level.

## **5: Comparing the options**

- 6.53. EIOPA believes that the proposed policy options help achieve the objectives pursued in enhancing the protection of policyholders and beneficiaries and improving the international competitiveness of EU insurers and reinsurers, in an efficient and effective way. A specific characteristic of the policy options proposed, and which contributes to an effective and efficient result, is that they allow for supervisory practices to be applied in a proportionate manner with respect to a risk based approach.
- 6.54. EIOPA appreciates that issuing these Guidelines may have an economic impact on undertakings. However, the benefits of having a common understanding of the requirements for the system of governance from the application of Solvency II Directive between undertakings and supervisors are a vital step to ensure a level playing field and the much needed transparency. By keeping the incremental costs of issuing preparatory Guidelines in mind the options were extensively discussed and pros and cons were compared in order to find the best solution.
- 6.55. For the option of determining whether EIOPA should make a Solvency II definition of differences between the terms "risk tolerance" and "risk appetite" in order to align the use of these terms on the European level EIOPA discussions were based on the necessity of streamlining the terms. The pro would be a common approach to the use of the terms which would make comparisons. The con, however, is that the terms are not new within the financial sector and many undertakings already apply them on a daily basis.

- 6.56. Accordingly, EIOPA decided that instead of giving a Solvency II definition and specify the differences of the terms risk tolerance and risk appetite it would facilitate discussions and understandings between supervisors and undertakings in the long run if characteristics were provided alongside building blocks for the undertakings to decide for themselves how to apply the terms. This ensures that supervisors and undertakings are equally responsible for reaching a common understanding of the use of the terms and limit misunderstandings.
- 6.57. When discussing the necessity of developing preparatory Guidelines on PPP as part of the system of governance EIOPA decided that since the application of the principle for insurance undertakings is a requirement in Solvency II Directive without any quantifiable thresholds for investments there is a strong link to the risk management system. Accordingly, the development of a separate set of Guidelines was discarded on account of the reference in Article 44 of Solvency II Directive and the significant link between risk management and investment policies.
- 6.58. Further, EIOPA received remarks from stakeholders during consultations and informal suggestions that some stakeholders were unsure what the principle entails. E.g. PPP does not mean "anything goes". In order to ensure and promote a common understanding among supervisors and undertakings as to what the principle and its requirements are, EIOPA developed these Guidelines. The Guidelines cover investment risk management, assessment of non-routine investment activities, investments in unit-linked and index-linked contracts and finally on the use of securitised assets and assets not admitted for trading on a regulated market to ensure a minimum level of harmonisation and understanding of the principle as well as the close link to risk management. The expectation is that undertakings should use the preparatory period to familiarise themselves with the application of the PPP and how it can be embedded in the investment policy.
- 6.59. In a similar context the option of developing Guidelines on the use of derivatives was discussed. Knowing that undertakings would be assessed according to certain expectations regarding the use of derivatives whether they are set out in Guidelines or not, and taking into account that new requirements could put obstacles in the way of using derivatives and create additional costs for undertakings with regard to organisation of processes and procedures (internal controls and documentation), EIOPA found that providing Guidelines would meet the objectives of Solvency II Directive more effectively and efficiently and provide for a better understanding of allocation of capital resources.
- 6.60. Furthermore, by ensuring a more common understanding of the use of derivatives and the risks they impose, undertakings could enhance policyholder protection while improving the international competitiveness of the insurance sector due to a common basis for investment strategies and better capital management.
- 6.61. Accordingly, EIOPA decided that Guidelines should be developed to ensure focus on the increased use of derivatives by undertakings but be kept to a minimum to ensure the flexibility as provided by the PPP. Guidance on how to handle investments in derivatives focuses on the

importance of this issue being addressed in the policy on risk management and that undertaking can demonstrate and document how derivatives are used to contribute to a reduction of risks or as risk mitigation technique.

- 6.62. The same flexibility applied to the option on whether to require combined annual information or just separate reporting on relevant issues from the actuarial function to the AMSB. According to the system of governance requirements, the AMSB must ensure that information regarding the undertaking's risks are generated and communicated to the individuals who need to see it. If reports are to be done at different times and communicated to different people the AMSB must consider the resulting impact upon the relevance, coherence and timeliness of information reporting within the organization to ensure clear processes and procedures in order to limit misunderstandings.
- 6.63. Nevertheless, since reporting processes and procedures are undertaking specific, EIOPA decided to leave the responsibility to undertakings for determining what reporting process and procedures fits the undertaking's specific business structure. Hence, EIOPA decided to leave it to the undertakings to decide how they wish to receive the information required in order to fit their reporting needs. Accordingly, the Guidelines only require that the AMSB receives at least an annual internal report documenting the tasks undergone by the actuarial function, the results and the identification of any deficiencies identified and how these can be remedied. Concerning option 6, regarding the notification requirement during the preparatory period, EIOPA decided that requiring a notification according to Article 42 (2) of Solvency II Directive for persons responsible for a key function would be too onerous to apply. However, undertakings are still responsible for conducting their own internal fit & proper assessment of people appointed during the preparatory period and ensuring that the appointed persons meet the requirements as set out in Article 42 of Solvency II Directive when applicable.

## **5: Concluding remarks**

- 6.64. The cost and benefits of introducing preparatory Guidelines can be summarised in the following breakdown:

### **Undertakings**

- 6.65. Additional costs for undertakings can be valued on a minor scale compared to those introduced by Solvency II Directive:
- a) Specifying certain terms used in Solvency II Directive, like risk tolerance and risk appetite, does not affect costs when applying the preparatory Guidelines;
  - b) The prudent person principle is already introduced in Solvency II Directive and by including it in the preparatory Guidelines the specification on how to apply the principle facilitates the use of the principle for undertakings as it clarifies supervisory expectations;
  - c) The minimum requirements that govern the use of derivatives also help undertakings to better understand what is required of them when engaging in the use of derivatives as part of their investment strategy. Furthermore, this will prepare the undertakings for the

increased scrutiny by the supervisory authorities when Solvency II is fully applied and the quantitative regulatory limits are replaced by the prudent person principle;

- d) EIOPA has left it up to undertakings to decide whether they want the actuarial function to submit combined annual information or submitting it as required by the AMSB. This leaves more discretion to undertakings without increasing costs and gives them the possibility to implement the solution most appropriate for their purposes;
- e) The postponement of the notification requirement will not increase costs for the undertakings during the preparatory period. Nevertheless, they still have to assess internally whether a person is fit and proper which is a requirement imposed by Solvency II Directive and not added by the preparatory Guidelines;

6.66. Undertakings would gain benefits from the preparatory Guidelines:

- a) They still leave undertakings with the freedom to organise themselves as they think is appropriate while making some of the principles and requirements clearer in order to facilitate compliance with Solvency II requirements;
- b) The preparatory Guidelines give the basis for a common European understanding for all undertakings about the relevance and requirements of governance, thus strengthening the soundness and transparency of the market and promoting good practices across Member States;
- c) Since they clarify supervisory expectations, they can facilitate the communication between undertakings and supervisory authorities, helping undertakings to avoid the possible costs of revisions following a supervisory review;
- d) They are designed to assist the industry in putting in place and testing the adequacy of new system of governance in preparation for the full implementation of the Solvency II regime.

### **Supervisory Authorities**

6.67. From the perspective of the supervisory authorities, the largest part of costs related to the System of Governance requirements arises directly from Solvency II. Directive Nevertheless, there are some costs related to the preparatory Guidelines where the undertaking has the freedom to decide what is best for them. This entails the necessity for supervisory authorities of making sure that they understand each undertaking's specific way of doing business in terms of how they are organised, how they define their investment strategy and how they apply terms not defined by Solvency II.

6.68. However, supervisory authorities will also benefit from the interaction needed since it gives them a better insight into how the undertakings work in practice.

### **Policyholders**

- 6.69. The indirect costs of introducing preparatory Guidelines on the system of governance could, at least to some extent, be transferred from undertakings to policyholders, depending on the market conditions prevailing in each Member State. However, EIOPA believes that no direct costs are expected for policyholders stemming directly from these Guidelines, which are different than those costs anticipated for the implementation of the final Solvency II requirements. Policyholders will benefit from the sounder governance and higher level of transparency associated with the preparatory Guidelines that ensures better policyholder protection.
- 6.70. EIOPA believes that the application of the proposed Guidelines as well as characteristics of terms ensures a harmonised and comparable basis for undertakings' risk and capital management as well as for the risk-based supervisory assessment. Moreover, EIOPA is convinced that the application of these Guidelines will ensure common understanding and a level playing field within the internal market.

## Appendix 2: Resolution of comments:

Summary of IRSG Comments on Consultation Paper No. 13/08 - EIOPA-CP-13/08 CP-13-008_System_of_Governance				02 October 2013
<p>EIOPA would like to thank EIOPA Insurance and Reinsurance Stakeholder Group (IRSG).</p> <p>The numbering of the paragraphs refers to Consultation Paper No. 13/08 (EIOPA-CP-13/08).</p>				
No.	Name	Reference	Comment	Resolution
20.	Insurance and Reinsurance Stakeholder Group (IRSG)	General Comment	<p>We agree with EIOPA that it is appropriate to propose preparatory guidelines in relation to requirements as to insurers' systems of governance. We have no difficulty with the judgments made as described in the section on impact assessment (although the guidelines with respect to derivatives are capable of being consolidated).</p> <p>We have considered the detail of the guidelines in terms of whether in our view:</p> <p>The degree of difference in standard across member states suggested a guideline was needed for sake of harmonization; and</p> <p>Whether a proposed guideline is clear and capable of being verified in implementation.</p> <p>The guidelines are largely silent on the subject of reporting by the AMSB. Unless provided for elsewhere, we suggest that the following be included</p>	<p>Noted.</p> <p>Noted.</p> <p>This does not fall within the remit of the System</p>

			<p>following paragraph 1.20:</p> <p>In accordance with Article 51 of Solvency II, national competent authorities should require the AMSB to report at least annually on the discharge of its functions both publicly and to specifically interested classes of stakeholder.</p> <p>Effective management of conflicts of interest is an important element of good governance. We suggest something like the following be added following paragraph 1.29:</p> <p>In accordance with Article 41 of Solvency II, national competent authorities should ensure that procedures are established and communicated by the undertaking for the identification and management of potential conflicts of interest in relation to governance.</p> <p>The guidelines appear to be silent on the importance of diversification of insurance risk. We suggest adding to Guideline 18 as set out below.</p> <p>We note that elements of these draft guidelines differ from corresponding texts issued by EBA even in relation to some generic and definitional matters. Such differences should be eliminated or clearly justified.</p>	<p>of Governance.</p> <p>This is expected to be covered by the draft Implementing Measures.</p> <p>Agree. EIOPA has added the aggregation of risk not in Guideline 18 but in Guideline 16.</p> <p>Noted. Please refer to the Feedback Statement, IRSG section.</p>
102.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.12	A point of general relevance is that taken in isolation this guideline may read over-prescriptively. Our understanding is that guidelines generally apply to NCA's only on a 'comply or explain' basis.	EIOPA does not see this danger. Guidelines should not be read in isolation.
191.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.21	In the spirit of proportionality, small and medium size insurance undertakings should be allowed to allocate more than one key function (other than internal audit) to an individual.	Noted. This is expected to be covered by the Implementing Measures.
219.	Insurance and	1.23	EIOPA might usefully clarify in the explanatory text or otherwise that it is	Persons who effectively

	Reinsurance Stakeholder Group (IRSG)		not necessary that there be two executives, for example in the case of captive undertakings, one of the parties to decisions may be a non-executive director.	run the undertaking is not limited to executives, provided the person can be said to be effectively running the undertaking a non-executive director is eligible.
243.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.26	The immediately preceding guideline specifies that NCA's should ensure that the AMSB of the undertaking decide the scope and frequency of governance reviews. It seems likely that this guideline also should apply to the AMSB also.	EIOPA deleted the Guideline.
251.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.27	This would usefully be expanded to embrace stakeholders:  In accordance with Article 41 of Solvency II, national competent authorities should ensure that the scope, findings and conclusions of the review are properly documented and reported to the administrative, management or supervisory body of the undertaking and to specifically interested classes of stakeholder as appropriate. Suitable feedback loops are necessary to ensure follow-up actions are undertaken and recorded.	Disagree, such a requirement would be beyond the scope of the Solvency II Directive. Such a requirement would fall within the remit of corporate governance.
262.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.28	Comment re explanatory text :  Art. 41 para. 3 subsection 2 of the Solvency II framework directive requires that the policies in relation to the risk management, internal control, internal audit and, where relevant, outsourcing need to be annually reviewed. The explanatory text in paragraph 1.29 now expands the review requirement to all policies (including « sub-policies »). This additional review may create an inappropriate additional administrative burden for undertakings and, accordingly, should be reduced to a minimum (e.g. review of sub-policies only where the main policy has been amended or where a review otherwise seems appropriate e.g. due to changes in the system of governance, etc.).	Article 41 (3) does not give an exhaustive lists of issues for which a policy needs to be in place ('at least').  So this article and the Guideline apply to any policy required by the Solvency II Directive or following the undertaking's strategy.  Policies have to be reviewed regularly

				<p>anyway.</p> <p>The Explanatory Text is changed to "relevant staff"</p>
290.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.31	<p>In accordance with Article 42 of Solvency II, national competent authorities should ensure that persons who effectively run the undertaking or have other key functions, including members of the administrative, supervisory or management body of the undertaking are 'fit' and take account of the respective duties allocated to and training arrangements for individual members to ensure appropriate diversity of qualifications, knowledge and relevant experience to ensure that the undertaking is managed and overseen in a professional manner.</p> <p>We have suggested that this guideline should include consideration of adequacy of training arrangements in support of diversity.</p>	<p>EIOPA does not disagree that it would be a good idea for undertakings to take this into consideration, would however not go so far as to say that undertakings have to provide this kind of training or justify why they do not consider this appropriate.</p>
315.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.33	<p>'Personal behaviour' may be inappropriately open-ended. It might be deleted or the phraseology might be '....character and conduct including any criminal, financial, supervisory aspects (both business and personal) regardless of location.</p> <p>We understand that what is proposed here is different from the corresponding wording used in relation to the banking sector. Any such difference seems unlikely to be helpful and it may be that the wording should be standardised.</p>	<p>EIOPA does not consider that there is a difference between "personal behaviour" and "personal conduct". However, what on purpose has been distinguished here is 'personal behaviour' and 'business conduct'.</p>
337.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.35	<p>We think it useful to concentrate on the persons taking responsibility for a key function, as opposed to all who may be working on it. This guideline might therefore be clarified as :</p> <p>In accordance with Article 42 and 49 of Solvency II, national competent</p>	<p>This would not be in line with the Solvency II Directive. The fit and proper requirements apply to all persons having key functions.</p>

			<p>authorities should ensure that the undertaking applies the fit and proper requirements to the persons designated by the service provider or sub service provider as responsible for the performance of an outsourced key function.</p> <p>Note : Paragraph 1.54 of the explanatory text should be amended similarly.</p>	<p>The requirement ensures a certain level of quality for the performance of the key function that cannot be circumvented by outsourcing the key function. Only the notification requirement is limited to the person responsible for the key function.</p>
353.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.36	<p>For undertakings which are members of groups, this guideline may not be workable as stated (because outsourcing may be managed at a group level).</p>	<p>Noted but the requirement follows from the Solvency II Directive and not the Guidelines.</p>
425.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.43	<p>We suggest more emphasis on monitoring of risk aggregation as follows :</p> <p>In accordance with Article 44 of Solvency II, national competent authorities should ensure that in its risk management policy, the undertaking covers at least the following with regard to underwriting and reserving risk:</p> <p>a) the types and characteristics of the insurance business, for example, the type of insurance risk the undertaking is willing to accept;</p> <p>b) how the adequacy of premium income to cover expected claims and expenses is to be ensured;</p> <p>c) the identification <b>and monitoring</b> of the risks arising from the undertaking's insurance obligations, including embedded options and guaranteed surrender values in its products, <b>and aggregations of risk</b>;</p> <p>d) how, in the design of a new insurance product and the premium calculation, the undertaking takes account of the constraints related to investments; and</p>	<p>Agree. EIOPA has included the aggregation of risks in Guideline 16 not 18 as this is more generally applicable and does not just concern underwriting and reserving risk.</p>

			e) how, in the design of a new insurance product and the premium calculation, the undertaking takes account of reinsurance or other risk mitigation techniques.	
456.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.45	This draft guideline goes well beyond the requirements of Article 44 and does not in practice add anything to the preceding paragraph. Unless it can be justified, it may be deleted.	<p>The Guideline only provides clarification. Stakeholder comments show that this is necessary since stakeholder otherwise would fail to apply explicit requirements to operational risk. According to Article 44 (1) undertakings are required to have in place an effective risk management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks, at individual and at an aggregated level, to which they are or could be exposed, and their interdependencies.</p> <p>In the Guideline operational data banks are not required either. The undertaking has to set up a proportionate system for collecting</p>

				and monitoring operational risk events.
499.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.48	While we have no disagreement with it, the intent of sub-paragraph (e) of Guideline 21 is not entirely clear. The importance of adherence to originally communicated aims for unit-linked funds is not limited to use of reinsurance or risk-mitigation (see Guideline 27). If it is retained, the intent of the sub-paragraph to the guideline might usefully be clarified in the explanatory text.	This is about the fund being run by another insurer. The Guideline is designed to ensure that the first insurer has processes in place to check that the reinsurer manages their assets in line with the investment strategy communicated to the policyholder, so that the fund meets the policyholder's expectations. EIOPA therefore considers it appropriate to retain sub-paragraph (e) as part of this Guideline.
614.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.61	In the interest of brevity of guidelines, we doubt that this really adds anything to the requirement in 1.60. It is the investment policy which should specify the purpose(s) of using derivatives.	EIOPA disagrees. This is not about specifying the purpose of using derivatives at all. It is about concrete criteria for assessing whether what the undertaking has done actually has facilitated portfolio management.
618.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.62	In the interest of brevity of guidelines, we doubt that this really adds anything to the requirement in 1.60. It is the investment policy which should specify the purpose(s) of using derivatives.	EIOPA disagrees. This is not about specifying the purpose of using derivatives ex ante at all. The documentation

				of the rationale refers to the rationale for choosing the specific derivatives actually used. In the same way the demonstration of the effective risk transfer does not refer to intentions but to showing that what was done worked as intended.
622.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.63	<p>We suggest that, consistently with the explanatory text, this guideline be amended to:</p> <p>In accordance with Articles 44 and 132 of Solvency II, national competent authorities should ensure that, where the undertaking invests in securitised instruments, it ensures that its interests and the interests of the originator <b>or sponsor</b> concerning the securitised assets are well understood and aligned.</p>	Agree. EIOPA has changed the wording according to your suggestion.
635.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.64	This draft guideline may require specific clarification in the probable circumstance where detailed own funds requirements under Solvency II will not have been implemented.	The guideline asks undertakings to begin developing capital management policy. Many aspects of this - such as procedures to manage capital issuance, and procedures to ensure that terms and conditions of own fund items (whether Solvency I or Solvency

				<p>II) are clear – are common to both Solvency I and Solvency II. Whilst some detailed calculations performed as part of the procedures will differ under Solvency I and Solvency II, EIOPA sees no reason why the overall procedures should vary significantly.</p> <p>This is a dynamic and evolutionary approach starting from Solvency I and moving towards Solvency II.</p>
647.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.65	This draft guideline may require specific clarification in the probable circumstance where detailed own funds requirements under Solvency II will not have been implemented.	<p>The Guideline asks undertakings to begin developing capital management policy. Many aspects of this - such as procedures to manage capital issuance, and procedures to ensure that terms and conditions of own fund items (whether Solvency I or Solvency II) are clear – are common to both Solvency I and Solvency</p>

				<p>II. Whilst some detailed calculations performed as part of the procedures will differ under Solvency I and Solvency II, EIOPA sees no reason why the overall procedures should vary significantly.</p> <p>This is a dynamic and evolutionary approach starting from Solvency I and moving towards Solvency II.</p>
683.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.69	While we readily agree with the principle, this guideline is so generally worded as to be unverifiable. Guidelines 6 and 7 appear to cover the point adequately.	EIOPA disagrees about the verifiability. Guideline 6 and 7 cover different aspects of decision-making with regard to the AMSB.
704.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.71	The rationale and intent of sub-paragraph (b) is ambiguous and is not explained by the explanatory text. We agree that there should be procedures for escalation of internal audit findings, usually via an independent audit committee. EIOPA needs to clarify what is intended by the reference to 'the supervisory authority'.	The supervisory authority is the national competent authority.
756.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.77	The need to manage conflicts of interest is an important general point in relation to all governance activities (see our general comment above). Discharge of both calculation and validation tasks does not give rise to a conflict of interest. The first paragraph of Guideline 40 may be deleted.	EIOPA disagrees. The Guideline is not only about calculation and validation and even for that conflicts of interest may arise as validation is a control task with

				regard to the calculation.
794.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.81	It is not clear how this relates to Article 48 of Solvency II. The intent is unclear and unless it can be explained, the guideline is unnecessary.	EIOPA has removed the Guideline and will include it in the Level 3 Guidelines on the valuation of technical provisions. EIOPA will review whether the wording should be changed.
814.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.83	This could be much more clearly worded as:  In accordance with Article 48 of Solvency II, national competent authorities should ensure that the undertaking ensures that the actuarial function reports on the effect of changes in data, methodologies or assumptions on the amount of technical provisions.  Alternatively it could be deleted.	Agree. EIOPA has changed the wording to take your suggestion into account.
876.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.88	Something seems to be missing from Guideline 48 – should it follow that there should be some sort of contingency planning in relation to a breakdown of critical or important outsourced functions?	The aspect is included in Guideline 51 and in particular in the paragraph 1.214 of the Explanatory Text.
924.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.94	This does not seem to add anything useful to the substance in 1.93 and may be deleted.	Disagree.
935.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.96	The second sentence (In particular, ...) is purely explanatory and would be better included in the explanatory text.	Noted.
943.	Insurance and	1.98	This does not seem to add anything useful to the substance of 1.97 and	Disagree: the second

	Reinsurance Stakeholder Group (IRSG)		may be deleted.	paragraph does not deal with the same issue.
948.	Insurance and Reinsurance Stakeholder Group (IRSG)	1.99	The intent of this guideline is very unclear and it seems unlikely to be verifiable. Unless a clear rationale can be offered it should be deleted.	The Guideline was deleted.
965.	Insurance and Reinsurance Stakeholder Group (IRSG)	2.7	We agree with sub-paragraph (b) particularly	Noted.
980.	Insurance and Reinsurance Stakeholder Group (IRSG)	2.25	<p>We agree with EIOPA that the terminology here can be quite diverse and ambiguous. We agree that EIOPA should limit itself in the guidelines to clarification that appetite and tolerance are not the same.</p> <p>EIOPA would usefully consider using similar language to that used in relation to the banking sector:</p> <p>"36. 'Risk tolerance/appetite' is a term that embraces all relevant definitions used by different institutions and supervisory authorities. These two terms are used here interchangeably to describe both the absolute risks an institution is a priori open to take (which some call risk appetite) and the actual limits within its risk appetite that an institutions pursues (which some call risk tolerance)."</p>	<p>Disagree.</p> <p>EIOPA abstained from defining the terms. See point 2.36.</p>
986.	Insurance and Reinsurance Stakeholder Group (IRSG)	2.49	We share EIOPA's recognition of the dilemma associated with prescription of the form of notification of key appointments. On balance we think the more pragmatic approach of these draft guidelines is to be preferred, but we are alert to the potential risks arising from subjective or inconsistent interpretation by both undertakings and NCA's which could be a systemic risk for the sector.	<p>Noted.</p> <p>EIOPA abstained from introducing the notification requirement during the interim phase, but would like to emphasize that this requirement is part of</p>

