

Internal Governance, Supervisory Review and Reporting Expert Group

Issues Paper on System of Governance - Feedback Statement

CEIOPS would like to thank all stakeholders who have commented on CEIOPS' Issues Paper on System of Governance. Comments received are being taken into account in CEIOPS' ongoing work of developing Level 2 advice on the topic. They have helped to identify the areas of agreement with our approach and some issues where further consideration or explanation by CEIOPS would be beneficial.

Generally stakeholders welcomed the publication of an Issues Paper setting out CEIOPS' views on the Level 1 text requirements on the system of governance. The general reaction of the respondents was positive but CEIOPS also received suggestions on a couple of issues where it should change or amend its analysis, further material for Level 3 guidance and draft advice. Stakeholders furthermore identified a number of points on which they would welcome clarification.

In particular respondents highlighted the actuarial function and outsourcing as the areas of the Issues Paper most in need of further consideration:

Actuarial function

- Some respondents were worried about the reference to self defined standards of professional organisations as these might lack external legitimacy. On account of these concerns CEIOPS has re-examined its position on the issue and now favours an approach that calls for the development of European technical standards to be endorsed by different stakeholders, including CEIOPS itself.
- Other stakeholders expressed concern that the role of the actuarial function was not specified in sufficient detail. In particular respondents suggested that "independence" from operational functions be introduced comparable to the independence of the internal audit function. CEIOPS considers the introduction of this characteristic for the actuarial function to be outside the scope of Level 2 implementing measures as it would go beyond the specification of Level 1. However, CEIOPS has sought to address the lack of detail on what some of the responsibilities listed in Article 47(1)(a) to (i) of the Level 1 text involve and has specified the minimum requirements for these tasks.
- A few stakeholders were not satisfied with the distribution of responsibilities between the risk management function and the actuarial function for internal model users. In CEIOPS' view Article 43(5) and Article 47(1)(i) of the Level 1 text indicate which tasks with regard to internal models require actuarial expertise. This

does not however prevent undertakings from employing staff with actuarial qualifications in risk management capacities. CEIOPS has amended the relevant part of its draft advice to make its position clearer; please refer to the section “Functions” below.

Outsourcing

- A number of stakeholders suggested that CEIOPS should focus more on external outsourcing and less on internal outsourcing within groups. In CEIOPS’ view the Level 1 text does not distinguish between external and internal outsourcing and Article 48 applies to both. CEIOPS has however commented on circumstances which may result in some relief to reflect the likely lower level of risk of an intra-group service provider.
- One respondent also proposed that CEIOPS should consider the risks associated with outsourcing outside the EU and specific risks of internal outsourcing. However, the comments in the Issues Paper are not specific to outsourcing inside the EU only. CEIOPS is of the opinion that there is no need to subject outsourcing outside the EU to additional requirements. The requirements on the written agreement between the undertaking and the service provider will ensure that the supervisor is able to monitor the undertaking’s compliance with its obligations irrespective of the location of the service provider. Furthermore, the necessary examination of the service provider prior to and during the outsourcing should ensure that the undertaking understands the main risks associated with the outsourcing which in the case of outsourcing outside the EU may include additional or higher risks such as political risks.

CEIOPS has addressed requests for clarification as far as possible in the Consultation Paper on Draft Level 2 advice. The more general points that CEIOPS has not included in Level 2 advice addressed to the EU COM are:

- **Terminology, definitions etc.**

Some respondents suggested that CEIOPS introduce additional terms or definitions, change definitions used or clarify the terminology employed. CEIOPS holds that the terminology and definitions used in its Issues and Consultation Papers should be fully in line with the Level 1 text (see Article 13). Consequently, CEIOPS has refrained from introducing new terminology or definitions.

Where the Level 1 text names different policies that undertakings need to have in place, CEIOPS follows this approach. In CEIOPS’ view different policies do however not imply that these policies have to be separately defined and documented.

With regard to risk areas to be covered by the risk management system the structure of the Issues Paper traces the structure of Article 43. CEIOPS notes that the explicit listing of risk areas that need to be covered stresses the importance of considering these areas but does not signify that risks should be “split” and addressed according to the list.

- **Functions**

There were quite a number of comments with regard to various functions that asked for clarification on the boundaries between different functions or suggested that the assignment of responsibilities between functions should be left to the undertakings. These comments seemed to be based on the mistaken assumption that the use of the term “function” means that undertakings have to establish a dedicated unit/department/specific person with the relevant responsibilities. In fact, the Level 1 text uses the term “function” to denote an administrative capacity

to undertake particular tasks and the identification of a particular function does not prevent the undertaking from deciding for itself how to organise the function unless this is otherwise specified in the Level 1 text.

In CEIOPS' view such specifications that need to be taken into account are in place with regard to the internal audit function, which is to be independent from operational functions, and concerning the tasks of the risk management function and the actuarial function, in case of the use of a (partial) internal model.

- **Internal model context**

A number of respondents had concerns with the fact that the Issues Paper does not explore the connection between the system of governance and internal models or does not address the overall and ultimate responsibility of senior management for internal models. In CEIOPS' view these issues are outside the scope of the Issues Paper. What is required by way of demonstration that an internal model is widely used in the system of governance will be covered by the draft advice for Level 2 measures on internal models according to Article 125 of the Level 1 text.

- **Group context**

One respondent commented on the lack of detail on the implications of the differences between the organisational and the legal structure on the system of governance, i.e. how being part of a group affects the system of governance. In CEIOPS' view the Level 1 text is quite clear in that the governance requirements apply to every undertaking, that is to say, to legal entities and not to a group as a whole. This does not mean functions cannot be performed at group level and need to be fully duplicated at the level of every legal entity. However, to the extent that functions and governance processes are carried out on a group level instead of at an individual entity level this constitutes (internal) outsourcing and is subject to the relevant requirements of Article 48 and its Level 2 implementing measures.

- **Expansion of the areas that are being developed**

Several respondents asked for CEIOPS to develop further areas such as the design of the system of governance and the duties of the board or the link between certain functions and the external audit. CEIOPS considers these areas to be outside the scope of the Issues Paper which is determined by Article 49 of the Level 1 text for Level 2 advice and only contains some connected Level 3 remarks. CEIOPS will consider whether these areas are suitable for its future Level 3 guidance.

Way forward

As indicated, CEIOPS continues developing Level 2 advice and has recently published a Consultation Paper on the proposed advice to the European Commission on Level 2 implementing measures with regard to the system of governance. The advice is based on the Issues Paper on System of Governance taking into account stakeholders' comments as well as CEIOPS' further thoughts on the issues. In particular CEIOPS has introduced amendments to the proposed Level 2 advice that implement lessons learnt from the current financial crisis.