

# PEER REVIEW OF KEY FUNCTIONS: SUPERVISORY PRACTICES AND APPLICATION IN ASSESSING KEY FUNCTIONS

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European Insurance and  
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KEY FUNCTIONS:  
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## EXECUTIVE SUMMARY

The main task of the European Insurance and Occupational Pensions Authority (EIOPA) is to enhance supervisory convergence, strengthen consumer protection and preserve financial stability.

In the context of enhancing supervisory convergence and in accordance with its mandate, EIOPA regularly conducts peer reviews, working closely with national competent authorities (NCAs), with the aim of strengthening both the convergence of supervisory practices across Europe and the capacity of NCAs to conduct high-quality and effective supervision.

In line with its mandate, the outcome of peer reviews, including identified best practices, are to be made public with the agreement of the NCAs that have been subject to the review. (1)

### BACKGROUND AND OBJECTIVES

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Enhancing the governance system of insurers (2) is one of the major goals of Solvency II (SII). The four key functions (risk management, actuarial, compliance and internal audit) as required under the SII regulation are an essential part of the system of governance. These key functions are expected to be operationally independent to ensure an effective and robust internal control environment within an insurer and support high quality of decision making by the management. At the same time it is also important that these governance requirements are not overly burdensome for small and medium-sized insurers. Therefore SII allows NCAs to apply the principle of proportionality in relation to compliance with key function holder requirements for those insurers.

Under SII, insurers may combine key functions in one holder. However, such combinations have to be justified by the principle of proportionality and insurers need to properly address the underlying conflicts of interest. Holding a key function should generally not be combined with administrative, management or supervisory body (AMSB) membership or with operational tasks because of their controlling objective. Thus, these combinations should rather occur in exceptional cases, taking into account a risk-based approach and the manner in which the insurer avoids and manages any potential conflict of interest.

This peer review assesses how NCAs supervise and determine whether an insurer's setting of key functions fulfils the legal requirements of SII with a particular emphasis on proportionality. The peer review examines practices regarding:

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(1) <https://eiopa.europa.eu/regulation-supervision/common-supervisory-culture/peer-reviews>

(2) In this report the term insurer refers to insurance or reinsurance undertakings as defined in Article 13 of the SII Directive.

- › combining key functions under one holder;
- › combining key functions with AMSB membership or with carrying out operational tasks;
- › subordination of one key function under another key function;
- › split of one key function among several holders;
- › assessment of the fitness of key function holders; and
- › outsourcing of key functions.

The period examined under the scope of this peer review was 2016 but also covered supervisory practices executed before 2016 in the preparatory stage of SII.

The peer review was conducted among NCAs from the European Economic Area (EEA) on the basis of EIOPA's Methodology for conducting Peer Reviews (Methodology).

Detailed information was gathered in the course of the review. All NCAs completed an initial questionnaire. This was followed by fieldwork comprising visits to 8 NCAs and 30 conference calls.

## MAIN FINDINGS

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The review showed that NCAs in general apply the principle of proportionality and that they have adopted similar approaches.

## SUMMARY RESULTS OF THE COMPARATIVE ANALYSIS

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- › **Supervisory framework:** Approximately half of NCAs use written supervisory guidance for the application of the principle of proportionality. Larger NCAs in particular use written supervisory guidance in order to ensure consistency of their supervisory practice among their supervisory staff (see 2.1).
- › **Approach of NCAs:** Most NCAs have a similar approach. NCAs assess the insurers' choice of key function holders at the time of initial notification regarding the key function holder's appointment. If any concerns are noted at this stage, for example regarding combinations or fitness, NCAs generally challenge and discuss these issues with the insurer, rather than issuing formal administrative decisions (see 2.2).
- › **Combining key functions in one holder:** This occurs in almost all countries. The most frequent combinations are between risk management and actuarial functions and between risk management and compliance functions. Combinations are most commonly used by smaller insurers but are also seen in large insurers. EIOPA has identified the need to draw the attention of NCAs to the need to challenge combinations more strongly, especially when they occur in bigger, more complex insurers, and to ensure that adequate mitigation measures are in place to warrant a robust system of governance (see 2.3).
- › **Holding the internal audit function and other key functions:** The combination of the internal audit function with other key functions occurs in 15 countries, although the frequency of such combinations is relatively low. Moreover, there were cases of the internal audit function holder also carrying out operational tasks which could lead to conflicts of interest and compromise the operational independence of the internal audit function. It is important to emphasise that the legal exemption of Article 271 of the Commission Delegated Regulation EU (2015/35) does not apply to the combination with operational tasks (see 2.4).

- › **Combining a key function holder with AMSB membership:** Most NCAs follow a similar and comprehensive approach regarding the combination of key function holder and AMSB member. In this regard, NCAs accept such cases only if deemed justified under the principle of proportionality (see 2.5). <sup>(3)</sup> This peer review shows that two NCAs request or support combinations of AMSB member and the risk management function holder regardless of the principle of proportionality in order to strengthen the knowledge and expertise regarding risk management within the AMSB.
- › **Combining key function holders (excluding internal audit function holder) with operational tasks:** In nearly all countries combinations of risk management, actuarial and compliance key function holders with operational tasks occur, but such combinations generally occur rarely or occasionally (see 2.3.2). However, several NCAs do not have a full market overview of such combinations with operative tasks. Adequate mitigating measures are essential to reduce potential conflicts of interest when key function holders also carry out operational tasks. The most common combinations are the compliance function holder with legal director and the risk management function holder with finance director (see 2.6).
- › **Splitting a key function between two holders:** About half of the NCAs reported cases where more than one individual is responsible for a particular key function ('split of key function holder'). The most common split concerns the actuarial function (split between life and non-life business). NCAs should monitor such splits in order to maintain appropriate responsibility and accountability among key function holders (see 2.7).
- › **Subordination of a key function holder to another key function holder or head of operational department:** This is observed in half of the countries reviewed. An organisational subordination can be accepted, but there needs to be a direct 'un-filtered' reporting line from the subordinated key function holder to the AMSB. In cases of subordination, conflicts of interest have to be mitigated and operational independence needs to be ensured including the mitigating measures concerning the remuneration of the subordinated key function holders (see 2.8).
- › **Fitness of key function holders:** Most NCAs assess the fitness of the key function holder at the time of initial notification and apply the principle of proportionality. Several NCAs did not systematically assess the key function holders appointed before 2016. These NCAs are advised to do so using a risk-based approach (see 2.9).
- › **Outsourcing of key function holders:** Most NCAs have observed outsourcing of key function holders. According to the proportionality principle, an AMSB member may also be a designated person responsible for overseeing and monitoring the outsourced key function. Eight NCAs make a distinction between intra-group and extra-group outsourcing and six NCAs do not require a designated person in all cases, which may give rise to operational risks (see 2.10).

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<sup>(3)</sup> These cases occur rarely (less than 5% of the insurers) or occasionally (between 5% and 25% of the insurers).



## BEST PRACTICES

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Through this peer review, EIOPA identified four best practices.

- › When NCAs adopt a structured proportionate approach based on the nature, scale and complexity of the business of the insurer regarding their supervisory assessment of key function holders and combination of key function holders at the time of initial notification and on an ongoing basis. The best practice also includes supervisory documentation and consistent and uniform data submission requirements (for example an electronic data submission system for key function holder notification). This best practice has been identified in Ireland and the United Kingdom (see 2.2.2).
- › When an NCA has a supervisory panel set up internally which discusses and advises supervisors about complex issues regarding the application of the proportionality principle in governance requirements regarding key functions. This best practice has been identified in the Netherlands (see 2.2.2).
- › When assessing the combination of key function holder with AMSB member, EIOPA considers the following as best practice for NCAs:
  - To publicly disclose the NCA's expectations that controlling key functions should generally not be combined with operational functions for example with the membership of the AMSB. Where those cases occur, NCAs should clearly communicate their expectation that the undertaking ensures that it is aware of possible conflicts of interest arising from such a combination and manages them effectively.
  - To require from insurers that main responsibilities as a member of the AMSB do not lead to a conflict of interest with the tasks as a key function holder.
  - To assess whether the other AMSB members challenge the key function holder also being an AMSB member.

This best practice has been identified in Lithuania (see 2.5.3).

- › When NCAs apply a risk-based approach for the ongoing supervision that gives the possibility to ensure the fulfilment of fitness requirements of KFHs at all times by holding meetings with key function holders on a regular scheduled basis as part of an NCA's work plan (annual review plan). The topics for discussion for those meetings can vary, depending for example on actual events and current topics. This best practice has been identified in Ireland and the United Kingdom (see 2.9.2).

These best practices provide guidance for a more systematic approach regarding the application of the principle of proportionality as well as for ensuring consistent and effective supervisory practice within NCAs.

## OVERVIEW OF RECOMMENDED ACTIONS

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The peer review also found that some NCAs had not yet assessed key functions according to SII requirements. Other NCAs had weaknesses, in particular regarding the depth of assessment and mitigating measures demanded from insurers for example in cases where combinations exist.

Based on the findings of the review, EIOPA has issued a number of recommended actions to NCAs (see 2.2 to 2.10). The table below provides an overview of the area of supervisory approaches of NCAs to which the specific recommended actions apply. Within each area, the recommended actions towards the NCAs are tailored to their specific situation.

Area of recommended actions	NCA(s) concerned
<b>SUPERVISORY APPROACH OF NCAS</b>	
<p>NCAs should develop and implement adequate supervisory procedures and criteria to assess governance requirements regarding key functions in a risk-based supervisory framework according to Article 29 of the SII Directive; this especially applies to the proportionality principle laid down in Article 41 of the SII Directive, followed by amongst others Article 42 of the SII Directive and the Articles 258 and 269 of the Commission Delegated Regulations EU (2015/35).</p>	<ul style="list-style-type: none"> <li>▪ Financial Supervision Commission (Bulgaria),</li> <li>▪ Cyprus Insurance Companies Control (Cyprus),</li> <li>▪ Bank of Greece (Greece),</li> <li>▪ Fjármálaeftirlitið Financial Supervisory Authority (Iceland),</li> <li>▪ Autoridade de Supervisão de Seguros e Fundos de Pensões (Portugal),</li> <li>▪ Dirección General de Seguros y Fondos de Pensiones (Spain)</li> </ul>
<p>The NCA should require all (re)insurers to have in place an effective system of governance which provides for sound and prudent management of the business.</p>	<ul style="list-style-type: none"> <li>▪ Fjármálaeftirlitið Financial Supervisory Authority (Iceland)</li> </ul>
<p>The NCA should take into account nature, scale and complexity when applying the proportionality principle in general (not only or mainly for insurers with market share up to 1%, as this threshold is too low).</p>	<ul style="list-style-type: none"> <li>▪ Komisja Nadzoru Finansowego (Poland)</li> </ul>
<b>COMBINATIONS WITH KEY FUNCTION HOLDERS OTHER THAN INTERNAL AUDIT</b>	
<p>NCAs should increase the monitoring process of combinations between key function holders and the knowledge of the situation in the national market and assess whether combinations of key functions fulfil the necessary conditions in relation to fitness and independence in the insurer's organisational structure.</p>	<ul style="list-style-type: none"> <li>▪ Financial Supervision Commission (Bulgaria),</li> <li>▪ Finanstilsynet (Denmark),</li> <li>▪ Financial Supervision Authority (Estonia),</li> <li>▪ National Bank of Slovakia (Slovakia)</li> </ul>
<p>In the situation where the actuarial function fulfils tasks in the remit of the risk management function. NCAs should assess conflicts of interest.</p>	<ul style="list-style-type: none"> <li>▪ Czech National Bank (Czech Republic)</li> </ul>
<b>COMBINATION OF THE INTERNAL AUDIT FUNCTION HOLDER WITH OTHER KEY FUNCTION HOLDERS</b>	
<p>NCAs should increase the monitoring process of combinations between internal audit key function and other key functions, as well as the knowledge of the situation in the national market and assess whether combinations of these key functions fulfil the necessary conditions in relation to fitness and independence in the insurer's organisational structure.</p>	<ul style="list-style-type: none"> <li>▪ Financial Supervision Commission (Bulgaria),</li> <li>▪ Finanstilsynet (Denmark),</li> <li>▪ Financial Supervision Authority (Estonia),</li> <li>▪ Autoridade de Supervisão de Seguros e Fundos de Pensões (Portugal)</li> </ul>
<p>The NCA should take proper measures to ensure that insurers are compliant with Article 271 of the Commission Delegated Regulation EU (2015/35) and internal audit function is not combined with operational functions.</p>	<ul style="list-style-type: none"> <li>▪ Commissariat aux assurances (Luxembourg)</li> </ul>
<b>COMBINATIONS OF KEY FUNCTION HOLDERS AND AMSB MEMBERS</b>	
<p>NCAs should assess whether combinations of key functions with AMSB membership fulfil the necessary conditions in relation to independence in the insurer's organisational structure.</p>	<ul style="list-style-type: none"> <li>▪ Financial Supervision Commission (Bulgaria),</li> <li>▪ Commissariat aux assurances (Luxembourg),</li> <li>▪ Autoridade de Supervisão de Seguros e Fundos de Pensões (Portugal),</li> <li>▪ National Bank of Slovakia (Slovakia)</li> </ul>

Area of recommended actions	NCA(s) concerned
<p>NCAAs should pay attention to that the key function holder who is as well member of the (executive) AMSB, is effectively able to accomplish its controlling responsibilities in an objective manner which is independent from the operational management of the business (e.g. no combination of responsibility for asset management and risk management function holder). It should be verified that insurers have implemented internal measures and procedures to mitigate conflicts of interest and to ensure that the AMSB (as a whole without the AMSB member who is as well the key function holder) can effectively challenge the key function holder. EIOPA acknowledges that some NCAs request and support such combinations for the key function holder on risk management in order to ensure that the AMSB possesses suitable knowledge of risk management.</p>	<ul style="list-style-type: none"> <li>▪ National Bank of Belgium (Belgium),</li> <li>▪ Czech National Bank (Czech Republic)</li> </ul>
<b>COMBINATIONS OF KEY FUNCTION HOLDERS WITH OPERATIONAL TASKS</b>	
<p>NCAAs should increase the monitoring process of combinations of key function holders and operational tasks and the knowledge of the situation in their national market and assess whether combinations of key functions fulfil the necessary conditions in relation to independence in the insurer's organisational structure.</p>	<ul style="list-style-type: none"> <li>▪ Financial Supervision Commission (Bulgaria),</li> <li>▪ Financial Supervision Authority (Estonia),</li> <li>▪ Malta Financial Services Authority (Malta),</li> <li>▪ National Bank of Slovakia (Slovakia)</li> </ul>
<b>SUBORDINATION OF A KEY FUNCTION HOLDER TO ANOTHER KEY FUNCTION HOLDER OR HEAD OF OPERATIONAL DEPARTMENT</b>	
<p>NCAAs to guarantee the independence of the key function holders including a direct reporting line to the AMSB.</p>	<ul style="list-style-type: none"> <li>▪ National Bank of Belgium (Belgium),</li> <li>▪ Financial Supervision Authority (Estonia),</li> <li>▪ Bank of Greece (Greece),</li> <li>▪ Finanstilsynet (Norway),</li> <li>▪ National Bank of Slovakia (Slovakia)</li> </ul>
<b>FITNESS OF KEY FUNCTION HOLDERS</b>	
<p>The NCA should also carry out fitness assessments for key function holders other than actuarial function holders.</p>	<ul style="list-style-type: none"> <li>▪ Commissariat aux assurances (Luxembourg)</li> </ul>
<p>The NCA should assess the fitness of key function holders after having received the notification of the key function holder's appointment whereby a risk-based approach can be used.</p>	<ul style="list-style-type: none"> <li>▪ De Nederlandsche Bank (the Netherlands)</li> </ul>
<p>The NCA should complete fit (and propriety) assessments for all key function holders.</p>	<ul style="list-style-type: none"> <li>▪ Autoridade de Supervisão de Seguros e Fundos de Pensões (Portugal)</li> </ul>
<b>OUTSOURCING</b>	
<p>NCAAs should apply Guideline 14 of EIOPA's Guidelines on system of governance (as well as Article 49 SII Directive and Article 274 of the Commission Delegated Regulation EU (2015/35)) in a proportionate manner.</p>	<ul style="list-style-type: none"> <li>▪ Financial Supervision Commission (Bulgaria),</li> <li>▪ Insurance Supervision Agency (Slovenia)</li> </ul>
<p>The NCA should improve its knowledge of the market and assess and challenge insurers regarding their outsourcing practices.</p>	<ul style="list-style-type: none"> <li>▪ FIN-FSA (Finland)</li> </ul>

The issues and corresponding recommended actions identified through this peer review give rise to a more consistent approach to supervision of the application of the principle of proportionality. In addition, several NCAs have already provided evidence of improvements made to their supervisory practices that have resulted from this peer review. Note that these improvements are not considered in this report since their implementation date is after the review's reference period. They will however be taken into consideration in the follow-up of the peer review.

## **IMPACT ON THE CREATION OF A COMMON SUPERVISORY CULTURE**

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Building a common supervisory culture is a fundamental task for EIOPA to ensure the development of high-quality, effective and consistent supervision across the European Union. Regular, open dialogue and exchanges of experience between national supervisors and EIOPA is essential so that supervisors can learn from each other and enhance supervision.

This peer review has made a direct contribution to fostering a common supervisory culture at the European level (see 2).

This peer review has resulted in a comprehensive overview of the insurance market and supervisory practices of NCAs in the European Economic Area (EEA) covering many issues related to key functions and key function holders. NCAs are now able to compare their supervisory approaches against those of peer NCAs. Such an overview is the basis for coherent and high quality supervision within the EEA.

EIOPA also shared some observations with NCAs stemming from additional findings made in the course of analysing NCA practices to support NCAs to further develop their supervisory practices. An example of such an observation is to obtain a better market overview by improving the supervisory databases regarding the appointments and roles of key function holders. These observations are directly related to this peer review although they were not qualified as recommended actions according to the Methodology.

The peer review process led not only to discussions within NCAs but also between NCAs. Through examining different practices and sharing experiences, the peer review has led to a better awareness of this important supervisory issue among NCAs.

## **FOLLOW UP AND NEXT STEPS**

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EIOPA will consider the outcome of this peer review in a revision of its Guideline 14 on system of governance, in which a distinction between intra- and extra-group outsourcing taking into account the proportionality principle could be made. In addition, EIOPA will consider how to best reflect the overall results (findings, best practices, recommended actions and observations) of this peer review in its work on the supervisory review process (SRP).

As follow-up of this peer review, NCAs' compliance with the recommended actions will be assessed as foreseen in the Methodology.

The overview of the market facts and of supervisory practices provides a sound basis for improving supervisory practices, using also formal decisions where appropriate, and for more consistent supervisory approaches within the EEA, which is essential for creating a level-playing field within the common market.

# 1. SCOPE AND APPROACH

The Terms of Reference of this peer review states: 'The aim of this peer review is to get an insight into how National Competent Authorities (NCAs) apply the proportionality principle when supervising insurers' key functions, taking into account the implementation of key function requirements introduced by the Solvency II (SII) Directive (4).' A key function holder is defined as the person responsible for a key function according to Article 42 of SII, as opposed to the persons carrying out or performing a key function. Under SII these correspond to the persons responsible for the risk management, the internal audit, the compliance and the actuarial functions.

The principle of proportionality applies throughout the SII framework and very specifically in the context of its governance requirements. The principle is not a right of insurers to be excluded from certain requirements, but that neither the requirements nor the supervisory powers executed with regard to those requirements are too burdensome for small and medium-sized insurers. (5)

Typically different persons will be responsible for the key functions as required by SII which need to be operationally independent. However, as these requirements should not be unduly burdensome, insurers may combine different functions under one function holder, as long as certain conditions are met. One of the objectives of this peer review is to gain insight into the circumstances and applicable criteria which are considered by NCAs in such cases of combinations of key functions. Criteria can be the size, the nature of business and the complexity of insurers, including their risk profiles, which may influence NCA expectations on how insurers fulfil the requirements with regard to key functions. Regarding the actuarial function, the peer review assesses if additional national requirements exist and how these influence supervisory expectations towards the actuarial function in a SII context.

Apart from previous requirements for actuaries and auditors under Solvency I, the supervision of key functions

(4) 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 (hereinafter "Solvency II"); OJ L 335, 17.12.2009, p.1-155.

(5) See Recital 19 of the SII Directive.

which includes actuarial, internal audit, risk management and compliance is new to NCAs under SII.

The peer review also explores possible conflicts of interest based on the organisational structure of an insurer's system of governance, for example in the case of a key function subordinated under another key function, and the mitigation measures requested by NCAs in such situations.

The peer review assesses how the principle of proportionality is applied by supervisors and identifies best supervisory practices. It focuses on the following areas:

- which combinations of key function holders occur and how the principle of proportionality is applied in practice by NCAs? The following combinations were assessed:
  - combinations of key function holders in general;
  - combination of the internal audit function holder with other key functions and operational functions;
  - combinations of key function holders and a member of the administrative, management or supervisory body (AMSB);
  - subordination of a key function holder to another key function holder;
  - combinations of key function holders and operational functions (including responsible/appointed actuary);
- splitting one key function among several holders;
- national guidance: whether NCAs have guidance on the principle of proportionality and understand how this guidance is applied. Furthermore, where relevant, the peer review assesses the methodology for the categorisation of insurers according to a risk-based approach ('clustering' of insurers);
- assess how the principle of proportionality is applied with regards to fitness of key function holders;
- assess how NCAs apply the principle of proportionality when a key function is outsourced;

- understand how NCAs identify potential conflicts of interest in cases of combinations, subordination or outsourced key functions. Furthermore, assess the mitigation measures applied by NCAs when such conflicts of interest are identified.

## ASSESSMENT CRITERIA

The assessment criteria of peer reviews are set in order to provide a common understanding of expected supervisory approaches and outcomes and also to compare supervisory practices between NCAs.

The assessment criteria for this peer review are summarised in table 1.

## REFERENCE PERIOD

For each peer review, a reference period is set to provide for an appropriate time period for assessing the application of EU measures, supervisory practices and outcomes achieved.

For this peer review the reference period was set at 2016. As the reference period coincided with the transition stage of SII (which started being applied from 1 January 2016), the Terms of Reference stated the reference period as: 'Supervisory practices in the context of the SII framework in place as of the final date of the self-assessment. This comprises not only supervisory practices executed in 2016 but also supervisory practices executed before 2016 in order to achieve compliance with the SII framework.'

The initial answers to the questionnaire were, in many cases, based on provisional information provided by supervised insurers to NCAs. By the time the field work of this peer review was concluded some NCAs had conducted further analyses in their national markets. Hence, in some cases the answers provided in the questionnaire were updated during field work and included in the final analyses. Although after the fieldwork further improvements were reported by several NCAs, these could not be taken into account as they were implemented after the reference period and would require an additional peer review assessment. These will be taken into account in the foreseen follow-up measures (see section 6).

Table 1 – Assessment criteria for the peer review for the application of the proportionality principle in governance requirements regarding key functions

	SII Directive 2009/138/EC	Commission Delegated Regulation (EU) 2015/35	EIOPA Guidelines on system of governance
Proportionality	Art. 41, especially Art. 41(2), and Art. 29		
Groups	Art. 246		Guidelines 65 and 66
Notification	Art. 42(2)		Guidelines 15 and 16
Segregation of duties and conflicts of interest	Art. 41(1)	Art. 258 and 268, especially Art. 258(1)(g) and (5)	Guideline 5
Internal audit key function	Art. 47	Art. 271	Guidelines 40 and 41
Actuarial function (especially regarding combination with responsible/appointed actuary)	Art. 48	Art. 272	Guidelines 46 to 51
Risk management function	Art. 44	Art. 269	Guideline 19
Compliance function	Art. 46	Art. 270	
Combinations with AMSB/operational tasks*		Art. 268	
Split of one key function*	Art. 41(1)	Art. 258 and 268, especially Art. 258(1)(g) and (5)	Guideline 5
Fitness	Art. 42	Art. 273	
Outsourcing	Art. 49	Art. 274	Guideline 14

\* Here all key functions are considered

## METHODOLOGY

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The peer review was conducted on the basis of EIOPA's Methodology for conducting Peer Reviews.

As part of this peer review, the following countries were assessed:

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AT – Austria	EL – Greece	IT – Italy	PL – Poland
BE – Belgium	ES – Spain	LI – Liechtenstein	PT – Portugal
BG – Bulgaria	FI – Finland	LT – Lithuania	RO – Romania
CY – Cyprus	FR – France	LU – Luxembourg	SE – Sweden
CZ – Czech Republic	HR – Croatia	LV – Latvia	SI – Slovenia
DE – Germany	HU – Hungary	MT – Malta	SK – Slovakia
DK – Denmark	IE – Ireland	NL – The Netherlands	UK – United Kingdom
EE – Estonia	IS – Iceland	NO – Norway	

A questionnaire was answered by all 31 NCAs. In April and May 2017 the reviewers (see below) conducted field work with 8 visits to NCAs and 30 conference calls. No field-work was undertaken for Iceland as SII had only started to be implemented at the time of the reference period of this peer review. On the basis of the detailed information given (including concrete cases), the comparative analyses were made, resulting in the identification of a number of recommended actions to 18 NCAs and 4 best practices. In addition to the recommended actions EIOPA also shared observations with NCAs which resulted from additional findings made in the course of analysing the NCAs practices. Although the observations are directly related to this peer review it was not possible to qualify these

as a recommended action according to the Methodology. Nevertheless, EIOPA believes that these observations contain important and relevant findings, which should be considered by NCAs.

## PEER REVIEW TEAM

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The team of reviewers was led by the Austrian Financial Market Authority.

Members of the peer review team were from: Czech Republic, France, Germany, Greece, Italy, the Netherlands, Portugal, Romania, Sweden, the United Kingdom and EIOPA.

## 2. COMPARATIVE ANALYSIS

### 2.1. SUPERVISORY FRAMEWORK

#### 2.1.1. GENERAL REMARKS

The purpose of the following section is to provide an overview of the supervisory framework within the NCAs for the application of the principle of proportionality regarding key functions. This section also includes the guidance NCAs provide to supervised insurers.

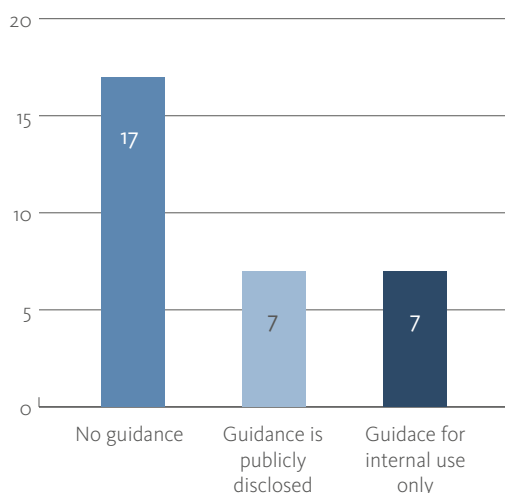
#### 2.1.2. OVERVIEW

##### Written supervisory guidance is provided by half of the NCAs

In total, 14 NCAs have written supervisory guidance which addresses the application of the principle of proportionality to key functions. <sup>(6)</sup> In 7 cases the guidance is publicly

<sup>(6)</sup> This does not include guidance which replicates the EIOPA Guidelines on system of governance.

Graph 1 – Number of NCAs with internal written supervisory guidance for applying the principle of proportionality regarding key functions



disclosed, while for the other 7 NCAs the guidance is only used for internal purposes (see graph 1 and table 2).

In Belgium, Denmark and the Netherlands the publicly disclosed guidance and the guidance for internal use have different levels of detail. In the Netherlands, the publicly disclosed guidance is in the form of a presentation with general principles.

The scope of the existing supervisory guidance, either publicly disclosed or used internally, is different between NCAs. In some cases (Czech Republic, Hungary, Liechtenstein, the United Kingdom), the guidance is generic covering governance aspects, but includes some specificities regarding key functions and/or proportionality. There are also NCAs which have developed guidance on key functions which include proportionality aspects (Belgium, Denmark, Poland) or generic guidance on proportionality (Ireland).

Besides the publication of written supervisory guidance, other supervisory initiatives have also been developed. For example, in Austria and the Netherlands, the NCAs held roundtables, meetings and/or information sessions with the industry in order to clarify aspects of the principle of proportionality. In Denmark and Poland, NCAs sent letters to their markets providing clarifications regarding the application of this principle. In Italy, the NCA informed the market via a letter that the Italian supervisory authority does not expect combinations between key functions, in particular for combinations with the internal audit function holder.



Table 2 – Internal written supervisory guidance for applying the principle of proportionality regarding key functions

	YES, written supervisory guidance is also publicly disclosed	YES, written supervisory guidance for internal use only	NO specific written supervisory guidance or only referring to EIOPA Guidelines
NCA have written supervisory guidance applying the principle of proportionality on the key functions*	BE, DE, DK, FR, HU, NL, UK	CZ, ES, IE, LI, LV, PL, SE*	AT, BG, CY, EE, EL, FI, HR, IS, IT, LT, LU, MT, NO, PT, RO, SI, SK

\* In general, the written supervisory guidance that is provided for internal purposes only, is not a source of statutory law and shall not serve as legal basis for administrative sanctions.

**DIVERSITY IN CRITERIA USED BY NCAS IN APPLYING THE PRINCIPLE OF PROPORTIONALITY**

The peer review considered whether supervisory guidance included quantitative or qualitative criteria for the assessment of proportionality - see table 3 and graph 2.

Under SII, the principle of proportionality refers to the 'nature, scale and complexity' of the risks inherent in the business of insurers. (?) In total, 8 NCAs have indicated that in order to concretise the aforementioned criteria they also consider the following (additional) factors in applying the principle of proportionality, as shown in graph 2. With regard to 'other' factors some NCAs stated that they consider the nature of the insurer's risk (e.g. long or short-tail business) (Czech Republic), as well as the insurer's systemic risk (the Netherlands).

Among the 17 NCAs which have not implemented any written guidance on the application of the principle of proportionality during the reference period, some have explicitly stated which criteria they take into account in the assessment of proportionality.

Most of these NCAs take into account similar criteria as described in graph 2 and table 3. Among those NCAs which have not adopted specific written guidance, 8 have adopted a 'case-by-case approach' (without written supervisory guidance) in relation to the supervision of proportionality aspects (Austria, Cyprus, Estonia, Italy, Lithuania, Malta, Slovakia and Slovenia). The majority of these are countries where the insurance market is relatively small with regard to the volume of premiums and the number of supervised insurers (see graph 3). These NCAs consider that they have a good understanding of the specificities of the market and each insurer, which allows them to adopt the most adequate approach for each case.

(?) According to Article 29(3) of the SII Directive.

Graph 2 – Specific criteria on which the written supervisory guidance on proportionality is based used by number/percentage of NCAs

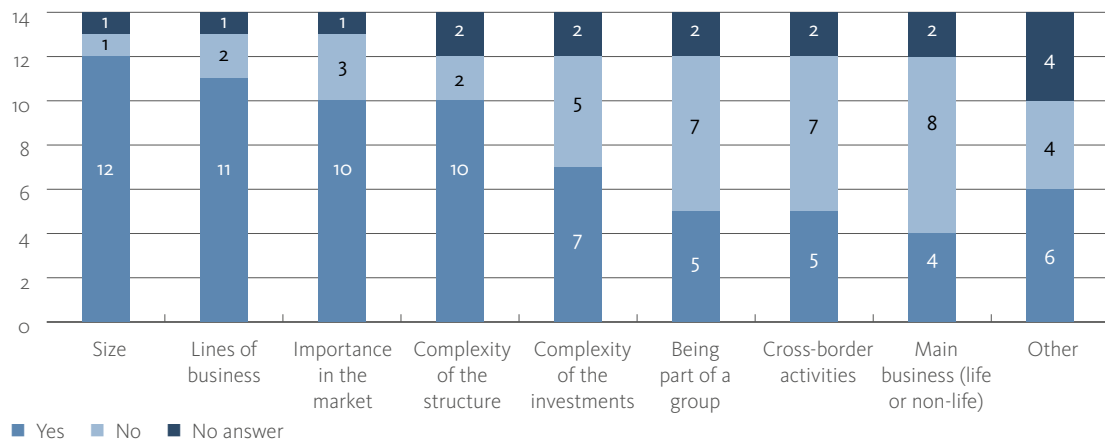
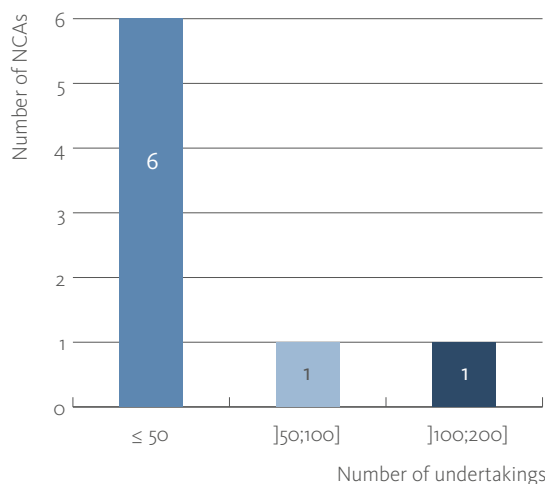


Table 3– Specific criteria on which the written supervisory guidance with respect to proportionality is based

Specific criteria related to 'nature, scale and complexity' on which the written supervisory guidance is based	
Size	BE, CZ, DK, FR, HU, IE, LI, LV, NL, PL, SE, UK
If the written supervisory guidance is based on size, then:	
Technical provisions	CZ, DK, FR, IE, NL, PL, UK
Premiums	BE, CZ, DK, FR, IE, LV, NL, PL, SE, UK
Other	BE, HU, IE, LI, LV, NL, SE, UK
Total balance sheet	BE, NL
Systemic importance	CZ, NL
Number of full time equivalents (FTE)	NL
Total assets (Life)	SE
Number of policyholders	UK
<b>Importance of the insurers in the market (i.e. impact in case of failure, specificities of the product...)</b>	BE, CZ, DK, HU, IE, LI, LV, NL, PL, UK
<b>Life and Non-Life</b>	DK, IE, LV, SE
<b>Belonging to a group</b>	DK, FR, IE, NL, UK
<b>Complexity of the insurer's business/group structure</b>	BE, CZ, DE, DK, IE, LI, LV, NL, PL, UK
<b>Lines of business/types of products/risks covered</b>	CZ, DE, DK, FR, HU, IE, LV, NL, PL, SE, UK
<b>Cross-border activities</b>	DE, IE, LV, NL, UK
<b>Complexity of investments (taking into account e.g. investment policy, for instance unusual investments/presence of embedded guarantees)</b>	CZ, DE, DK, IE, LV, NL, UK

Graph 3 – Number of insurers supervised by NCAs which do not have written guidance and explicitly apply a case-by-case approach



**SUPERVISORY PRACTICES FOR A CONSISTENT APPROACH WITHOUT WRITTEN GUIDANCE**

When there is no explicit written guidance the question arises how those NCAs ensure a consistent approach regarding the application of the principle of proportionality.

Some NCAs (Greece, Hungary, Italy, Lithuania, Malta, Slovakia) conduct meetings between the different supervisory teams. In Greece and Finland major issues are escalated inside the supervisory authority to ensure consistency in the application of the principle of proportionality. In Austria, there is a specialised function in the NCA responsible for the approval of all key function holders. In Malta all decisions where an element of proportionality is applied are documented. In Slovakia and Slovenia, NCAs stated that consistency is ensured because the market is small.

### 2.1.3. SPECIFIC TOPICS

This section provides further insight on the practices of those NCAs which have adopted written guidance for the application of the principle of proportionality with regard to key functions. The following does not distinguish whether an NCA's guidance is publicly disclosed or not.

#### SUPERVISORY METHODOLOGY TO APPLY PROPORTIONALITY

Some NCAs apply proportionality in such a way that certain insurers are granted proportionality as a general rule. These insurers often combine key functions and are generally not challenged by supervisors. One example is the captive industry (Ireland, Luxembourg, Sweden).

In some other NCAs as a general rule certain insurers are not allowed to apply the principle of proportionality. For example, in Denmark life insurers cannot as a starting point apply the principle of proportionality due to the long term nature of their business. Exemptions are granted only after a detailed case-by-case analysis.

In addition to the criteria described in the section 2.1.2. <sup>(8)</sup> some NCAs consider the specificities of the insurance products offered by the insurer, e.g. whether products are long-tailed or not, or types of unit-linked products, or, whether products are related to special (social) regulation such as disability insurance (Denmark, Poland, Sweden).

In Germany and the Netherlands, NCAs take into account factors such as the number of employees of the insurer and the number of outsourced key functions in order to determine whether the principle of proportionality can be applied.

<sup>(8)</sup> See subsection 'Diversity in criteria used by NCAs in applying the principle of proportionality.'

#### CLUSTERING OF INSURERS ACCORDING TO PROPORTIONALITY ASPECTS

Out of the 14 NCAs that have issued written supervisory guidance, 9 NCAs cluster their supervised insurers into risk categories according to their supervisory risk assessment framework. NCAs determine the categorisation based on quantitative and/or qualitative criteria.

The use of clusters determines the intensity and frequency (one- to four-year cycle) of supervisory actions and assessments regarding but not limited to key functions. Intensity and frequency plus the level of detail for supervisory assessments have an impact on NCA resources. For example, for low risk categories some NCAs request supervised insurers to perform a self-assessment of key functions instead of performing a supervisory analysis. In Ireland and the United Kingdom, the risk of false or misleading information given by insurers is mitigated by conducting on-site inspections on a sample basis.

In Belgium, the NCA uses an internal tool for 'score-carding' insurers. This tool relies on questions concerning activities, system of governance, risk profile, <sup>(9)</sup> valuation of assets and liabilities for solvency requirements and capital management. As an outcome this tool distinguishes between significant and less significant insurers. Within the last category, the tool also distinguishes between medium and small insurers. The frequency of the assessment will depend on the categorisation of the insurer.

In addition, in the Netherlands, the NCA considers the insurer's specific circumstances including the nature and complexity of governance structure in order to understand the context in which key functions should be assessed. As mitigation measures in the case of combined key functions, the Netherlands puts special focus on the direct reporting line to the AMSB. Furthermore, the Netherlands has set up a 'panel' on proportionality (see best practice in section 2.2.1) where all complex cases related to combination of key functions are reviewed and assessed and this ensures a level of consistency in the application of the principle of proportionality across the insurance sector in the Netherlands.

<sup>(9)</sup> Regarding underwriting, market, credit, liquidity and operational risks.

Table 4 – Internal categorisation ('clustering') of insurers by NCAs which have written supervisory guidance

NCAs which internally categorise ('cluster') insurers according to proportionality aspects	BE, CZ, DK, IE, LV, NL, PL, SE, UK
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## **SUPERVISORY GUIDANCE ADDRESSING CONFLICTS OF INTEREST INVOLVING KEY FUNCTION HOLDERS**

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The written supervisory guidance of 12 NCAs (Belgium, Czech Republic, Denmark, France, Germany, Ireland, Latvia, Liechtenstein, the Netherlands, Poland, Sweden and the United Kingdom; see graph 2) provides how potential conflicts of interest for key function holders are taken into account in the supervisory assessment. Potential conflicts of interest always occur in case of combined key function holders and are an important issue which may give rise to operational risks for the insurer. These could arise where several key functions are combined in one holder, key functions are subordinated or where the key function holder also performs operational tasks.

As key functions can be seen as the second line of defence<sup>(\*)</sup> in the insurer's system of governance they need to be operationally independent in order to fulfil their control function. Some NCAs do not accept any conflicts of interest especially for complex insurers with a high risk profile or for insurers which are clustered in a high impact or high risk category (Czech Republic, Germany, Ireland).

For the 12 NCAs mentioned the written guidance requests specific mitigation measures for cases of conflicts of interest. Written policies with regard to how conflicts of interest are managed by the insurer are requested by 8 of these aforementioned NCAs (Czech Republic, Denmark, France, Liechtenstein, the Netherlands, Poland, Sweden and the United Kingdom).

In addition, in Belgium, the NCA also takes into consideration the remuneration of key functions when assessing conflicts of interest. In Denmark and France insurers have to indicate how they manage the underlying risks.

## **2.1.4. CONCLUDING REMARKS**

In total, 14 NCAs have implemented written supervisory guidance for the application of the principle of proportionality in order to ensure consistency and a coherent approach within their NCA.

Publicly disclosed supervisory guidance is a way to ensure the insurance market knows about supervisory expectations. This aim can also be achieved through roundtable discussions and training activities held by NCAs for stakeholders.

Written guidance can be particularly useful for NCAs with a larger number of staff involved in supervision or with a high number of insurers; most 'larger NCAs' have such internal guidance. However, there are also other means available to ensure coherence, such as regular meetings and information sharing between individual supervisors or supervisory teams or tracking of cases through a data management system regarding administrative decisions on key functions.

However, written guidance also bears the risk of inconsistency within the Single European Market. This may hinder full harmonisation according to the Commission Delegated Regulation (EU) 2015/35 and the relevant EI-OPA Guidelines.

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<sup>(\*)</sup> The first line of defence is within the operational performance of a function, the second is the control of such function and the third line of defence is the internal audit of such controls.

## 2.2. APPROACH OF NCAS

### 2.2.1. GENERAL REMARKS

In the following section an insight is provided into practices and procedures existing internally within the NCAs as to their approach in assessing issues of key function holders (covered by this peer review).

### 2.2.2. ASSESSMENT METHODOLOGY ADOPTED BY NCAS

According to the answers provided by NCAs, a similar approach has been noted for the assessment of the following cases: (i) combinations of key function holders, (ii) combinations of key function holders and AMSB members and (iii) combinations of key function holders and operational tasks. The most common aspects found are included in this section while the specificities inherent in individual cases of combinations are dealt within the relevant sections.

NCAs have provided an overview of the supervisory measures used in their evaluation process – immediately after notification and on an ongoing basis for key function holders.<sup>(1)</sup>

The frequency of the supervisory assessments in most cases depends on the risk profile of the insurer. In general, consistent with the conclusion of paragraph 2.1., it is observed that significant insurers with a high risk profile

are assessed more often and in more detail than less significant insurers with a lower risk profile.

In addition NCAs take into consideration an insurer’s internal policies, reporting lines, remuneration policies and practices, risk analysis and the organisational structure.

In general the assessment of combinations is part of an NCA’s regular supervisory risk assessment framework or is carried out on a case-by-case basis, especially in countries with smaller insurance markets.

NCAs from 24 countries assess the identified combinations immediately after receiving a notification.

The most common activities are a plausibility check of the submitted documents immediately after receiving the notification, off-site inspection as part of the assessment or the regular reporting and ad-hoc request of information. One method does not exclude the other.

Many NCAs (for example in Austria, Bulgaria, Denmark, Greece, Lithuania and Sweden) obtained information regarding the appointment of key function holders starting in 2016. In Bulgaria, Denmark, Finland, Lithuania and Sweden, NCAs have not requested a notification of key function holders who have their position in place before 1 January 2016. In few cases, such as in Bulgaria, a specific survey was conducted in order to increase the NCA’s awareness and knowledge of key function holder appointments in the market. Some NCAs (for example in Greece and Portugal) did not have a complete overview of combinations within their market during the reference period of the peer review. Those NCAs may for example launch a survey in order to collect information on all key function holders.

<sup>(1)</sup> According to Article 42 of the SII Directive and Article 273 of the Commission Delegated Regulation (EU) 2015/35.

Graph 4 - Assessment methods adopted by (number of) NCAs in the ‘first’ evaluation

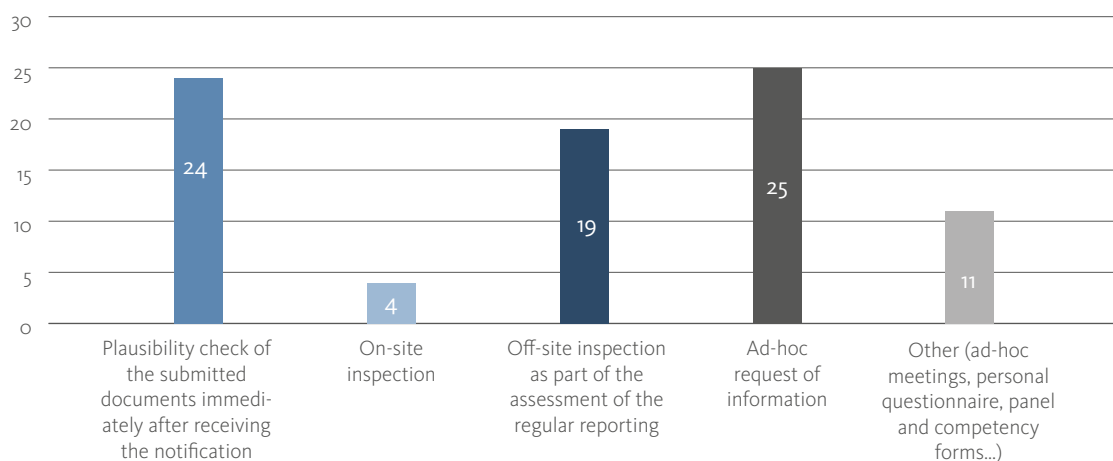


Table 5 – Assessment methods adopted by NCAs for the ‘first’ evaluation

Assessment of key function holders - just after they were notified to the NCA	Yes	No
Plausibility check of the submitted documents immediately after receiving the notification	AT, BE, BG, CZ, DE, DK, EE, EL, ES, FI, FR, HR, HU, IE, IT, LI, MT, NL, PL, RO, SE, SI, SK, UK	CY, IS, LT, LU, LV, NO, PT
On-site inspection	DK, EE, MT, NL	AT, BE, BG, CY, CZ, DE, EL, ES, FI, FR, HR, HU, IE, IT, LI, LT, LU, LV, NO, PL, PT, RO, SE, SI, SK, UK
Off-site inspection as part of the assessment of the regular reporting	BE, CZ, DE, DK, EE, EL, FI, FR, HU, IE, IT, LI, LU, MT, NL, PL, SI, SK, UK	AT, BG, CY, ES, HR, LT, LV, PT, RO, SE
Ad-hoc request of information	AT, BG, CZ, CY, DE, DK, EE, EL, ES, FI, FR, HR, HU, IE, IT, LI, LU, LV, MT, NL, PL, RO, SE, SK, UK	BE, LT, PT, SI
Other (ad-hoc meetings, personal questionnaire, panel and competency forms...)	CZ, DK, EE, FI, HU, IE, LT, LU, LV, MT, NL, UK	BE, DE, EL, FR, LI, PL, RO, SE, SI, SK

The United Kingdom uses a database for gathering information provided by insurers (including information provided at the moment of notification). All information from this database is used to monitor key function holders.

Regarding ongoing assessment, 20 NCAs (Austria, Belgium, Croatia, Czech Republic, Estonia, Germany, Greece, Finland, France, Italy, Ireland, Latvia, Liechtenstein, Malta, the Netherlands, Poland, Portugal, Slovakia, Slovenia, the United Kingdom) carry out evaluations by off-site inspections. This includes assessment of the regular reporting and via ad-hoc request of information. One method does not exclude the other. In total, 8 NCAs (Austria, Belgium, France, Germany, Italy, the Netherlands, Poland, the United Kingdom) tend to adopt a combination of supervisory

tools (e.g. on-site as well as off-site inspections as part of the assessment of the regular reporting). In Belgium and Lithuania, NCAs use additional methods for the ongoing assessment of cases of combinations such as holding meetings with the insurer and conducting surveys.

The trigger, based on the limited experience during the start-up phase of SII, for the ongoing assessment varies greatly among NCAs. These include clustering, lack of reporting (e.g. no own risk and solvency assessment (ORSA) report), significant changes in the risk profile of the insurer, changes in control and transfers of business, extraordinary events and cases of non-compliance discovered during on-site inspections or off-site analyses.

## BEST PRACTICE



## ADOPTION OF A STRUCTURED PROPORTIONATE APPROACH

*EIOPA considers it a best practice when NCAs adopt a structured proportionate approach based on the nature, scale and complexity of the business of the insurer regarding their supervisory assessment of key function holders and combination of key function holders at the time of initial notification and on an ongoing basis. The best practice also includes supervisory documentation and consistent and uniform data submission requirements (for example an electronic data submission system for key function holders' application).*

This best practice is taken from the supervisory practice in place in Ireland and the United Kingdom. These NCAs perform a more rigorous assessment and evaluation for key function holder appointments and combinations of key function holders for high risk/impact insurers within their jurisdiction. For example, the evaluation for key function holder appointments for higher risk insurers may include carrying out interviews in addition to desk-based reviews whereas low risk insurers are evaluated only through desk-based reviews.

The NCAs also introduced an electronic application portal that increases the consistency and uniformity of the documents submitted for review at the initial notification stage.

The structured supervisory assessment process includes the following activities:

1. Review of the application form including employment history.
2. Review of scope of responsibilities for the individual key function holder taking into account segregation of responsibilities and any potential conflicts of interest.
3. Review of the insurer's governance map.\*
4. Assessing the insurer's justification for the proposed key function holder combination.
5. Supervisory judgement taking into account the risk profile of the insurer.

Additional steps could include ad-hoc requests for information and assessing segregation of duties and adequacy of internal controls in light of combination of key functions.

In order to identify any potential conflict of interest, the NCAs review the scope of responsibilities of the applicant, taking into account the segregation of responsibilities by reviewing the governance map of the insurer.

Where an insurer proposes a combination of key function holder, it is required to submit justification for this combination. The plausibility of the justification is evaluated and challenged by exercising supervisory judgement, taking into account the risk profile of the insurer.

It is noted that there is the potential risk of weakening supervision of low categories if the system is too automatically applied.

\* For qualitative reporting insurers are required to disclose their organisational structure and in case of a financial group the legal structure to their NCA.

BEST PRACTICE




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**EXPERT PANEL**

EIOPA considers it a best practice when an NCA has a supervisory panel set up internally which discusses and advises supervisors about complex issues regarding the application of the proportionality principle in governance requirements regarding key functions.

This best practice is identified in the Netherlands where an expert panel consisting of staff with different backgrounds and experience in compliance, risk management, actuarial issues and audit has been set up. This panel advises supervisors on how to deal with the proportionality principle in relation to key functions.

The panel's advice can be used by the NCA as good national practices for its insurance sector.

In case of combinations, the supervisor assesses all information regarding this combination (e.g. a risk analysis provided by the insurer with mitigating measures and an explanation why the specific combination is in line with the principle of proportionality) and shares his/her conclusions with the panel members. After the panel discussion, the panel advises the supervisor about the appropriateness of the combination. This system ensures a consistent and coherent approach within the NCA.

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**INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD**

Based on the findings of the peer review, recommended actions for implementing adequate supervisory procedures have been issued for 7 NCAs:

NCAs should develop and implement adequate supervisory procedures and criteria to assess governance requirements regarding key functions in a risk-based supervisory framework according to Article 29 of the SII Directive; this especially applies to the proportionality principle laid down in Article 41 of the SII Directive, followed by amongst others Article 42 of the SII Directive and the Articles 258 and 269 of the Commission Delegated Regulations EU (2015/35).

The recommended action applies (with tailored variations) to: *Bulgaria, Cyprus, Greece, Spain, Iceland, Portugal*.\*

The NCA should require all (re)insurers to have in place an effective system of governance which provides for sound and prudent management of the business.

The recommended action applies to: *Iceland*\*\*

The NCA should take into account nature, scale and complexity when applying the proportionality principle in general (not only or mainly for insurers with market share up to 1%, as this threshold is too low).

The recommended action applies to: *Poland*.

\* Regarding PT, during the reference period, the cases of combination have not been notified yet, since the correspondent regulation was still under development/approval.

\*\* In IS the key function holder appointments were not completed by insurers during the reference period of the peer review.



### 2.2.3. ASSESSMENT AND SUPERVISORY MEASURES

The majority of NCAs prefer to discuss or have meetings or interviews with representatives of the insurers to challenge or review the choices of the insurers regarding cases of combinations at the time of notification or an on-going basis. It is considered a good supervisory approach to get a better understanding of the rationale behind the combinations and how the insurer avoids or mitigates conflicts of interest. This approach is preferred by NCAs regardless of the size of the insurance market.

In Greece, the NCA will discuss within their college of supervisors responsible for group supervision of cross-border insurance groups any matters with a possible negative impact on the governance of the entity of a group with the aim to contribute to strengthening the supervision of the group, especially in cases where such combinations form a pattern within the group.

A large majority of NCAs (27) indicated that they assess how insurers deal with the segregation of responsibilities and the potential conflicts of interest emerging from the combination of key function holders. In Bulgaria, Iceland, Portugal and Slovenia, <sup>(\*)</sup> NCAs have specified that they do not conduct a review of these aspects.

Examples of mitigation and supervisory measures adopted by NCAs are:

- requiring the insurer to complete written policies (including segregation of responsibilities; information lines; escalating mechanism);
- requiring an action plan for compliance (reflecting the issue of conflict of interest);

<sup>(\*)</sup> Regarding PT, during the reference period, the cases of combination have not been notified yet, since the correspondent regulation was still under development/approval. In IS the key function holder appointments were not completed by insurers during the reference period of the peer review.

- assessing in depth the direct reporting to the AMSB and how the AMSB defines the objectives of the function, the remuneration of key function holders and the function policy;
- assessing the time consumption of the tasks when one person holds one or more key function; and
- requiring changes in the organisation.

Once a combination has been identified, most NCAs assess those cases by applying the principle of proportionality. In Bulgaria and Romania, NCAs do not apply the principle of proportionality in such assessment; this is partly due to the characteristics of their market such as the small number of insurers operating in their country.

#### FACTORS TAKEN INTO ACCOUNT IN SUPERVISORY PRACTICES WHEN ASSESSING CONFLICTS OF INTEREST

By assessing the segregation of responsibilities and the mitigation of conflicts of interest, NCAs take into consideration the following factors: combinations with operational functions, the existence of a direct reporting line to the AMSB, the minutes of the AMSB and audit committee, the appointment of the key function holder by the AMSB, how the AMSB defines the objectives of the key function and key function holder, the remuneration policy and the responsibilities of the key function holder.

For large insurers, combinations of key function holders are generally not accepted. Some NCAs accept temporary combinations within large insurers as interim solutions, but require a change in the long term.

NCAs pay particular attention to the fit and proper assessment in order to understand the capabilities of the key function holder and also assess the insurers' ability to manage potential conflicts of interest in cases of combinations.

Table 6 – Assessment by NCAs of segregation of responsibilities

	YES	NO
NCAs which assessed how the insurers deal with segregation of responsibilities in case of combinations of key function holders, (according to Article 41(i) of the SII Directive) and conflicts of interest (according to Article 258(1)(g) and 258(5) of the Commission Delegated Regulation (EU) 2015/35)	AT, BE, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HR, HU, IE, IT, LI, LT, LU, LV, MT, NL, NO, PL, RO, SE, SK, UK	BG, IS, PT, SI

Most NCAs have not adopted strong supervisory measures such as issuing formal decisions regarding segregation of responsibilities and the mitigation of conflicts of interest. Nonetheless, most NCAs chose to challenge insurers when conflicts of interest were identified. This can take several forms: official letters sent to the insurers, ad-hoc reporting, interviews, on-site inspections.

Most NCAs let the insurer decide on the specific measures in order to mitigate conflicts of interest. However, some NCAs require insurers to define a new allocation of tasks or have declined the appointment of a key function holder. Besides, where potential conflicts of interest are identified, most NCAs verify that the insurers have put in place appropriate reporting lines between the key function holder and the AMSB.

## 2.2.4. CONCLUDING REMARKS

In most cases, NCAs conduct the assessment of the key functions on the basis of the documents received at the time of notification of the key function holder. NCAs ensure that in case of non-compliance or incomplete notification documentation insurers are contacted and open issues are followed up in a timely manner.<sup>(13)</sup>

For those NCAs that are currently not assessing the settings for key function holders in the insurer's system of governance after notification in a timely manner it is strongly recommended to implement this approach in their supervisory procedure which enables insurers to implement effective mitigation measures before conflicts of interest may give rise to operational risks.

Some NCAs do not assess key function holders appointed before 2016. Considering that all key function holders need to be fit and proper at all times,<sup>(14)</sup> it is expected that NCAs conduct supervisory assessments as well. In case a complete overview of key functions in the market

is lacking the NCA is advised to launch a survey in order to collect information on all key function holders.

The supervisory approach for this ongoing assessment should be risk-based and proportionate meaning that ongoing assessment could be done through on-site inspections or in certain intervals depending on the nature, scale and complexity of the business of the insurer. Generally the assessment process should be more in depth for larger, high risk insurers compared to smaller, less risky ones.

In Ireland, the Netherlands and the United Kingdom, the NCA's risk assessment framework has a direct link to how the principle of proportionality is applied in the practice of supervising insurers. In these NCAs the skill and experience level of the key function holder is also taken into consideration when assessing the individual's suitability of holding one or several key functions. The skills and experience requirements are generally higher for individuals holding key functions in large, complex and more significant insurers.

At the start of the SII regime, in case of supervisory concerns, NCAs engaged with and challenged insurers rather than adopting strong supervisory measures. It is expected that NCAs will also apply in the near future supervisory measures including supervisory sanctions and administrative decisions if insurers do not meet SII governance requirements.

<sup>(13)</sup> See as well section 2.9. Fitness of the key function holder.

<sup>(14)</sup> According to Article 42(1) of the SII Directive.

## 2.3. COMBINATIONS WITH OTHER KEY FUNCTION HOLDERS

### 2.3.1. GENERAL REMARKS

In this section, cases have been analysed where the same person has been appointed as a key function holder for two or more different key functions. This section does not address combinations with the internal audit function as this specific case is dealt with in section 2.4.

Although the combination of key function holders in one person is possible under the SII framework, if this is supported by proportionality considerations, each NCA should ensure that in such cases appropriate additional processes and procedures have been implemented by the insurer in order to fulfil all necessary requirements.<sup>(15)</sup> First and foremost these control mechanisms need to address concerns regarding conflicts of interest.

### 2.3.2. OVERVIEW OF THE MARKET

One of the main findings of the peer review is that almost all NCAs observed combinations of key function holders within their market. Where the same person has been appointed as a key function holder for two or more different key functions, this does not always link to the principle of proportionality.

<sup>(15)</sup> According to Articles 258 and 268 of the Commission Delegated Regulation (EU) 2015/35; see also EIOPA Guideline 5 on system of governance.

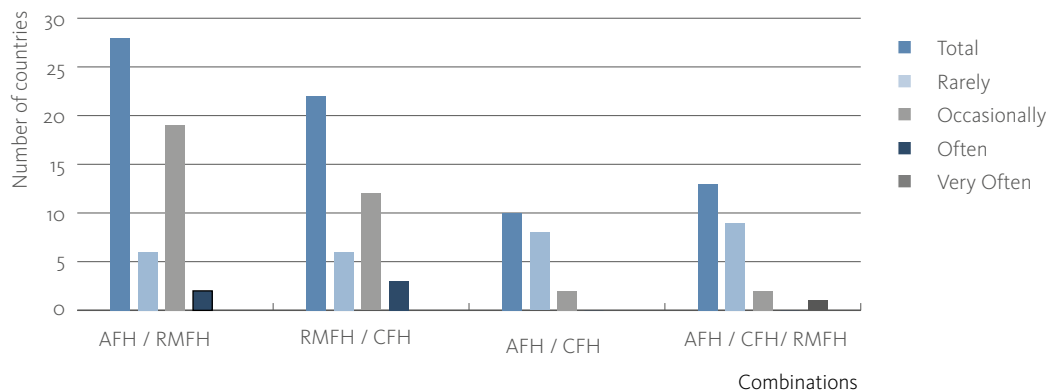
The combination of the actuarial and the risk management functions is the most common, as it occurs in 28 countries. On the contrary, the combination of the actuarial and the compliance functions is the least frequent. This can be easily explained by the difference of skills and expertise required to perform these two functions. However, the combination of actuarial function holder, risk management function holder and compliance function holder also occurs in 12 jurisdictions (Belgium, Czech Republic, Denmark, Estonia, France, Germany, Italy, Luxembourg, the Netherlands, Sweden and the United Kingdom). Most of the combinations of these three function holders exist in small-sized entities and are rare. Many cases of combinations occur as a result of outsourcing of the key functions, by bringing into one key function holder the responsibility of several outsourced functions.

Graph 5 illustrates the different types of combinations and their frequency within the EEA.

For the indication of frequency the following categories are used:

- **Rarely:** very few exceptional cases of this combination, which only occur under rare circumstances; if presented in an average percentage this represents less than 5% of the supervised insurers within a country that fall under the SII framework;
- **Occasionally:** some cases of this combination, which are nevertheless not common; if presented in an average percentage this represents between 5% - 25% of the supervised insurers within a country that fall under the SII framework;

Graph 5 –Types and frequency of combinations in the European insurance market



- **Often:** many cases of this combination which is quite common; if presented in an average percentage this represents between 25% - 50% of supervised insurers within a country that fall under the SII framework;
- **Very often:** very many cases of this combination which presents rather a general rule; as an average percentage this represents more than 50% of the supervised insurers within a country that fall under the SII framework.

The data shown in graph 5 are to be considered with caution as not all NCAs have a complete overview of their market. Whereas some NCAs require the notification of all key function holders, including the ones already in place before the entry into force of SII, some only require the notification at the time of the appointment of a new key function holder and some assess key function holders only during on-site inspections.

#### INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD

Based on the findings from the peer review, recommended actions that focus on the improvement of the supervision of combinations of key function holders have been issued for 5 NCAs:

NCAs should increase the monitoring process of combinations between key function holders and the knowledge of the situation in the national market and assess whether combinations of key functions fulfil the necessary conditions in relation to fitness and independence in the insurer's organisational structure.

The recommended action applies (with tailored variations) to: *Bulgaria, Denmark, Estonia, Slovakia.*

In the situation where the actuarial function is fulfilling tasks in the remit of the risk management function, NCAs should assess conflicts of interest.

The recommended action applies to: *Czech Republic.*

### 2.3.3. SPECIFIC TOPICS

#### THE REASON FOR COMBINING KEY FUNCTIONS IS NOT ALWAYS THE PRINCIPLE OF PROPORTIONALITY

Combinations occur more frequently in smaller insurers. Combinations are also more frequent where the insurer outsources one or several key functions and the responsibility for the outsourced functions is combined in one internal key function holder.<sup>(6)</sup>

However, there were also combinations identified without a link to the principle of proportionality. In some countries cases of combinations occur from previous regulation before SII which was less stringent. In other cases scarcity of competence as well as the availability of financial resources lead to combinations. Cases of combination occur as well for significant insurers (United Kingdom).

In total, 14 NCAs (Austria, Belgium, Bulgaria, Denmark, Estonia, France, Hungary, Italy, Luxembourg, Malta, Romania, Slovakia, Slovenia, the United Kingdom) adopt a case-by-case approach to assess combinations of key functions taking into consideration the following factors: combinations with operational functions, direct reporting to the AMSB, appointment of the responsible key function holder by the AMSB and how the AMSB defines the objectives of the key function holder and the remuneration of the responsible key function holder.

For NCAs that do not apply the principle of proportionality, different approaches were found:

- no differences among insurers in requiring information details (about internal procedures on potential conflicts of interest, measures in order to mitigate the risk of conflicts of interest, measures to ensure that the fact that one person has multiple attributions does not hinder his/her ability to perform duties accordingly (Romania));
- all insurers are considered small and therefore the same approach is used by the NCA (Bulgaria); and
- temporary solutions could be accepted (Italy).

NCAs sometimes accept combinations e.g. between the risk management function holder and the compliance function holder taking into account the principle of proportionality and the mitigation measures put in place by insurers. For example, in Lithuania and the Netherlands staff that perform operational risk management and compliance tasks are separated.

<sup>(6)</sup> These cases of outsourcing will be further analysed in section 2.10.

Not all countries, NCAs and insurers have yet completely adapted their legal and/or supervisory instruments for system of governance in relation to the entering into force of the SII Directive in 2016: some were still in the implementation phase (Iceland, Portugal) during the reference period, whereas some countries have updated their national regulatory framework transposing SII requirements but have not yet accurately applied the principle of proportionality (Italy, Romania).

#### **COMBINATIONS OF MORE THAN TWO KEY FUNCTIONS OCCUR RARELY**

Some cases of combination of three key functions have been identified as noted in the previous section. Insurers having this kind of combination represent a very small market share (e.g. in Luxembourg); for life and non-life insurance combinations occur in insurers with up to EUR 0.3 billion of technical provisions and/or premiums at the most. When assessing those cases of combinations of several key functions, NCAs also take into account other indicators e.g. complexity and risk profile of the insurer or if the insurer is part of a group.

#### **2.3.4. CONCLUDING REMARKS**

Combinations of key functions can be found in almost all countries. Most frequent combinations are combinations between risk management and actuarial function as well as between risk management and compliance function. Combinations are more commonly used by smaller insurers due to their limited human and financial resources, but combinations are also seen in large insurance groups. Some NCAs, for example in Ireland, the Netherlands and Poland, more rigorously scrutinise and challenge larger insurers with regard to combinations of key function holders. Certain NCAs, such as in the Netherlands and Poland do not allow combinations of key function holders for some of the largest and most significant insurers in their jurisdiction.

The risks of combined key functions are that conflicts of interest may arise which may impact the insurer as operational risk. It is therefore recommended to NCAs to use the following supervisory approach.

A peer group of insurers could be formed for supervisory purposes based on proportionality aspects determined by the NCA. Supervisors then could assess whether combinations of key functions occur on a more frequent basis in that peer group and whether the potential conflicts of interest have less impact because of the low risk profile of the insurers of that peer group. NCAs should challenge the insurer's approach in cases where the risk profile of the insurer gives rise to supervisory concerns with regard to operational risks.

In addition, NCAs should identify (a group of) insurers where combinations are generally challenged because of the high risk profile of those insurers or their impact on the national market in case of failure. Only exceptional circumstances could justify a combination for this high impact peer group. Criteria for the classification of the insurers by written premium, technical reserves and market share can be used. <sup>(17)</sup>

In case of a supervisory challenge of combinations of key functions, focus should be on the existence and effectiveness of mitigating measures (for instance, clear reporting lines to the AMSB, processes implemented by written policies to address potential conflicts of interests), which could be assessed for example during on-site inspections or by review of written policies.

<sup>(17)</sup> See for further detail section 2.1.2.

## 2.4. COMBINATION OF THE INTERNAL AUDIT FUNCTION HOLDER WITH OTHER KEY FUNCTION HOLDERS

### 2.4.1. GENERAL REMARKS

In this section NCAs identified cases where the internal audit function holder is combined with another key function or carries out operational tasks or functions. The internal audit key function is expected to be operationally independent from other tasks <sup>(18)</sup> in line with the assumptions made as third line of defence. Therefore, there must not be a combination with operational tasks or with tasks and functions not covered by the exemptions of Article 271 Commission Delegated Regulation (EU) 2015/35. It is expected that NCAs pay special attention when the internal audit function holder is combined with another key function and assess how any conflicts of interest are managed by the insurer.

### 2.4.2. OVERVIEW OF COMBINATIONS

Combinations of the internal audit key function holder with other key functions are identified by 15 NCAs (Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Germany, Ireland, France, Luxembourg, the Netherlands, Poland, Portugal, Spain, the United Kingdom).

The remaining 16 NCAs did not report any cases of combination of the internal audit function holder with another

key function holder (see graph 6). In Hungary, Italy, Norway and Slovenia NCAs reported that there is specific national legislation in place that restricts the combination of the internal audit function holder with other key function holders. However, in 2017 Italy changed its national regulation to allow combination of the internal audit function holder with other key function holders within the legal constraints. <sup>(19)</sup>

Graph 6 shows the reasons for non-combinations of the internal audit function holder with other key function holders. The most common ‘other reasons’ noted by NCAs was a continuation of national practice in place prior to SII that did not allow for such combinations (Hungary, Lithuania, Romania). <sup>(20)</sup>

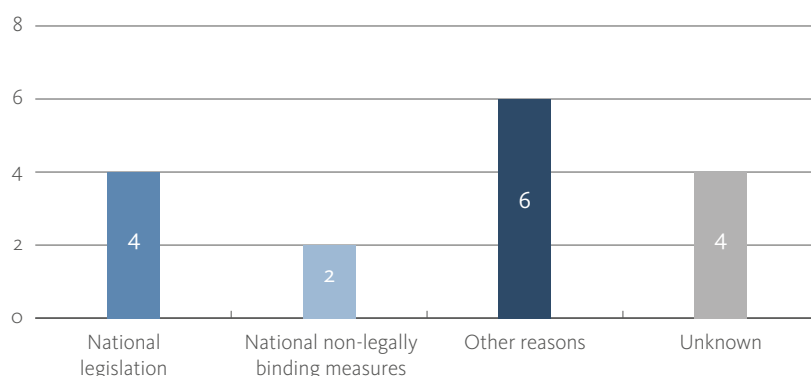
In terms of frequency of combination of the internal audit function holder with other key function holders, such combinations were generally reported as ‘rare’ (less than 5% of insurers within a country). Among the 15 NCAs that reported combinations of the internal audit function holder with another key function 12 NCAs (Austria, Belgium, Bulgaria, Czech Republic, France, Germany, Ireland, Luxembourg, the Netherlands, Poland, Spain, the United Kingdom) identified the combination of the internal audit function holder with the compliance function holder the most frequently. NCAs from 6 countries (Belgium, France, Germany, Luxembourg, Spain, the United Kingdom) reported that the combination of the internal audit function holder with the actuarial function holder was the least frequently identified.

<sup>(18)</sup> According to Article 47 of the SII Directive and Article 271 of the Commission Delegated Regulation (EU) 2015/35; see also EIOPA Guideline 40 on system of governance.

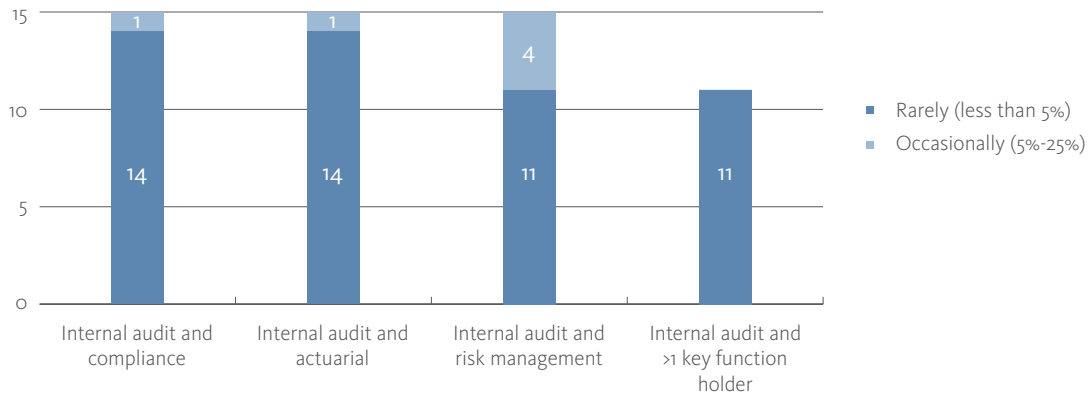
<sup>(19)</sup> According to Article 271 Commission Delegated Regulation (EU) 2015/35.

<sup>(20)</sup> 3 NCAs did not provide specific reasons.

Graph 6 – Reasons for no combinations of the internal audit function holder with another key function holder



Graph 7– Frequency of combinations of IAFH with other KFH reported by NCAs



Graph 7 provides an overview of the number of countries in which the combination of the internal audit function with other key function holders has been identified.

Belgium reported that combinations of internal audit function holder and compliance function holder, internal audit function holder and actuarial function holder and internal audit function holder and risk management function holder occur ‘occasionally’ (i.e. in 5%-25% of the supervised insurers). Belgium noted that the designated person responsible for the outsourced internal audit function occasionally combines with another key function holder in less significant insurers (medium and small) and this is considered to be a proportionate solution to achieve the regulatory requirement on key functions.

In Estonia, Luxembourg and Portugal, NCAs reported that the combination of internal audit function holder and risk management function holder exists ‘occasionally’ in their jurisdiction. In Estonia all such cases of combinations (internal audit function holder and risk management function holder) exist in insurers with an outsourced internal audit function. In Luxembourg, the NCA reviews and approves such combinations on a case-by-case basis. In Portugal, the NCA was in the process of assessing and reviewing combinations of key function holders during the reference period of this peer review.

No cases of the combination of internal audit function holder with other key function holders were noted for large insurers. NCAs where mid-sized insurers have combinations with other key function holders generally applied mitigating measures. NCAs generally do not intervene against combinations in the case of very small insurers or in the case of outsourcing.

There are 9 NCAs (Belgium, Czech Republic, Denmark, France, Germany, Ireland, the Netherlands, Poland, the United Kingdom) that did not intervene in specific cases subject to proportionality pursuant to Article 271 Commission Delegated Regulation (EU) 2015/35: In Austria, one case of combination occurred but the insurer already appointed a separate internal audit function holder with effect from January 2018.

The following are examples of actual cases of combinations with internal audit function holder and mitigation measures noted.

In the Netherlands, a mid-sized insurer combined the internal audit function holder and compliance function holder; the NCA approved the combination since an internal audit assessment of the compliance function was done by an external accountant as a mitigation measure. Moreover, the NCA allowed the combination in this exceptional case as it was confident about the high quality of the internal audit report and the staff involved.

In the United Kingdom, where the internal audit function holder is combined with another key function holder the NCA expects a direct reporting line from the internal audit function holder to the AMSB (for example to the chair of the audit committee) to mitigate any conflicts of interest and ensure proper escalation of issues.

## INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD

Based on the findings of the peer review, recommended actions that focus on the improvement of the supervision of combinations of the internal audit function holder with other key function holder have been issued for 5 NCAs:

The recommended action as mentioned in 2.3.2. applies (with tailored variations) to: *Bulgaria, Denmark, Estonia, Portugal.*

The NCA should take proper measures to ensure that insurers are compliant with Article 271 of the Commission Delegated Regulation EU (2015/35) and internal audit function is not combined with operational functions.

The recommended action applies to: *Luxembourg.*

### 2.4.3. SPECIFIC TOPICS

Generally speaking a combination of the internal audit function holder and the key function holder is 'allowed' under the legal circumstances. <sup>(\*)</sup>

In some countries, the combination is not formally forbidden but the NCAs communicated that they want to prevent such cases and will assess them very strictly. For example, in the preparatory phase towards SII, the Netherlands communicated to its market that a combination of the internal audit function holder and another key function is not preferred. When publishing supervisory expectations regarding the internal audit function holder, NCAs should mention Article 271 Commission Delegated Regulation (EU) 2015/35 which clearly sets the (restrictive) conditions for a combination with the internal audit function holder.

#### COMBINATIONS OF THE INTERNAL AUDIT FUNCTION HOLDER AND OPERATIONAL TASKS

Some 23 NCAs stated that there are no combinations of the internal audit function holder with operational tasks in their jurisdictions identified.

As shown in graph 8, 10 NCAs stated that specific national legislation is in place that prohibits combination of the internal audit function holder with operational tasks

(Austria, Bulgaria, Estonia, Hungary, Latvia, Lithuania, Norway, Poland, Slovenia, Spain).

Further, 8 NCAs (Belgium, Denmark, Greece, Ireland, France, Luxembourg, the Netherlands, the United Kingdom) have identified such combinations.

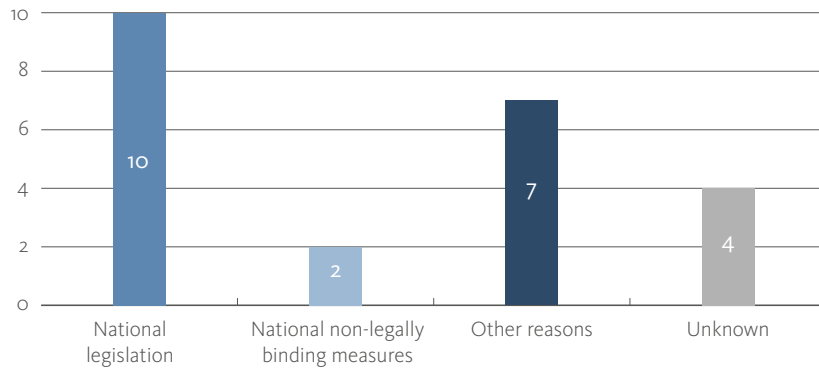
NCAs in two countries reported cases of combinations of the internal audit function holder with operational tasks in specific situations. In Denmark, the NCA identified three separate cases of combinations of the internal audit function holder and operational functions. In each case, the Danish Financial Supervisory Authority challenged the insurers and has not accepted the combinations of internal audit function holder with operational tasks. In the Netherlands, the NCA identified one case of a combination of the internal audit function holder and a member of the investment committee. In this case, once the combination was identified by the NCA and following supervisory intervention, the insurer resolved the issue and currently no combination of the internal audit function holder with operational task exists in the Netherlands.

In France, Ireland and the United Kingdom, NCAs assess such situations on a case-by-case basis using the proportionality aspects of Article 271 of the Commission Delegated Regulation (EU) 2015/35.

<sup>(\*)</sup> According to Article 271 Commission Delegated Regulation (EU) 2015/35.



Graph 8– Reasons for no combination of the internal audit function holder and operational tasks by number of NCAs



#### 2.4.4. CONCLUDING REMARKS

Combinations of the internal audit function holder with other key function holders exist in 15 countries.

A strict application of Article 271(2) of the Commission Delegated Regulation (EU) 2015/35 is highly recommended for combinations of the internal audit function holder with other key functions.

Combinations of the internal audit function holder with operational tasks are observed in 8 countries (Belgium, Denmark, France, Greece, Ireland, Luxembourg, the Netherlands, the United Kingdom). For those NCAs where combinations have been identified, 3 assess and might approve the combination on a case-by-case basis referring to Article 271 of the Commission Delegated Regulation (EU) 2015/35. For the rest of these NCAs combinations were only allowed in very exceptional cases and in two cases (Denmark, the Netherlands) it was already challenged and subsequently changed.

In 23 countries combinations of the internal audit function holder with operational tasks have not been observed. In 10 of these countries (Austria, Bulgaria, Estonia, Hungary, Latvia, Lithuania, Norway, Poland, Slovenia, Spain), combinations of the internal audit function with operational tasks is legally forbidden by national legislation.

As previously stated, many NCAs do not have a full overview of all possible combinations between key function holders and operational tasks. This is due to the fact that this information is mostly gathered by NCAs during on-site inspections and not on a systematic basis.

It is therefore expected that all NCAs improve the overview in their jurisdiction regarding combinations of operational tasks with all key function holders and especially with the internal audit function holder. Secondly, the approach of the NCAs not to accept combinations of operational tasks with the internal audit function holder should be made clear to the market by referring to the requirements of Article 271 Commission Delegated Regulation (EU) 2015/35.

## 2.5. COMBINATIONS OF KEY FUNCTION HOLDERS AND AMSB MEMBERS

### 2.5.1. GENERAL REMARKS

This section refers to the combinations of key function holders with AMSB members. When such a combination occurs, the insurer needs to consider whether this combination is proportionate to the nature, scale and complexity of the risk profile of the insurer. This kind of combination might especially lead to conflicts of interest as it may compromise the operational independence of the key function <sup>(22)</sup> in case no mitigation measures are implemented by the insurer. It is important to understand the different nature of the responsibilities and activities of the AMSB members and that of the key function holders. The key function holder is responsible for providing expert advice to the AMSB on the concerned key function. It is therefore essential that person responsible for a key function comply with the relevant requirements, which calls for a more specific level of expertise. The key function is the control function <sup>(23)</sup> of a specific area, for example risk management, whereas the main responsibility of the (executive) AMSB is the management of the business which is an operational task. Nevertheless the AMSB has ultimately to ensure a proper and functioning risk management and internal control systems. Each member of the AMSB needs to possess individual fitness as well the whole AMSB to collectively possess suitable knowledge to oversee and challenge the work of each key function holder. In case the key function holder is at the same time a member of the AMSB, the operational risk may arise that this key function holder might be less challenged by other AMSB members regarding the performance of their key function. As the AMSB acts as the ultimate responsible body for the insurance business it could be a potential operational risk if the key function holder cannot be challenged by the AMSB. Article 268 of the Commission Delegated Regulation (EU) 2015/35 specifies that 'each function is free from influences that may compromise ... and independent manner'.

<sup>(22)</sup> According to Articles 41 of the SII Directive and Article 268 of the Commission Delegated Regulation (EU) 2015/35.

<sup>(23)</sup> As second line of defence in the model of three lines of defence for governance.

In some cases, a member of the AMSB may also be the designated person within the insurer with overall responsibility for the outsourced key function. <sup>(24)</sup> This subject will be addressed in section 2.10. on outsourcing.

### 2.5.2. OVERVIEW OF COMBINATIONS

As shown in table 7, a large majority of NCAs have reported cases of combinations between key function holders (risk management, actuarial, and compliance) and AMSB members. Overall, the combination between the risk management function holder and AMSB member is most commonly followed by the combination between the compliance function holder and AMSB member.

The general response of most NCAs is that the combinations generally occur in small insurers, in captives or in less complex insurers where the activities of the key functions are outsourced.

NCAs in 5 countries (Croatia, Iceland, Norway, Romania, Slovenia) have not identified any combination between a key function holder and AMSB member. One of the reasons mentioned by these NCAs is that insurers might have chosen not to combine key function holders with members of AMSB to avoid possible conflicts of interest, which could hinder the operational independence of the key functions. Another reason for not having this combination in place is to ensure that the direct reporting line of the key function holder to the AMSB is free from undue influences.

NCAs in 15 countries (Belgium, Czech Republic, Denmark, Estonia, France, Germany, Ireland, Liechtenstein, Luxembourg, Norway, Poland, Portugal, Spain, Sweden, United Kingdom) have identified combinations of internal audit function holder with AMSB member (see table 8). It appears that this type of combination occurs very rarely in the majority of countries.

NCAs that have observed this combination explain that it mostly occurs in small insurers that e.g. hold very low market share on national level or in cases where the internal audit function is outsourced. For example, in Ireland, the NCA has seen the combination between the head of internal audit and the chief executive officer in low impact captive insurers.

<sup>(24)</sup> According to EIOPA Guideline 14 on system of governance.

Table 7 – NCAs reporting a combination of actuarial, compliance and/or risk management function holder and AMSB members

Frequency of occurrence	Number of NCAs	Country
Rarely (less than 5% of supervised insurers)	10	BG, CZ, DK, ES, FI, IE, IT, LI, SE, UK
Occasionally (between 5% - 25% of supervised insurers)	11	AT, CY, DE, EL, HU, LT, MT, NL, PL, PT, SK
Often (between 25% - 50% of supervised insurers)	1	FR
Very often (above 50% of supervised insurers)	4	BE, EE, LU, LV
No combination identified	5	HR, IS, NO, RO, SI

Table 8 – NCAs reporting a combination of internal audit function holder and AMSB member

Frequency of occurrence	Number of NCAs	Country
Rarely (less than 5% of the supervised insurers)	11	BE, CZ, DE, DK, ES, IE, LI, PL, PT, SE, UK
Occasionally (between 5% - 25% of the supervised insurers)	2	FR, NO
Often (between 25% - 50% of the supervised insurers)	-	-
Very Often (above 50% of the supervised insurers)	2	EE, LU
No combination identified	16	AT, BG, CY, EL, FI, HR, HU, IS, IT, LT, LV, MT, NL, RO, SI, SK

NCAs in 16 countries (Austria, Bulgaria, Croatia, Cyprus, Finland, Greece, Hungary, Iceland, Italy, Latvia, Lithuania, Malta, the Netherlands, Romania, Slovakia, Slovenia) have not identified any combination of internal audit function holder with AMSB members. Most clarify that this type of combination is not allowed due to national legislation or non-legally binding measures.

In Estonia and Luxembourg, NCAs have seen this combination very often in their insurance market. The Luxembourg NCA reports that this is due to the fact that most of the captive insurers <sup>(25)</sup> do not have any employees, and therefore a combination of the internal audit function holder with a non-executive AMSB member (i.e. supervisory function) will be necessary to fulfil the requirements of the SII regulation. The Estonian NCA clarified that in 6 out of 12 cases there are combinations between the designated person for the internal audit function holder and an AMSB member, meaning that in all these cases the internal audit function is outsourced.

NCAs agree that it is very important that all key functions – especially the internal audit function holder - act independently from other functions and that the reporting line to the AMSB is free of undue influences. They stress that conflicts of interest have to be avoided or mitigated in order to ensure the effectiveness of the system of governance.

<sup>(25)</sup> As defined in Article 13(2) of the Solvency II Directive.

## INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD

Based on the findings of the peer review, recommended actions that focus on the improvement of the supervision of combinations of key function holders and AMSB members have been issued for 6 NCAs:

NCAs should assess whether combinations of key functions with AMSB membership fulfil the necessary conditions in relation to independence in the insurer's organisational structure.

The recommended action applies (with tailored variations) to: *Bulgaria, Luxembourg, Portugal and Slovakia.*

NCAs should pay attention to that the key function holder who is as well member of the (executive) AMSB, is effectively able to accomplish its controlling responsibilities in an objective manner which is independent from the operational

management of the business (e.g. no combination of responsibility for asset management and risk management function holder). It should be verified that insurers have implemented internal measures and procedures to mitigate conflicts of interest and to ensure that the AMSB (as a whole without the AMSB member who is as well the key function holder) can effectively challenge the key function holder. EIOPA acknowledges that some NCAs request and support such combinations for the key function holder on risk management in order to ensure that the AMSB possesses suitable knowledge of risk management.

The recommended action applies (with tailored variations) to: *Belgium, Czech Republic.*

### 2.5.3. SPECIFIC TOPICS

#### NCA APPROACHES

When assessing the combination of an AMSB member that also holds the position of a key function holder, NCAs should take into consideration the following:

- the AMSB member's knowledge of the key function;
- objectivity of the AMSB member to be able to be both AMSB member and key function holder at the same time;
- organisational structure, nature, size, complexity and risk profile of the insurer;
- the key function holder in the AMSB has to report to the whole AMSB in order to avoid filtering of information; and
- possibility of the other AMSB members to challenge the key function holder must be sufficiently ensured.

It is important that NCAs have an appropriate supervisory approach in place for carrying out assessments of such combinations.

The establishment of an adequate transparent organisational structure with a clear description and allocation, and proper segregation of responsibilities <sup>(26)</sup> is a possibility to avoid conflicts of interest. This also applies to the segregation of roles and responsibilities within the AMSB, especially when combined with the key function holder. Insurers also need to ensure that proper mitigating measures are implemented to manage and mitigate any conflicts of interest.

Moreover, an analysis of the workload of the AMSB member and the assessment of the decision making process within the insurer are examples of supervisory measures that can be applied by NCAs to monitor combinations of key function holder with AMSB membership.

<sup>(26)</sup> According to Article 41 of the SII Directive and Article 268 of the Commission Delegated Regulation (EU) 2015/35, see in addition EIOPA Guideline 5 on system of governance.

The assessments of combinations mentioned in this section are either part of the regular supervisory risk assessment framework of NCAs or are carried out on a case-by-case basis. NCAs carrying out their supervisory activities in small insurance markets tend to use the latter approach. <sup>(27)</sup>

NCAs use different methods for assessing combinations that also apply to the combination between key function holders and AMSB members. <sup>(28)</sup> Specifically regarding the combinations mentioned in this section, it is observed that NCAs during their regular, ongoing supervisory assessments also have meetings with AMSB members to discuss the existing or proposed governance structure of the insurers' key functions.

<sup>(27)</sup> See also Section 2.1. "Supervisory framework".

<sup>(28)</sup> See also Section 2.2.

## APPLICATION OF THE PRINCIPLE OF PROPORTIONALITY

When assessing the legality regarding the combination between key function holder and AMSB member, it is important that NCAs always consider whether the (proposed) combination is appropriate and proportionate to the specific risk profile of the insurer. In principle, a combination of controlling and operational functions should be avoided, for example in the case where the AMSB member also holds a key function because of possible conflicts of interest. Where those cases occur, the under-taker has to ensure that it is aware of such conflicts and manages them effectively. However, in case such combinations occur and are accepted by the NCA, the NCA should request the insurer to implement mitigation measures and procedures in order to separate the controlling function and the operational function of this person. In addition the NCA should assess whether the key function holder/AMSB member is challenged by the (members of the) AMSB which is the ultimate responsible for the insurance business.

### BEST PRACTICE



#### WHEN ASSESSING THE COMBINATION OF THE KEY FUNCTION HOLDER WITH AMSB MEMBER, EIOPA CONSIDERS THE FOLLOWING ACTIVITIES AS BEST PRACTICE FOR NCAS:

- To publicly disclose NCA expectations that controlling key functions should generally not be combined with operational functions, for example with the membership in the executive AMSB. Where those cases occur, NCAs should clearly communicate their expectation that the under-taker ensures that it is aware of possible conflicts of interest arising from such a combination and manages them effectively.
- To require from insurers that the main responsibilities as a member of the AMSB do not lead to a conflict of interest with the tasks as a key function holder.
- To assess whether the other AMSB members challenge the key function holder who is also an AMSB member.

This best practice is taken from the supervisory practice in Lithuania. In case of combination of key function holder with an AMSB member the NCA ensures that overall responsibility of the member in the AMSB is assigned in a way that it ensures the independence of the key function holder. Furthermore an external expert (auditor) periodically assesses the work of the key function holder in the AMSB.

#### 2.5.4. CONCLUDING REMARKS

Regarding the combination between compliance, actuarial or risk management and AMSB members, most NCAs follow a coherent approach, as in two thirds of the jurisdictions' combinations occur rarely or only occasionally. The combination between the internal audit function and an AMSB member occurs mostly rarely or not at all.

Combinations of key function holders with an AMSB member need special attention when being assessed due to the fact that the AMSB is ultimately responsible for the management of the insurer including the setting of duties allocated to key function holders and the oversight and challenge of their performance. It is essential to preserve the independence of the key function holder so that the key function holder can undertake its controlling function in an objective, fair and independent manner from the operational function of the AMSB e.g. no responsibility for asset management and risk management function holder. <sup>(29)</sup> In some cases a combination of key function holder with an AMSB member may lead to the situation that the independence of the key function holder is no longer guaranteed, therefore NCAs should carry out a deeper assessment regarding such notifications. NCAs should however take into account the nature, scale and complexity of the operations of the insurers and assess whether this application justifies the AMSB member to fulfil his responsibility as controlling key function holder.

Some NCAs allow the combination between key function holder and AMSB members in cases where insurers have taken proper measures to manage possible conflicts of interest. This usually concerns small insurers. This peer review has identified that one NCA (Belgium) requests combination of AMSB member and risk management function holder and one NCA (Czech Republic) supports this combination if all potential conflicts of interest are mitigated in order to ensure that suitable knowledge of this important area is represented in the AMSB.

Considering the risk-based approach, and for a supervisor to be able to assess whether in complex cases the structure of the key functions is suitable and does not limit a good countervailing power, a best practise observed was an NCA having in place an independent supervisory panel within the NCA. Based on the supervisors' assessment, this panel advises about the (proposed) structure of key functions (see section 2.2.2).

NCAs are expected to assess the decision making process within the insurer and to make sure there is no overlap of responsibilities. This could also be assessed by an external party, e.g. an external auditor.

When an AMSB member holds the position of a key function holder, NCAs are also advised to assess whether the function of the AMSB member is as executive or as non-executive member. The AMSB member, in case of a combination, should not be the sole or main decision maker.

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<sup>(29)</sup> See Article 268 of the Commission Delegated Regulation (EU) 2015/35.

## 2.6. COMBINATIONS OF KEY FUNCTION HOLDERS WITH OPERATIONAL TASKS

### 2.6.1. GENERAL REMARKS

This section deals with the specific cases when the key function holder is also responsible for carrying out operational tasks and/or operational functions.

If such a combination is in place, the insurer needs to consider whether this combination is proportionate to the nature, scale and complexity of its operations. This kind of combination might lead to potential conflicts of interest and may compromise the operational independence of the key function. <sup>(30)</sup>

<sup>(30)</sup> According to Article 41 of the SII Directive and Article 268 of the Commission Delegated Regulation (EU) 2015/35.

### 2.6.2. OVERVIEW OF COMBINATIONS

Cases of combinations of key function holders (risk management, actuarial, compliance or internal audit) with operational tasks or responsibilities were observed in almost all insurance markets within the EEA – namely by 28 NCAs (see table 9). Iceland did not yet have data about combinations of key function holders with operational tasks available. Only in Norway and Romania, were no combinations of key function holders with operational tasks identified.

Combinations occur in smaller and less complex insurers (up to the 5% market share) but there are also special combinations such as compliance function holder and legal department director which occur in insurers of different size, number of employees and complexity of the business.

The function of responsible/appointed actuary is included in 10 jurisdictions (Austria, Bulgaria, Croatia, Denmark, Finland, Germany, Liechtenstein, Malta, Portugal and Slovenia). Generally those NCAs accept the combination of the responsible/appointed actuary and actuarial function holder. However, in Malta and Portugal, NCAs do not accept any combination with the appointed actuary.

Table 9 – Frequency of occurrence of cases of combinations between key function holders and operational tasks

Frequency of occurrence	Number of NCAs	Country
Rarely	6	CY, EL, IE, IT, LT, SI
Occasionally	8	CZ, DE, DK, ES, LU, MT, PL, SE
Often	5	BG, EE, FI, FR, LV
Very often	3	HR, NL, SK
Unknown frequency	6	AT, BE, HU, LI, PT, UK
No combination identified	2	NO, RO

### INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD

Based on the findings of the peer review, recommended actions that focus on the improvement of the supervision of combinations of key function holders with operational tasks have been issued for 4 NCAs:

NCAs should increase the monitoring process of combinations of key function holders and operational tasks and the knowledge of the situation in

their national market and assess whether combinations of key functions fulfil the necessary conditions in relation to independence in the insurer's organisational structure.

The recommended action applies (with tailored variations) to: *Bulgaria, Estonia, Malta, Slovakia*.

The most frequent combinations reported by NCAs are:

Table 10 – Most frequent observed combinations of key function holder and operational tasks

Key function holder	Operational task/responsibility	Country
RMFH	Financial Director	CY, ES, LU, LV, NL, PL, SE
	Actuarial Department Employee	NL, SK
	Accounting Department Director	DE, PL
AFH	Financial Department Director/Employee	CY, IT
	Technical Provision Calculation Execution	CZ, ES, FR, HR, IT, LT, LU, NL, PL, SK
	Pricing Execution	CZ
	Underwriting Department Director	BG, IE
CFH	Legal Department Director	BG, CY, CZ, DE, DK, ES, FI, HR, LU, LV, MT, NL, SE, SI, SK
	Accounting Department Director	LT
	Financial Department Director/Employee	CY
	HR Department Director/Employee	SI
IAFH	Reporting Department Employee	EL

### 2.6.3. SPECIFIC TOPICS

#### LINK WITH PROPORTIONALITY

The supervisory assessment of possible conflicts of interest may differ depending whether the key function is outsourced or not. When a key function is combined with operational tasks one NCA (Belgium) stated that its level of assessment is higher compared to a situation in an insurer where the designated person responsible for the outsourced key function is assessed.

NCAs from 23 countries (Austria, Belgium, Croatia, Cyprus, Czech Republic, Denmark, France, Germany, Ireland, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, the Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, the United Kingdom) apply the principle of proportionality when assessing the combination of key function holder with operational tasks or responsibilities; whereas 6 NCAs (Bulgaria, Estonia, Finland, Greece, Italy, Romania) do not apply the principle or do not have an overview in their national market. NCAs usually allow such a combination in small insurers with for example a simple business model, standardised insurance products and a clear organisational structure. The insurer's low-risk investment strategies and limited amount of management levels are other criteria mentioned.

NCAs from 9 countries (Austria, Bulgaria, Croatia, Denmark, Estonia, Finland, Germany, Liechtenstein, Slovenia) that identified the combination of actuarial function holder and responsible/appointed actuary applied the principle of proportionality. Criteria used most frequently in relation to nature, scale, complexity were:

- size/balance sheet size of insurer;
- market share and importance; and
- business and risk complexity.

#### SEGREGATION OF RESPONSIBILITIES

As common supervisory practice, 21 NCAs (Belgium, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Italy, Ireland, Latvia, Liechtenstein, Lithuania, Malta, the Netherlands, Poland, Portugal, Slovakia, Slovenia, Sweden, the United Kingdom) assess segregation of responsibilities in case of combinations of key function holder with operational responsibility; whereas in Bulgaria, Greece and Romania, NCAs do not assess the segregation or do not have an overview in their national market. NCAs have different ways to assess this, such as:

- having meetings with the AMSB to discuss and challenge the position of the key function holder;



- carrying out on-site/off-site inspections; and
- requesting the insurers to submit additional information such as policies and information about the organisational structure.

Some NCAs (e.g. Luxembourg, Norway, Spain) explain that they will carry out further inspections in the future.

### **CONFLICTS OF INTEREST/MITIGATING MEASURES**

Conflicts of interest should be avoided when combining the responsibilities of key function holder with any operational tasks. In the situation where this is not possible, the insurer needs to make sure that proper mitigating measures of this potential operational risk as well as continuous monitoring of this conflict are being implemented.

The NCAs which apply the principle of proportionality assess the combinations in the context of the insurer's governance system. This assessment is either part of their supervisory review process or based on a case-by-case approach.

In general, NCAs have the following off-site/on-site activities in place:

- assessment of the rules and principles defined in the insurer's internal policies to determine that there is no overlap in responsibilities and tasks between the key function holder and the operational tasks;
- having meetings with employees and AMSB members to challenge the insurer's justification for the proposed key function holder combination;
- assessment of the decision making process within the insurer;
- four-eyes-principle (e.g. Lithuania: the actuarial function holder is also responsible for technical provision calculation and therefore the results of the actuarial function are checked by an external company); and
- committees (e.g. Malta: the NCA aims to ensure that it must be possible to challenge the work of any individual including key function responsible also for an operational task - there has to be a committee or the AMSB in order to review the work of such individual).

If the insurer has managed the conflicts of interest properly or no conflicts of interest were identified, NCAs usually allow the combination of key function holder with operational responsibility based on the principle of proportionality. With regard to systemically important insurers it is recommended that combinations of key function

holder with operational responsibility are not acceptable on the long term.

In the Czech Republic, when assessing the combination of key function holder with an operational task, one of the required mitigating measures is the insurer's internal control system including relevant reporting lines and committees. This system is to be regularly evaluated in terms of efficiency and possible changes by the insurer itself. The NCA also expects the insurer to have clear and consistent documentation regarding internal control, compliance and internal audit. For example, significant conflicts of interest are indicated when the actuarial function holder is also responsible for the execution of the technical provisions calculation or pricing or in case the risk management function holder is chief financial officer (CFO) responsible also for e.g. reinsurance or investments. In the Czech Republic, relations in organisational structures and reporting lines are assessed in detail. When a conflict of interest is identified, the insurer is required to shift the conflict of interest between the first and second line of defence to the highest possible level (preferably AMSB level) – all considering the proportionality principle. As there will always be potential conflicts of interest between first and second (potentially also third) line of defence – taking into account not only roles and responsibilities of the person but also system of remuneration etc. – the preferred solution is that this conflict is at the highest possible level. One example of this shifting would be to the level of AMSB when the actuarial function holder is combined with the chief actuary, the risk management function holder combined with the CFO or compliance function holder combined with the head of the legal department. The ultimate responsibility for first and second and possibly also for the third line stays on the AMSB level. The most complex insurers are required to remove all potential conflicts of interest.

The combination of actuarial function holder and operational actuary (pricing, reserving) is not accepted for a long-term period in the Czech Republic.

### **MOST FREQUENT (AND PROBLEMATIC) COMBINATIONS (SEE TABLE 10)**

#### **Actuarial function holder and technical provisions calculation/pricing**

This kind of combination has been observed by 10 NCAs. The actuarial function holder is usually historically interconnected with the actuarial department responsible for either technical provisions calculation or pricing or both. As the actuarial function holder should provide an

independent view on the methodology and the results of the calculation of technical provisions as well as the pricing of products, there is a high probability of conflicts of interest.

#### **Risk management function holder and financial department director/employee**

This kind of combination was identified by 8 NCAs. As the risk management function holder should bring an independent view on operational activities <sup>(31)</sup> including finance, investment etc. there is a high probability of conflict of interest.

#### **Compliance function holder and legal department director/employee**

The compliance function holder is usually historically interconnected with legal. Such combinations have been observed by 15 NCAs. As the compliance function holder should bring an independent view on operational activities <sup>(32)</sup> including legal department activities etc. there is a high probability of conflicts of interest.

#### **Actuarial function holder and appointed actuary**

The institute of responsible/appointed actuary is included (mostly for historical reasons) only in 10 EEA jurisdictions. NCAs in 19 countries (Belgium, Cyprus, Czech Republic, Estonia, France, Greece, Italy, Ireland, Lithuania, Luxembourg, Latvia, the Netherlands, Norway, Poland, Romania, Slovakia, Spain, Sweden, the United Kingdom) stated that there is no responsible/appointed actuary required by their national legislation. NCAs in 10 countries (Austria, Bulgaria, Croatia, Germany, Denmark, Finland, Liechtenstein, Malta, Portugal, Slovenia) stated that they recognise the role of responsible/appointed actuary.

In the case of combinations of the responsible appointed actuary with the actuarial function holder, 5 NCAs (Austria, Croatia, Germany, Liechtenstein, Slovenia) carried out a supervisory assessment to ensure operational independence and mitigation of potential conflicts of interest. However, in Bulgaria, Denmark and Finland, NCAs do not see the need to assess this combination because it is either not forbidden or restricted or it is explicitly allowed.

<sup>(31)</sup> According to the model the key function is the second line of defence controlling the first line of defence which is the operational function.

<sup>(32)</sup> According to the model the key function holder is the second line of defence controlling the first line of defence which is the operational function.

## **2.6.4. CONCLUDING REMARKS**

In half of the EEA countries, combinations of key function holders and operational tasks occur rarely or occasionally, however, there are several NCAs that observe this combination often or very often. Several NCAs do not have a full awareness of cases of combinations that have been implemented before 2016. A complete overview of combinations with operational tasks does not seem to be possible for NCAs as this assessment can be mainly achieved through on-site inspections.

Most often combinations of compliance function and legal function, the actuarial function with the calculation of technical provisions and the risk management function with finance responsibilities have been observed.

When reviewing combinations of key function holders with operational tasks it is expected that NCAs assess which mitigating measures are implemented by the insurer in order to reduce the potential conflicts of interest which gives rise to operational risk. When a conflict of interest is identified, an effective measure is that the insurer is required to remove this conflict or mitigate this conflict by shifting it to the highest possible level, <sup>(33)</sup> preferably to the AMSB level. It is therefore advised/recommended that NCAs put more focus on combinations of key function holders with operational tasks and try to obtain an overview whether and how such combinations occur using a risk-based approach.

For larger and more risky insurers combinations with operational tasks should be generally challenged by NCAs and only accepted for exceptional cases on a temporary basis.

Potential conflicts of interest can only be assessed using a case-by-case approach as responsibilities and powers vary widely depending on each individual insurer's organisational structure.

The institute of responsible/appointed actuary is included in 10 EEA jurisdictions. Generally those NCAs accept the combination of the responsible/appointed actuary and the actuarial function holder.

<sup>(33)</sup> According to the model of three lines of defence whereas the higher level controls the lower level.

## 2.7. SPLITTING KEY FUNCTIONS

### 2.7.1. GENERAL REMARKS

This section relates to those cases where insurers have two or more holders of one key function. That means that the responsibility for one key function is allocated (split) to more than one person. In these cases it is important to have an overall view of the risks and responsibilities of the key function as a whole and how this is managed within the organisation. <sup>(34)</sup>

NCA's indicated whether they had identified such cases in their jurisdiction and described how they assess such cases taking into account the nature, scale and complexity of the insurer's business.

### 2.7.2. OVERVIEW OF THE MARKET

NCA's from 17 countries (Austria, Belgium, Bulgaria, Croatia, Czech Republic, Estonia, Italy, Latvia, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, the United Kingdom) reported cases of where one key function has been split among several holders.

For the 14 NCA's (Cyprus, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Liechtenstein, Lithuania, Norway, Spain, Sweden) which did not report cases of a split, the explanation given - when known - was that such cases were forbidden by national legislation (in the case of France, Hungary, Lithuania and Spain) or by national non-legally binding measures (Germany, Sweden) but also for other reasons.

NCA's from 11 countries (Austria, Belgium, Croatia, Czech Republic, Latvia, Malta, the Netherlands, Romania, Slovakia, Slovenia, the United Kingdom) which have observed cases of a split take into account the principle of proportionality when assessing these cases. However, a split of key functions occurs in large insurers but also in smaller ones and is therefore not solely related to proportionality.

### 2.7.3. SPECIFIC TOPICS

The most common case of a split of key functions reported is the split of the actuarial function holder into life and non-life business. This case is commonly accepted by NCA's provided that the nature of the business of the concerned insurer justifies such a split and that there is no gap in responsibility and accountability between the two key function holders.

Cases of a split of the risk management and compliance function holder into two holders have also been observed but occur far less frequently. As an example, several cases reported by the Netherlands concerned a split of the risk management function holder into a financial risk management function holder and a non-financial risk management function holder in large and complex insurers. In small and medium-sized insurers, the same split has also been occasionally observed but this split is also associated with a combination of financial risk management function holder with the actuarial function holder and the non-financial risk management function holder with the compliance function holder.

Some isolated cases were also reported where a key function was held by more than two holders.

#### INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD

Based on the findings of the peer review, no specific recommended actions have been provided to NCA's.

<sup>(34)</sup> Article 268 of the Commission Delegated Regulation (EU) 2015/35.

#### 2.7.4. CONCLUDING REMARKS

In 17 NCAs a split of one key function among several holders is observed. The most common case is a split of the actuarial function between life and non-life business.

A split of one key function amongst several persons or a person and a committee puts additional focus on the proper implementation of clear allocation and appropriate segregation of responsibilities. <sup>(35)</sup>

NCAs should be restrictive in their approach. Generally a split amongst more than two persons for one key function or a split between one person and a committee should not be accepted. In the first case all key function holders for this one key function have to be qualified and notified to the NCA. In addition, the split of one key function among different key function holders should be logically and correctly justified because of the unique characteristics of the tasks (for example actuarial function) and/or the organisational structure of the insurer (for example clear segregation of life and non-life business). NCAs should closely monitor such split of key functions in order to maintain appropriate responsibility and accountability among key functions holders.

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<sup>(35)</sup> Article 41(1) of the SII Directive.

## 2.8. SUBORDINATION

### 2.8.1. GENERAL REMARKS

This section covers cases where one key function holder is subordinated to the other key function holder or to an operational function holder.

Under the SII framework different ways of organisation of the key functions are possible. However, the structure should be such that it ensures the existence of appropriate controls and mechanisms to deal with conflicts of interest. The operational independence of key functions should be maintained. <sup>(36)</sup> Especially for internal audit function the specific requirements with respect to objectivity and independence <sup>(37)</sup> have to be fulfilled.

NCA's were asked to provide details of actual cases, highlighting:

- types of subordination observed;
- national legislation and/or national non-legally binding measures in relation to subordination of key function holders; and
- the link of subordination to the application of the principle of proportionality.

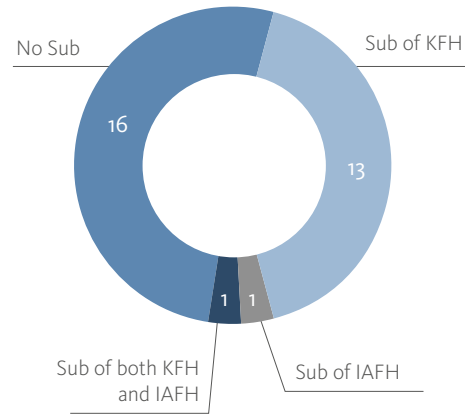
### 2.8.2. OVERVIEW OF THE MARKET

Subordination was identified by 15 NCAs (Austria, Belgium, Denmark, France, Greece, Ireland, Latvia, Liechtenstein, Luxembourg, the Netherlands, Norway, Poland, Portugal, Slovakia, the United Kingdom) as shown in graph 9.

<sup>(36)</sup> Article 268 of the Commission Delegated Regulation (EU) 2015/35.

<sup>(37)</sup> Article 271 of the Commission Delegated Regulation (EU) 2015/35.

Graph 9 – Number of NCAs that reported cases of subordination of key functions



However, in 16 countries there were no reported cases of subordination due to the reasons as shown in table 11:

NCAs in 12 countries (Austria, Belgium, France, Ireland, Latvia, Luxembourg, the Netherlands, Norway, Poland, Portugal, Slovakia, the United Kingdom) reported cases of subordination between the key function holders. The most common subordination is of the actuarial function holder to the risk management function holder, followed by the compliance function holder to the risk management function holder.

NCAs in 10 countries (Belgium, Denmark, France, Greece, Ireland, Liechtenstein, Luxembourg, the Netherlands, Norway, Slovakia) reported cases of subordination of a key function holder to an operational function holder. The most common cases are the subordination of the compliance function holder to the head of the legal department and of the actuarial or risk management function holder to the CFO or financial controller.

Table 11 – Reasons of no subordination amongst key function holder per NCA

Reasons for No subordination	Country
No, due to national legislation	HU, IT*
No, due to national non-legally binding measures	AT, DE
No, due to other reasons	BG, ES, LT, RO, SE, SI, UK
No, due to unknown reasons	CZ, EE**, EL, HR, MT

\*IT: the key function holder can be subordinated to operational function holders (but not to key function holders)

\*\*EE: But one case regarding IAFH reported (see below)

In Belgium and Estonia, NCAs reported cases of subordination of the internal audit function holder. Belgium reported subordination to another key function holder, which occurred occasionally. The reported subordination of internal audit function holder by Estonia was to a third party service provider with only an indirect reporting line from the internal audit function holder to the AMSB.

The most common supervisory approaches adopted by NCAs to assess subordination are plausibility checks of the submitted documents conducted immediately after the notification (occurring in 10 NCAs – Belgium, Denmark, Estonia, France, Greece, Ireland Liechtenstein, Poland, Slovakia, the United Kingdom) and ad-hoc requests for information (also occurring in 10 NCAs – Belgium, Denmark, Estonia, France, Ireland, Latvia, Liechtenstein, Poland, Slovakia, the United Kingdom).

#### INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD

Based on the findings of the peer review, recommended actions that focus on the improvement of the supervision of the subordination of key function holders, to guarantee the independence of the key function holders including a direct reporting line to the AMSB, have been issued for 5 NCAs: *Belgium, Estonia, Greece, Norway and Slovakia.*

### 2.8.3. SPECIFIC TOPICS

#### SPECIFIC CRITERIA USED ACCORDING TO PROPORTIONALITY

Most of the NCAs where subordination occurs, do not apply specific criteria for the principle of proportionality.

In France, Ireland and Slovakia, NCAs use specific criteria for assessing cases of subordination:

- in France the available human resources within the insurer's organisational structure is evaluated on a case-by-case basis, with special attention given to the written policies regarding conflicts of interest. France also requires that both key function holders have direct access to the person who runs the insurer;
- however, in general the NCA prefers the insurers to combine functions instead of subordinating them;
- in Ireland subordination is not allowed in cases of ultra-high and high impact insurers.

#### MEASURES FOR OPERATIONAL INDEPENDENCE: REMUNERATION AND CONFLICTS OF INTEREST

Most NCAs emphasise the requirement that the insurers have written procedures in place for avoiding conflicts of interest.

The answers provided by NCAs reveal the importance of clear organisational structures and the existence of a direct reporting line between the key function holder and the AMSB. NCAs from 10 countries (Belgium, Denmark, France, Greece, Ireland, Latvia, Liechtenstein, Luxembourg, Poland, Slovakia) that identified subordination during the reference period observed direct reporting lines from the subordinated key function holders to the AMSB.

The subordination of the internal audit function to an operational function holder is usually not accepted, as it is considered to cause or to be likely to result in a conflict of interest.

All in all, it is preferable that there is no subordination of key function holders. However, in case of subordination it is a good practice when an NCA assesses the independence of key function holders in case of subordination by reviewing especially remuneration policies and the effectiveness of direct reporting lines to the AMSB.

This practice is taken from supervisory practices identified in Finland. In order to address the independence<sup>(38)</sup>, reviews of internal policies such as the remuneration policies are conducted and discussions with the key function holders are held using a risk-based approach. In addition, the effectiveness of the direct reporting line to the AMSB is assessed by reviewing AMSB minutes.

#### 2.8.4. CONCLUDING REMARKS

NCAs from 15 countries reported that they have observed cases of subordination. There are cases of subordination of key function holder under another key function holder and also under an operational function holder. As the requirements with regards to independence of key function holders have to be implemented, cases of organisational subordination could raise less supervisory doubts than cases of functional subordination.

In case of organisational subordination (where the key function holder works in an organisational unit of another key function holder or holder of an operational function) proportionality aspects should be used to assess if it is justified by the insurer to implement a simplified governance structure. To ensure the independence of the key function holder mitigating measures such as clear documentation of the direct reporting line to the AMSB are expected to be implemented and documented in the insurer's written policies. Another example of how to mitigate potential conflicts of interest is the responsibility for remuneration which for the subordinated key function holder should lie at AMSB level. Functional subordination has to be challenged and NCAs are advised not to accept a subordination which would be in a conflict with the requirement of operational independence, e.g. where no direct, unfiltered reporting line to the AMSB exists or where the subordinated key function holder has to act according to instructions of another key function holder (or holder of an operational function).

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<sup>(38)</sup> Article 268 Commission Delegated Regulation (EU) 2015/35.

## 2.9. FITNESS OF KEY FUNCTION HOLDERS

### 2.9.1. GENERAL REMARKS

The fitness of key function holders was not the main focus of this peer review and therefore the self-assessment questionnaire only had two questions on this topic. This section aims to understand how the NCAs consider the principle of proportionality when assessing the fitness of key function holders and the designated person for an outsourced key function. This section also provides information on whether NCAs perform an ongoing assessment of a key function holder's fitness and how this assessment is integrated into their supervisory approach.

### 2.9.2. OVERVIEW OF THE MARKET

#### ASSESSMENT OF THE KEY FUNCTION HOLDER

In the reference period, 26 NCAs applied the principle of proportionality when assessing the fitness of key function holders at the time of initial notification. In Bulgaria, Finland and Greece, NCAs do not apply the proportionality principle in assessing fitness requirements for key function holders. In Portugal and Spain, the regulation was under review.

In the cases where the proportionality is applied, the fitness requirements are usually less demanding (e.g. in terms of years of past experience, degree, title etc.). Examples are:

In Luxembourg:

According to the nature, scale and complexity of the insurers' business, fitness requirements of the actuarial differ as follows:

- Standard degree: A graduate in actuarial sciences with at least three years of professional experience in actuarial techniques and a profound knowledge of the insurer can be appointed;
- First degree: A graduate in statistics or mathematics can be appointed; and
- Second degree: A graduate in finance, economics or engineering can be appointed.

Additional training of the appointees and their active participation in the elaboration of the insurers' policies are also taken into account.

In Belgium:

- For less significant insurers it will ensure that the proposed key function holder has a relevant professional experience of at least 3 years; and
- For significant insurers it will require a relevant professional experience of at least 5 years.

#### BEST PRACTICE



*EIOPA considers it a best practice when NCAs apply a risk-based approach for the ongoing supervision that gives the possibility to ensure the fulfilment of fitness requirements of key function holders at all times by holding meetings with key function holders on a regular scheduled basis as part of the NCA's work plan (annual review plan). The topics for discussion for those meetings can vary, depending for example on actual events and current topics.*

This best practice is taken from the supervisory practice in Ireland and the United Kingdom. The NCAs engage in regular discussions with the key function holder as part of the ongoing assessment of their fitness. The impact categorisation of an insurer determines the minimum frequency of meetings between the NCAs and the key function holders: the higher the impact category of the insurer, the higher the intensity and frequency of the ongoing assessment and supervision of the fitness requirements in general.



## ONGOING ASSESSMENT

Assessing the fitness of key function holder on an ongoing basis <sup>(39)</sup> has been carried out by 18 NCAs. The most common triggers for the ongoing assessment are:

- any changes to the information provided at the time of the initial notification (appointment);
- the awareness of certain risks or gaps regarding the a key function holder's level of competency;
- indication of customer complaints;
- changes in the business strategy or organisational changes (new products, new lines of business, change in distribution channels, management structure);
- changes in the risk profile, market share, lines of business and any information that is included in the own risk and solvency assessment report.

The ongoing assessment of the fitness requirements is either performed by the NCAs due to a specific trigger (see examples above) or it is part of the regular supervisory review performed by some NCAs (e.g. based on the outcome of the risk assessment framework, on/off-site review). A regular and/or ad-hoc ongoing assessment specific for key functions was not put in place by the vast majority of NCAs given that the reference period was shortly after SII came into effect.

## ASSESSMENT OF THE PERSONS RESPONSIBLE FOR OUTSOURCED KEY FUNCTIONS

In case of outsourcing of the key functions, 20 NCAs (Austria, Belgium, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Germany, Italy, Ireland, Liechtenstein, Malta, the Netherlands, Norway, Poland, Romania, Slovenia, Spain, Sweden, the United Kingdom) applied the principle of proportionality when assessing the fitness of the persons responsible for outsourced key functions.

Two different approaches have been identified: for the majority of NCAs, the designated person has to possess the similar fitness requirements as the key function holder in order to challenge the person performing the outsourced key function. In certain NCAs (Belgium, Sweden) the fitness requirements for the designated persons can be lighter or less demanding than for situations where the key function is not outsourced.

<sup>(39)</sup> Article 42(1) of the SII Directive.

## INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD

Based on the findings of the peer review recommended actions that focus on the improvement of the supervision of the fitness of key function holders are issued for 3 NCAs:

The NCA should carry out fitness assessments also for key function holders other than actuarial function holders.

The recommended action applies to: *Luxembourg*

The NCA should also assess the fitness of key function holders after having received the notification of the key function holder's appointment whereby a risk-based approach can be used.

The recommended action applies to: *the Netherlands*

The NCA should complete fit (and propriety) assessments for all key function holders.

The recommended action applies to: *Portugal*

## 2.9.3. SPECIFIC TOPICS

### SUPERVISORY APPROACH FOR FITNESS ASSESSMENT

In Italy, Lithuania and the Netherlands, NCAs rely on insurers to carry out fitness assessments. In Malta and the Netherlands, the NCAs provided insurers with guidance in relation to how to conduct fitness assessment for key function holders. In Italy, insurers are required to take into account the risk profile and the organisational structure of the insurer when assessing fitness requirements. In Malta, when the key function is going to be outsourced, the Malta Financial Services Authority only relies on the insurer to carry out fitness assessment in relation to the service provider carrying out the (outsourced) functions. In Luxembourg fitness assessments were conducted only on actuarial function holders. In the future this will be extended to cover all key function holders.

### **KEY FUNCTION HOLDERS APPOINTED BEFORE 2016**

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NCA in 5 countries (Austria, Greece, Malta, Portugal, Romania) performed (systematic) fitness assessments according to SII only for key function holders that were appointed after 1 January 2016.

### **LACK OF EXPERTS LEADING TO APPLICATION OF PRINCIPLE OF PROPORTIONALITY**

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In one case (Slovakia) the lack of experts in the market with adequate actuarial skills makes it difficult for the insurers to find the proper holders for the function and, consequently, for the NCA to have adequate criteria on how to apply the principle of proportionality.

## **2.9.4. CONCLUDING REMARKS**

NCA in 26 countries apply the principle of proportionality for assessing the fitness of key function holder at the time of initial notification. Fitness requirements are less demanding for smaller and less significant insurers.

NCA that do not perform fitness assessment as well as NCA that have not assessed fitness of key function holders nominated before 2016 are recommended to do so using a risk-based approach.

The vast majority of NCA have an ad-hoc approach, meaning re-assessments are performed only when there is a trigger that initiates re-assessment of fitness. A regular and/or ad-hoc ongoing assessment specifically for key functions was not put in place by the vast majority of NCA given that the reference period for this peer review was shortly after SII came into effect.

Finally, where one person holds two key functions, the person must be fully qualified for both functions. This approach is applied by all NCA.

## 2.10. OUTSOURCING

### 2.10.1. GENERAL REMARKS

This section focuses on whether and how NCAs consider the principle of proportionality when assessing the outsourcing of a key function. The focus is on the designated person responsible for the outsourced key function. <sup>(40)</sup> The report also covers intra-group and extra-group outsourcing and how NCAs supervise these outsourcing arrangements. <sup>(41)</sup>

There are cases where an AMSB member is designated as the person responsible for the outsourced key function. The fitness and the workload of the responsible person can be of specific relevance for the supervisory assessment of the outsourced key function. The level of knowledge and possible conflicts with other tasks may arise especially for AMSB members who are designated to oversee outsourced key functions.

There are other cases where several key functions, for example from different insurers, are outsourced to one single service provider. These cases might require a supervisory assessment whether the workload for the service provider is manageable.

### 2.10.2. OVERVIEW OF THE MARKET

Table 12 provides an overview of the outsourcing requirements by NCAs regarding the designated persons in the outsourcing insurer.

<sup>(40)</sup> According to Recital 37 and Article 49 of SII Directive 2009/138/EC and Article 274 of the Commission Delegated Regulation (EU) 2015/35; and EIOPA Guidelines on system of governance: Guideline 14 - Outsourcing of key functions.

<sup>(41)</sup> See EIOPA Guidelines on system of governance: Guideline 14 - Outsourcing of key functions, Guideline 62 - Intra-group outsourcing and Guideline 64 - Written notification to the supervisory authority.

### DESIGNATED PERSON RESPONSIBLE FOR THE OUTSOURCED KEY FUNCTION

As presented in table 12, 26 NCAs require a designated person to be responsible for the outsourced key function. NCAs in 5 countries do not require such a designated person. In particular, for 3 NCAs (Hungary, Latvia, Slovakia) no cases of outsourcing occurred during the reference period. One NCA (Iceland) is in the process of requesting a designated person for outsourced functions.

### DISTINCTION BETWEEN INTRA-/EXTRA-GROUP OUTSOURCING

When requiring a designated person, 19 NCAs (Belgium, Croatia, Cyprus, Czech Republic, Denmark, Estonia, France, Greece, Ireland, Latvia, Liechtenstein, Luxembourg, Malta, Norway, Poland, Portugal, Slovenia, Spain, Sweden) do not distinguish between intra-group outsourcing and outsourcing to a third party service provider (extra-group outsourcing).

Out of these 19 NCAs, those from Cyprus, Greece, Liechtenstein and Lithuania explicitly stated that they do not apply the principle of proportionality. NCAs from Belgium, Croatia and Poland assess the designated person for an outsourced key function in a similar manner as to the situation that the key function is carried out inside the insurer.

In one case (Belgium), there are different authorisation conditions for outsourcing depending on the risk profile of the insurer. Belgium does not allow full outsourcing of the internal audit function to a third party for significant insurers. Belgium considers on the other hand that in small and medium size insurers the use of external outsourcing could be valuable because it could give the insurer access to special experts' knowledge which they do not have in-house. In addition, the fitness requirements for the 'designated person' are lighter for small and medium-sized insurers in Belgium.

Table 12 – Overview of outsourcing requirements regarding designated persons by NCAs

26 NCAs request a designated person		5 NCAs do not request a designated person
No distinction between intra and extra-group	Distinction between intra and extra-group	
BE, CY, CZ, DK, EE, EL, ES, FR*, HR, IE, LI, LT, LU, MT, NO, PL, PT, SE, SI	AT, DE, FI, IT, NL, RO, UK	BG, HU, IS, LV, SK

\* Not in every case (see below).

France also considers outsourcing to be a mitigating factor for reducing operational risks for insurers that lack internal expertise.

NCA in 7 countries make a distinction between intra/extra-group outsourcing. In 2 of these countries (the Netherlands, Romania) NCAs consider that the operational risks in case of extra-group outsourcing are higher and therefore require closer supervisory scrutiny. Outsourcing within groups is considered to be less complicated by the Netherlands and Romania since the level of control and reporting lines are guaranteed within the group. Another NCA (Finland) does not require the appointment of designated persons for outsourced functions in small insurers that belong to an insurance group. Another NCA (Germany) takes a specific approach in dealing with conflict of interest: AMSB members holding the post of 'outsourcing representatives' (the designated person) are especially assessed during the supervisory review of governance arrangements.

France accepts the key function holder of the solo entity of a group to be designated among other entities of the group (in most cases the key function holder at the group level), provided that the key function holder is subordinated to the person 'effectively running' the solo entity.

#### **COMBINATION OF AMSB MEMBER AND DESIGNATED PERSON FOR AN OUTSOURCED KEY FUNCTION**

Cases where an AMSB member holds the position of the designated person for an outsourced key function have been reported by 21 NCAs (Austria, Belgium, Bulgaria, Cyprus, Denmark, Finland, France, Germany, Liechtenstein, Lithuania, Luxembourg, Italy, Ireland, Malta, the Netherlands, Poland, Portugal, Romania, Spain, Sweden, the United Kingdom), occurring very often in 5 of these countries (Belgium, Cyprus, Italy, Ireland, Sweden).

The key principles of the supervisory approach of these 21 NCAs are:

- the AMSB member possesses sufficient knowledge and experience ('fit') to be able to challenge the performance and the outcome of the services provided (Germany, Liechtenstein, Lithuania, the Netherlands, Portugal); in addition the AMSB member has sufficient time to carry out all duties properly (Belgium, Germany); and

- there must be a separation of functions, with an appropriate and transparent allocation of oversight and management responsibilities to prevent conflicts of interest (Ireland, the United Kingdom).

Applying the principle of proportionality, combinations of AMSB members as designated persons are usually allowed in small insurers and non-complex business. In Luxembourg for example, in case of captives that generally do not have any employees, the authority allows a non-executive AMSB member to have the responsibility for the outsourced day-to-day operations of key functions. In Poland, in 75% of the cases regarding combinations of AMSB members as designated person concern small insurers offering only non-complex products. In Belgium, in less significant insurers, outsourcing of one or several key functions to third parties is very common (in more than 50% of the concerned insurers). In these cases a 'designated person' for these outsourced key functions is very often also a member of the AMSB. In France, this kind of combination mainly occurs in small health mutual insurers.

Other criteria for the supervisory assessment for outsourced functions are:

- complexity of an insurer's organisational structure (Lithuania) and its economic feasibility (Italy) in terms of costs saving;
- absence of cross-border activities (Lithuania);
- thresholds in terms of premiums and technical provisions based on the types of risks insured by the insurer (France);
- lines of business (Austria, Romania);
- timeframe of the governance arrangement (long-term or provisional) (Finland); and
- the type of key function that is outsourced (Finland).

#### **CONSIDERATIONS OF THE WORKLOAD FOR OUTSOURCED KEY FUNCTIONS:**

##### **Workload of the designated person**

14 NCAs (Austria, Belgium, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Italy, Ireland, Liechtenstein, Malta, the Netherlands, the United Kingdom) consider the workload of the designated person when

assessing the appropriateness of outsourcing a key function. Liechtenstein requires insurers to provide information regarding outsourcing and the designated person on the basis of a checklist. In Ireland, the NCA asks insurers to explain the rationale for choosing this outsourcing arrangement and for information on the suitability and fitness of the designated person. Another element considered in this assessment is the time commitment of the designated person taking into account the nature, scale and complexity of the insurer’s business.

**Workload of the service provider executing the key function**

NCA’s that consider the workload of the service provider are shown in table 13.

During the reference period 16 NCA’s (Belgium, Croatia, Estonia, Finland, France, Greece, Hungary, Lithuania, Luxembourg, Norway, Poland, Portugal, Romania, Slovenia, Spain, the United Kingdom) did not exercise any form of supervision on the third party service provider to which a key function was outsourced.

Table 13 – Supervision of workload of outsourced service provider

	Yes	No
(Intra-Group outsourcing): Several insurers within the same group outsource to a single entity within the group	AT, BE, CZ, DK, EL, FI, FR, IE, IT, MT, NL, UK	BG, CY, DE, EE, HU, LU, NO, PL, PT, RO, SI
(Extra-Group outsourcing): Several insurers within the same group outsource to the same third party service provider	BE, DK, IT, LI, UK	BG, CZ, DE, EE, EL, ES, FI, FR, HU, IE, LU, LT, MT, NL, NO, PL, PT, RO, SI,
Several solo insurers outsource to the same third party service provider	CZ, DK, EL, IE, IT, LI, MT, NL, PL, UK	AT, BE, BG, CY, DE, EE, ES, FI, FR, HU, LU, LT, NO, PT, RO, SI

**INDIVIDUAL RECOMMENDED ACTIONS IDENTIFIED DURING THE REFERENCE PERIOD**

Based on the findings of the peer review, recommended actions that focus on the improvement of the supervision of the outsourcing of key function holders have been issued for 3 NCA’s:

NCA’s should apply Guideline 14 of EIOPA’s Guidelines on system of governance (as well as Article 49 SII Directive and Article 274 of the Commission Delegated Regulation EU (2015/35)) in a proportionate manner.

The recommended action applies to: *Bulgaria, Slovenia*

NCA should improve its knowledge of the market and assess and challenge insurers regarding their outsourcing practices.

The recommended action applies to: *Finland*

### 2.10.3. SPECIFIC TOPICS

EIOPA Guideline 14 on system of governance states:

*1.46. The undertaking should apply the fit and proper procedures in assessing persons employed by the service provider to perform an outsourced key function.*

*1.47. The undertaking should designate 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. This designated person should be considered as the person responsible for the key function according to Article 42(2) of the SII Directive that needs to be notified to the supervisory authority.*

During the reference period of this peer review, the following situations have been identified:

#### **PRACTICE NOT IN LINE WITH EIOPA GUIDELINES**

Designated person is not required in outsourcing insurer which is part of a group

This specific situation has been identified in 6 NCAs (Bulgaria, Finland, France, Germany, Latvia, Slovenia): where a key function has been outsourced within the group and these NCAs have allowed that the designated person responsible for the outsourced function (the ‘outsourcing manager’) is not necessarily an employee of the outsourcing insurer, but instead an employee of another entity within the group or of the parent insurer.

These cases do not seem to be perfectly aligned with the provisions of EIOPA’s Guideline 14 on the system of

governance, in particular with the following provision ‘The undertaking should designate a person within the undertaking...’ and therefore this could be seen as a case of non-compliance.

These cases could result from the application of the principle of proportionality. However, supervisors should be aware that not having a designated person within the outsourcing insurer may give rise to operational risk. For example, due to a lack of autonomy/independence the outsourcing entity cannot challenge the fulfilment of the key function via an internal designated person.

In order to address these cases and risks involved, NCAs are recommended to:

- verify whether an outsourced key function holder who reports to the AMSB also holds regular discussions with the AMSB. NCAs should also review if the AMSB has taken a decision that is different from the proposed decision by the outsourced key function holder;
- verify whether a policy regarding conflicts of interest is in place and implemented at the entity that is performing the outsourced key functions; and
- assess the workload and resources available to the key function holder performing the outsourced key function.

One NCA (France) stated that it does not comply with EIOPA’s Guidelines on system of governance as it does not require all insurers of a group to nominate a designated person within their insurer. <sup>(42)</sup>

<sup>(42)</sup> The concerned national regulation allows insurers to have a designated person within the group and not necessarily within the outsourcing entity.

Table 14 - Compliance related to EIOPA Guideline 14 – system of governance

Comply	Intend to comply	Do not comply
AT, CY, ES, FI, HR, IE, LI, LT, LU, LV, MT, NL, PL, RO, SK, UK	BE, BG, CZ, DK, EE, EL, HU, IS, IT, NO, PT, SI, SE	DE, FR

(Source: EIOPA website, Compliance tables filled-in by the NCAs within the comply-or-explain procedure for Guidelines on system of governance)

#### 2.10.4. CONCLUDING REMARKS

NCAs in 7 countries make a distinction between intra/extra-group outsourcing in their supervisory approach.

NCAs in 26 countries require insurers to nominate a designated person when a key function is outsourced. Most NCAs use proportionality criteria for assessing the requirements for the designated person. In 21 countries the designated person for the outsourced key function was also a member of the AMSB.

NCAs that do not require a designated person should be aware that not having such a person within the outsourcing insurer may give rise to operational risks. For example, due to a lack of autonomy/independence the outsourcing entity may not be able to challenge the fulfilment of the key function via an internal designated person. Moreover, NCAs should ensure that the reporting line between the key function holder performing the outsourced key function and the AMSB of the outsourcing insurer is appropriate and that the ultimate responsibility for the outsourced key function remains with the AMSB of the outsourcing insurer.

### 3. IMPACT ON COMMON SUPERVISORY CULTURE AND SUPERVISORY APPROACH

NCA's and EIOPA want to promote a common supervisory culture. The European supervisory culture can be defined as a common understanding of the way supervisors think, behave and work within their community. In an ongoing dialogue and exchange of experiences supervisors can learn from each other, enhance supervision and improve policyholder protection. This peer review has a large impact on a common supervisory culture; some areas of development shall be mentioned:

#### **BETTER OVERVIEW OF MARKET AND SUPERVISORY PRACTICES**

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This peer review leads to a comprehensive overview of the insurance market and of supervisory practices conducted by all NCA's in the EEA regarding many issues of key functions, especially key function holders, the combination of functions and their position within the governance structure (see the sections of comparative analyses). It also pushes NCA's to gaining a deeper overview of their markets. Some NCA's have launched specific surveys in their national markets as a result of the peer review. So NCA's could classify their own supervisory approaches in comparison to the approach of the peer NCA's. Such an overview of supervisory practices is the basis for a coherent and high quality supervision within the EEA.

#### **IMPROVEMENT OF PRACTICES**

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Several NCA's gave evidence in their response letter to EIOPA in reply to the recommended actions that they have already improved their supervisory practices in accordance with the feedback. This proves that carrying out this peer review had an impact per se. And, as all the recommended actions are based on a common European understanding, these improvements in national supervisory practices lead at the same time also to improvements in the common supervisory culture.

#### **MORE CONSISTENT APPROACHES**

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The improvements already put in place also lead to more consistent supervisory approaches within the EEA. The recommended actions issued as well as the best practices identified give guidance for future supervision. As a consequence the NCA's' approaches regarding the application of the principle of proportionality become more consistent.

#### **AWARENESS RAISED**

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For many NCA's the peer review also raised the awareness regarding specific issues. Because the NCA's had to fill out the self-assessment questionnaire and also through the additional telephone interviews and country visits the awareness increased with regard to the supervision and application of the principle of proportionality. Thus the review stirred up the internal discussion process in the NCA's. For example, in case of combinations of holding key functions more emphasis is laid on mitigation measures regarding conflicts of interest. Seeing practices and sharing experiences of other NCA's lead to a better awareness for supervisory key issues.

#### **BEST PRACTICES AS INSPIRATION FOR SUPERVISORY DEVELOPMENT**

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During a peer review the focus is not only focus on weaknesses but also on strengths of supervisory approaches by identifying best practices.

Best practices are an inspiration for the other NCA's showing that improving supervisory culture is an ongoing process, and also by learning from each other.

#### **FURTHER IMPROVEMENTS BY NCA'S ALREADY ON THEIR WAY**

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Further improvements by NCA's' approaches have already been monitored in several countries. However, these improvements cannot be taken into account as they were implemented after the reference period and would require an additional assessment. The improvements will be taken up in the follow-up activities of the peer review.



## 4. ACTIONS TO BE UNDERTAKEN BY EIOPA

### **RESULTS OF THIS PEER REVIEW TO BE REFLECTED IN A REVISION OF EIOPA GUIDELINE 14 ON THE SYSTEM OF GOVERNANCE (OUTSOURCING)**

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According to EIOPA Guideline 14 on system of governance NCAs should ensure that the insurer designates a person within the insurer (that means: employed by this concerned solo insurer) 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 outsourced service. This designated person should be considered as the person responsible for the key function according to Article 42(2) SII Directive that needs to be notified to the supervisory authority.

The peer review has shown that 8 NCAs make a distinction between intra- and extra-group outsourcing. NCAs in 6 countries did not nominate a designated person within the outsourcing insurer (employment contract) but within another insurer of the same group.

EIOPA will consider the outcome of this peer review in a revision of the Guidelines on system of governance and especially in relation to Guideline 14 regarding outsourcing (especially the last sentence of 1.47). The aim would be to reflect the different situations of insurance groups as outlined by this peer review. The principle of proportionality could be taken into account during the revision. At the same time it should be considered that the absence of a designated person within the outsourcing entity may give rise to operational risks. Operational risks may also arise for groups, as conflicts of interest could arise if the designated person is not employed by the outsourcing solo entity but by another entity of the group. Therefore, mitigating measures could be required for the management of this operational risk. Advisable could be: a strong focus on the implementation of a direct reporting line of the outsourced key function holder to the AMSB of the outsourcing entity, a detailed analysis of conflicts of interest in the entity performing the outsourced key function

and measures to be applied in order to manage the identified conflicts as well as an assessment of the workload for the outsourced key function.

### **RESULTS OF THIS PEER REVIEW TO BE REFLECTED IN EIOPA'S WORK ON THE SUPERVISORY REVIEW PROCESS (SRP)**

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The practical findings, best practices, recommended actions and observations will be taken into account when updating EIOPA's SRP work. For example the supervisory approaches and practical implementation of the principle of proportionality in connection with the assessment of key functions and key function holders and related governance-requirements could be reflected in the SRP-Handbook.

It should be stressed, that the criteria for the application of the principle of proportionality should reflect a common European approach leading to real convergence. As SII is (in this regard) a maximum harmonization, NCAs should not only refer to their national markets and their own view regarding proportionality, but also include a European perspective regarding size, nature and complexity of insurers. This is required to ensure a level-playing field within the common European market.



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