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**CEIOPS Issues Paper on Implementing Measures on System of Governance – CEIOPS-IGSSR-24/08**

AMICE, the association of Mutual Insurers and Insurance Cooperatives in Europe, welcomes the opportunity to provide CEIOPS with comments on the Issues Paper on Supervisory Review Process and Undertakings' Reporting Requirements published in November 2008.

We noted the shorter consultation period than usual (two instead three months, which were in addition shortened by the holiday season). This limited the amount of comments provided by our members and therefore the answers we provide today should be seen as preliminary and should be read in the context of our responses to the previous Pillar-II-related papers (on ORSA and on the SRP and Reporting Requirements).

As a general remark, we believe that CEIOPS' paper constitutes an excellent piece of work and we welcome that the standards for the system of governance are based on best practice considerations.

Our main concerns related to your paper are as follows:

- The development of an appropriate system of governance as stated in the Framework Directive that comprises the developing of four separate functions, namely an actuarial function, a compliance function, an internal audit function and a risk management function, may be amongst the most costly requirements for insurance undertakings included in the Solvency II framework. Our members believe that implementing Pillar II requirements and embedding them into their existing organisational structure would be very costly. For that reason, we deem it necessary to grant insurance undertakings an appropriate timeframe for a smooth transition into the new structure and into an enhanced risk management culture. This becomes the more important the later the implementing measures are finalised and approved. A finalisation of the level II texts less than two years before the entry into force of the Directive would in our view require a transition period that reaches beyond the starting date of Solvency II.

- As stated in our response to the ORSA paper, we reiterate our criticism of the frequent references to “business planning” (among other planning activities), to “risk appetite” or to “risk strategy”. Firstly, we believe that pillar II requirements should not open the door for the interference of supervisors with the strategic management of the insurance undertaking. Secondly, we regard some of the requirements as suggested as highly sophisticated, thus particularly challenging for our small and medium size members and, as a consequence, not in line with the principle of proportionality.
  
- We greatly appreciate the last section of the paper covering the outsourcing of key functions , however, we believe that the list of steps to be undertaken by the outsourcing company when choosing a service provider is not very realistic in practice; at least in the case of outsourcing to licensed service providers (such as, but not exclusively, banks and investment banks), the outsourcing undertaking should be allowed to rely on the supervision of the service provider’s license requirements by a supervisor. Our members also find that they require more guidance to understand
  - (a) which functions CEIOPS and its members would regard as “key functions included in the system of governance” and/or as “critical or important operational functions” (as referred to in the Framework Directive); and
  - (b) to what extent which of the requirements for outsourcing control as specified by CEIOPS apply to which type/level of outsourced function.

We are looking forward to further good cooperation with you and are of course available for any further discussion on these and related issues.

With kind regards,



Gregor Pozniak  
Secretary General

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Reference	Comment
General comment	Insurance regulators should focus on achieving good corporate governance overall rather than defining in detail all the functions and organisational structures of insurance undertakings. Even less should the supervisors' expectations in this area try to determine a particular corporate structure.
General comment	Overall, appropriate time must be given to all EU insurance undertakings subject to Solvency II (i.e. all that appropriate re not exempt due to their small size) to put in place all required functions. As laid out in our cover letter, we are particularly concerned that a delay of level 2 measures could leave undertakings very little time to implement changes as finally defined on level 2.  We think here in particular of small and medium-sized insurers for whom an appropriate timeframe for a smooth transition into new structures and enhanced risk management culture could be seen as an expression of the proportionality principle.
General comment	The development of an appropriate system of governance comprising the four functions defined in the Framework Directive, actuarial function, compliance system, internal audit function and risk management function, may be amongst the most costly requirements associated with the implementation of Solvency II. It is therefore of paramount importance that the proportionality principle is duly applied throughout pillar II.
General comment	AMICE notes that CEIOPS' paper mentions on several occasions reporting certain functions to an Administrative <b>or</b> management body, and reporting the actuarial function to an administrative <b>and</b> management body. We suggest checking the paper for internal consistency while maintaining due regard to the existing variety of board structures (single, two-tiered boards, etc).
Para. 4.8	Since CEIOPS' paper relates to implementing measures on the system of governance and since the scope of the paper includes (only) the areas of internal control/compliance, internal audit, actuarial function, risk management, and outsourcing, the requirements should only relate to the staff members involved in and/or responsible for these key functions.
Para. 4.9 and 4.14	We agree that crisis management planning and contingency planning minimise the loss in the event of a significant event due to its nature and/or severity and allow the organisation to provide an adequate response and to ensure the continuity of the operations. However, the request for contingency plans must remain realistic and commensurate to the relevance of the undertaking from a macro-prudential point of view. In that sense, proportionality must apply also to required contingency plans.

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Para. 5.5-5.7	<p>The reference to nature, scale and complexity is welcomed, especially regarding the fitness and professional qualifications, the knowledge and experience requirements. As CEIOPS is aware, many mutual insurers have a board composed of a combination of independent professionals and members. We ask CEIOPS to give this particularity due consideration as it is of highest importance to many of our members that this typical element of the mutual business model (namely the direct presence of policyholder-members in the board) can be fully maintained.</p> <p>AMICE agrees that in any case each of the members of the administrative or management body should be “proper”. We note in this context in particular (and welcome the concept) that the organisational structure should ensure that the members of the administrative/management bodies should <u>collectively</u> be able to provide a sound and prudent management.</p>
Para. 6.6	<p>CEIOPS writes that an “effective risk management system” requires a suitable own risk and solvency assessment process. AMICE agrees that ORSA is, along other elements, at the core of Pillar II requirements and is a key element to foster a risk management culture within the undertaking, but care is needed to avoid obliging companies in an excessive way. We make this point both with a view to avoiding quantitative overburdening as well as regarding confidentiality. Supervisors should not have the opportunity to interfere with the management of the undertaking, e.g. when having to scrutinise the risk management strategy including its objectives, key principles and the setting of its risk tolerance or “risk appetite” etc.</p>
Para. 6.18	<p>The requirement that the undertaking should assure that all policies and procedures established for underwriting and reserving are applied by <u>all distribution channels</u> of the undertaking is far reaching. We would like CEIOPS to consider that only some markets manage claims at the level of the distribution channel (e.g. Italy).</p> <p>We also question whether this is part of the governance implementation measures.</p>
Para. 6.28	<p>The paragraph states that when launching new products, consideration to the effect on ALM should be given. This should not result in an ex-ante control on product design by the supervisors.</p> <p>In this context we question even more whether this requirement is within the scope of level 2 implementation measures on the system of governance.</p>
Para. 6.40	<p>We believe that requiring the management of liquidity risk in the short, medium, and long term could prove very burdensome for small and medium sized undertakings. We hope that supervisors will, here too, see an area where proportionality must be applied to the tools used to measure this risk and suggest including a reference to this already in its advice.</p> <p>CEIOPS writes that liquidity risk management should take into account claims management; we miss any reference to lapse claims in this context and would see a need for further guidance.</p>

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Para. 6.55	CEIOPS' paper defines operational risk as the risk of loss arising from inadequate or failed internal processes, or from personnel and systems and external events. To assess this risk, CEIOPS expects the undertaking to identify its exposure to high severity events and to assess "its vulnerability" to these risks through stress and scenario testing. We wonder whether this implies that the operational risk should be quantified again, in addition to Pillar1 calculations. If this is the case, we believe that the different scenarios should be set up by the undertaking in collaboration with the supervisor. An open dialogue with the supervisor is key in this field.
Para. 6.69	This paragraph states that undertakings should be capable of hedging credit risk via derivatives. We believe that hedging credit risk should not be exclusively linked to derivatives.
Para. 6.84	See comments to paragraph 6.40
Para. 6.85	In line with our general request for flexibility, it is crucial to allow this function to be arranged in <u>a centralised way</u> . Special reference should be made to the possibility of centralisation of the risk management function at group level in order to adapt these requirements to the existing organisational structure in some undertakings.
Para. 7.2	AMICE's members agree that an effective internal control system should aim to secure effectiveness and efficiency of the undertaking's operations. However, we believe that diligence is required when uniformly defining "effectiveness" and "efficiency". Many mutual insurers pursue qualitative objectives in addition to and/or (partially) replacing quantitative ones found in public-limited type undertakings (e.g. increasing shareholder value).  AMICE notes that Article 45 of the Framework Directive requires undertakings to have a compliance function that shall advise management on compliance with "the ... provisions <u>adopted pursuant to this directive</u> ". In contrast, CEIOPS states in para. 7.2. c) that the internal control system shall secure at least ... "compliance with [all?] applicable laws etc".
Para. 7.7	This paragraph states that " <i>an effective internal control system should comprise robust and efficient control activities at all levels of the undertaking...</i> ": see comments to para. 7.1
Para. 7.24 - 7.25	Para. 7.24 seems to be too broadly formulated to make the requirement workable. We suggest changing "In order to assess ..." into "In order to be in a position to assess ...".  In addition, we wonder whether the reference to "statutes" in 7.24 relates to (internal) statutes (articles of association etc) while the remainder of the sentence refers to external changes (regulations, laws, etc). The text could probably be made clearer.

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Para. 8.2.	<p>This paragraph states that the internal audit function needs to be independent from the organisational activities audited. The principle of independence means that the internal audit function operates under the direct control of the administrative or management body. This means that independence is preserved.</p> <p>AMICE welcomes such independence that clearly delineates the role of the internal audit.</p> <p>We would like to share with CEIOPS, however, that among AMICE members there was quite a discussion about the “independence” and the “right of initiative” of the audit function. Not all members were certain how this concept would fit within the overall concept of ultimate responsibility of the top management for all management decisions in the undertaking. Members agree that any individual member of management should not have the possibility to suppress an audit of activities under his responsibility.</p> <p>This discussion shows us that additional thinking may be necessary on the side of CEIOPS to make the respective passage in any future consultation or advice less ambiguous.</p>
Para. 8.3	<p>See our more general comment above</p>
Para. 8.6	<p>CEIOPS writes that all business units should have the obligation to report deficiencies. The internal audit function should define the appropriate parameters/triggers for this obligation. We believe that either the management board or the management committee are better placed to take such decisions.</p>
Para. 8.7	<p>When the complexity and extent of risks do not justify a full time staff member as internal auditor, a third party can be commissioned. This implies a contrario that CEIOPS expects in most cases that an internal audit is not a function but a full time assignment. We would suggest inverting the reasoning: The internal audit function does not require a full time staff member but this depends on the scale, nature and complexity of the business. It can also be entrusted to a qualified party.</p> <p>We understand that when referring to a qualified party, CEIOPS means a third or external party.</p>
Para. 8.8	<p>CEIOPS calls for an audit plan spanning several years. We would like to make sure that the time between the passing of the level II text and the implementation date of the overall framework takes into account that not all insurers today have an internal audit function and/or plan and that such a plan cannot be made overnight (see our general comment in the cover letter).</p>
Para. 8.17	<p>This paragraph states that every activity and every unit of the undertaking shall fall within the scope of the internal audit function. We believe that materiality is an inherent principle of all auditing activity.</p>

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Para. 9.11	We take note of the fact that the actuarial function can be combined with the risk management function. We see this clarification as an important example of practically applied proportionality and we welcome this important flexibility in particular for our small and medium sized members. AMICE supports this statement; we would appreciate if CEIOPS could extend the thought and indicate to what extent other functions could also be combined.
Para. 9.16	Article 47.5 FD states that the actuarial function should be carried out by persons with the relevant qualifications and experience. While taking note of the use of “relevant” in this requirement, our members would still appreciate if the requirement of qualifications and experience were restricted to the persons chiefly responsible for this function.
Para. 10.5	<p>CEIOPS’ paper points out that when outsourcing, the undertaking needs to retain in-house staff with the necessary expertise to ensure effective control and manage risk associated with outsourcing. We believe that this is counter to the aim of outsourcing and may not be feasible for some of our smaller members.</p> <p>To say that an undertaking should “retain in-house staff” sounds as if the purpose of outsourcing would never be fully reached. We suggest a rewording that maintains ultimate responsibility for the outsourcing process in the enterprise, but that allows in particular small and medium-sized insurers to truly benefit from outsourcing opportunities.</p> <p>The insurance undertaking, regardless of its size, has the possibility of asking the outsourcing undertaking for its internal documents on the processes defining the realization of the operations.</p>
Para. 10.6	<p>When choosing a service provider for a critical or important function, no conflicts of interest should occur. At the same time, we note in para. 10.12 that outsourcing within the same group is possible. We believe that the same requirements of absence of conflicts of interest are applicable.</p> <p>We note in the wording of para. 10.6.c and attach particular relevance to the contents of the outsourcing contract including the specification of the information/disclosure obligations of the service provider. Our members think that in several contexts where CEIOPS obliges the outsourcing undertaking to “ensure” certain qualities and procedures on the side of the service provider, the possibilities of the undertaking end at contractually obliging the service provider to provide information/disclosure (see below).</p>
Para. 10.8.g)	Reference is made to “the auditor”; We presume that this refers to the <u>internal</u> auditor (whether in-house or outsourced).
Para. 10.9	The undertaking remains responsible for the sub-outsourcing contract; AMICE believes that disclosure is the right approach to ensure transparency but more guidance would be required about the expected level of granularity.

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Para. 10.13	CEIOPS writes that the insurance undertaking shall <u>ensure</u> that the service provider discloses any material changes to its financial resources or its risk profile. AMICE believes that it is more appropriate for insurance undertakings to require service providers <u>contractually to inform them</u> of any material changes to their financial resources and/or risk profile.
Para. 10.16	<p>CEIOPS believes that functions such as the selling of insurance products or claims handling are key functions (or at least fundamental to carry out its core business) for outsourcing control purposes.</p> <p>Does this imply that all requirements regarding outsourcing are applicable to independent intermediaries (brokers, non-salaried agents) selling insurer's policies? What about claims call-centres or assistance call-centres (for assistance insurers)? Does CEIOPS want to imply that the service provider should have an adequate risk management and internal control system in place?</p> <p>Read in context with 10.17, as commented above, the obligation on the insurance undertaking should be to enter into Solvency II compliant <u>contracts</u> – not to “ensure” that the service provider itself is “Solvency II compliant”. This should be clarified.</p> <p>We suggest defining more clearly the distinction between the service provider and the activities falling under the scope of “outsourcing”.</p>
Para. 10.18	<p>CEIOPS aims to require the outsourcing undertaking to assess the fitness and propriety of the relevant management body of the service provider. This is in our view impossible in some of the aspects raised, e.g. for the requirements under letters a) and d). We believe that (in the case of licensed service providers) these requirements should be fulfilled by checking the license of the service provider.</p> <p>Here, too, the only requirement for the outsourcing undertaking should be to <u>oblige the service provider contractually</u> to adhere to these principles.</p>