



THE INSTITUTE  
OF CHARTERED  
ACCOUNTANTS  
IN ENGLAND AND WALES

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Dear Sir or Madam

## **SUPERVISORY REVIEW PROCESS AND UNDERTAKINGS' REPORTING REQUIREMENTS**

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on your views on *Supervisory Review Process and Undertakings' Reporting Requirements*.

The ICAEW's Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues and challenges facing the financial services industry, acting in the public interest and free from vested interests. It draws together professionals from across the financial services industry and from the 25,000 ICAEW members specialising in the sector. This includes those working for regulated firms, in professional services firms, intermediaries, and regulators.

Please contact Iain Coke, Head of the Financial Services Faculty or me, should you wish to discuss any of the points raised in the attached response.

Yours faithfully

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## ICAEW Representation

ICAEW REP 127/08

### SUPERVISORY REVIEW PROCESS AND UNDERTAKINGS' REPORTING REQUIREMENTS

Memorandum of comment submitted in November 2008 by The Institute of Chartered Accountants in England and Wales, in response to CEIOPS issues paper *Supervisory Review Process and Undertakings' Reporting Requirements* published in August 2008

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## INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the issues paper *Supervisory Review process and Undertakings' Reporting Requirements* published by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

## WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

## MAJOR POINTS

4. We welcome the opportunity to engage with CEIOPS as it works to develop a framework for supervisory review and reporting requirements. Our response follows the structure of your paper, as we comment on each of your chapters in turn.

## RESPONSES TO SPECIFIC CHAPTERS

### ***Chapter 1, Executive Summary***

5. We welcome the emphasis on the principle of proportionate supervision. However, we think it likely that in practice the reporting requirements outlined in the Issues Paper (IP) will be more of a burden for smaller insurers relative to larger ones.
6. We think that annual reporting of quantitative information is the right frequency.
7. From the IP it is not clear exactly what narrative reporting will be required if nothing has materially changed since the previous year and the supervisor is not undertaking a detailed periodic assessment. IP 1.8 refers to 'full' narrative information not necessarily being required every year but what constitutes this 'full' narrative information is not defined. Article 50 paragraph 1 of the Draft Framework Directive requires quite a lot of narrative information to be included in the Solvency and Financial Condition Report (SFCR) but this does not appear to be the 'full narrative information' referred to at IP 1.8.

## ***Chapter 2, Introduction***

8. We note the requirement that “supervisory authorities shall conduct their tasks in a transparent and accountable manner”. The publication of the CEIOPS Issues Paper contributes to the supervisors’ working in a transparent manner; it could be more explicit as to whom the supervisors are accountable to in developing these proposals.
9. We think that the requirements around internal models, including the extent to which external review by independent actuaries or auditors might be needed in order for the models to be approved by the supervisor, and around groups will be of great interest to industry bodies. We would like to see CEIOPS engage with these at the earliest opportunity.

## ***Chapter 3, Background***

10. We support the use of a risk-based approach to supervision which sees undertakings that pose a greater risk to policyholders being subject to a more intensive and frequent supervisory regime. The requirement for a public SFCR and private Report to Supervisors (RTS) is reasonable. We would like further information from CEIOPS as to what it envisages being reported publicly and privately. The content of each report will influence what type of review is appropriate.

## ***Chapter 4, Supervisory Review Process - Composition***

11. We welcome the intention to foster dialogue between the supervisor and the undertaking (IP 4.7) as we consider this will support effective supervision which allows the supervised undertakings to develop innovatively.
12. We agree that the level of harmonisation is potentially limited by the subjective nature of the risk assessment process but also that discretionary decision-making must remain with supervisors (IP 4.24). This is potentially a significant obstacle to harmonisation. It may be possible to promote harmonisation through giving supervisors in different EU countries opportunities to work together, for example by supporting secondments.
13. In IP 4.45 there is a suggestion that insurers will have to notify supervisors of any breach in their internal capital needs as derived from the Own Risk and Solvency Assessment (ORSA). The implications of such a breach should not be too onerous or there is a risk of firms holding ‘buffer’ capital over and above the ORSA level, thereby undermining one of the main benefits of Solvency II, the matching of capital resources and risk.
14. On a related note, although IP 4.38 quite rightly states that early warning indicators should not function as a new solvency control level, the fact that ‘breaches’ of these would be reported to the supervisor (IP 5.26) gives the impression that they are an additional solvency control level.
15. The requirement to report ‘breaches’ of early warning indicators and of internal capital needs as derived from the ORSA are reporting requirements additional to the SFCR and RTS. This is in tension with the statement at IP 1.7 that additional reporting requirements are not envisaged. We appreciate this additional information may be necessary but as stated at IP 4.2 ‘there must be a clear understanding of why the information is needed and what it will be used for’.

16. We welcome the requirement in Level B of the Supervisory Ladder for insurers to keep their external auditors informed.

### ***Chapter 5, Supervisory Review Process - Information Analysis***

17. This section asks supervisors to assimilate a wide variety of complex information about the entities they supervise in the course of conducting the Supervisory Review Process. To perform this analysis, individual supervisors will need to be of a high calibre and national supervisors will need to be resourced so that they can field appropriate teams.
18. IP 5.12 states: "The supervisor could place reliance on a qualified person, such as a person from the actuarial function, to certify the calculation of the technical provisions.' If this involves the person reporting directly to the supervisor, this would appear to go beyond what is envisaged for the actuarial function in Article 47 of the Draft Framework Directive. Obtaining such a certificate could be a significant burden for an insurer and the circumstances in which the supervisor could call for an actuarial report should be specified.
19. The solvency early warning indicators will need to be set sensitively so as to avoid creating a disproportionate administrative burden and a plethora of notifications that do not merit any regulatory action. The indicators will need to be justified by the specific circumstances of the individual firm. Developing appropriate indicators may require more supervisory resources than is immediately obvious.
20. IP 5.35 indicates that undertakings should have an effective and permanent internal audit function and sets out expectations in this area. CEIOPS should clarify that internal audit can be outsourced and that appropriate management control must be exercised over the outsourced activity.
21. Similarly, IP 5.38 states that 'the supervisor should be satisfied that within the undertaking there is a permanent and effective actuarial function'. We would expect that, as envisaged by the Directive, this could be contracted out. For a small insurer, it would be very expensive to have an in-house actuarial function. The insurer's management would retain responsibility for an outsourced actuarial function.

### ***Chapter 6, Undertakings' Reporting Requirements***

22. IP 6.12 raises the possibility that insurers will normally only have to submit details of material changes to narrative information or report that no material changes have occurred. This suggests that every insurer will have to submit full narrative information in the first year of Solvency II which will put a considerable strain on regulatory resources.
23. What constitutes a 'material change' will need to be defined and applied consistently by supervisors to support harmonisation.
24. In addition, the Paper does not give a minimum frequency for a full review of narrative information provided by firms. It is possible that some regulators may leave this longer than others for similar types of firms, undermining the extent to which harmonisation is achieved.

25. It is essential to get the right allocation of items to be reported between those in a public return and those reported privately, in order to strike the right balance between informing stakeholders and protecting legitimate commercial interests. The CEIOPS Issues Paper *Policy on Harmonisation of Contents and Formats for Public Disclosure and Supervisory Reporting* states that the Draft Framework Directive 'requires undertakings to publicly disclose annually a report covering essential and concise information on their solvency and financial condition'. Your 2007 IP further states that information should be 'readily understandable' and 'in a format that can be readily used by the public.'
26. In the light of this, we think the SFCR should be as simple and concise as possible, and that as much of the information as possible should be included in the RTS. The SFCR should contain the information necessary to comply with Article 50 of the Draft Framework Directive but should not go further. Our reason for this is that we are not convinced that there is a general public appetite for the detailed disclosures outlined in the reporting template. What matters to policyholders and other stakeholders is that the insurer is in good standing with its supervisor and has at least the required level of capital.
27. We do not believe the routine audit of the RTS is necessary. Our members have different opinions on the extent to which information in the SFCR should be subject to independent external review, and we relay these for your consideration in this and the following two paragraphs. On the one hand, there is the view that the SFCR should be subject to external audit and a reasonable assurance opinion. It is argued that this would enhance its credibility, comparability and reliability and help achieve the level playing field and stronger market discipline that are among the objectives of Solvency II. Although there has to date been little public demand for external assurance on non-financial information, demand can be expected to increase as public confidence in the statements made by financial services firms will have been shaken by the recent market turmoil.
28. A differing argument is that independent external reviews should not be routinely required but restricted to matters that are considered highly important to the regulator or to the wider public. Moreover, reviews should only be for information that cannot readily be found in or reconciled to the financial statements. Where reviews are deemed necessary, it is argued that they should not extend to systems controls or forward-looking information, but should be on the historic quantitative information only. This would be consistent with audit opinions upon financial statements which specifically report upon the financial statements and notes but only confirm that other information, such as directors' reports, are not inconsistent with the financial statements. As reviews of systems controls and forward-looking statements are more subjective than reported numbers it is typically more difficult to give positively worded opinions on such matters and such reviews may incur significant additional cost. Opinions on such subjective matters therefore often take the form of either negatively-worded opinions following a limited assurance engagement or else require significant explanation regarding the nature of the review and findings. The benefit in relation to the cost of such opinions may therefore be less clear to the parties involved. Companies can always choose to request additional audit or review work to be performed on information they want to make public. In the UK banks regulatory returns are not routinely subject to review by an independent external party but they nevertheless provide useful information to the FSA.

29. A greater level of external review is likely to be appropriate in the first year or two following implementation of Solvency II, as this will be a new regime, and errors and misjudgements are more likely to arise as it is implemented.
30. We would not support a regime where the same information was subject to scrutiny by multiple parties as this will lead to excessive costs for business. For example, where a supervisor is satisfied that an internal model is fit for purpose we would not also want to see an auditor reviewing the internal model for a similar purpose.
31. The RTS should only need to be formally approved by the Board. The supervisor should not need to see sign off by the actuarial function, internal audit function or any other function of the insurer. Approval by the Board should be sufficient and understood to mean that these other functions had signed off on it internally. The Board taking ownership of the content of the return should give regulators more confidence that the information is likely to be fit for purpose than sign off by any individual function within the undertaking.
32. On the subject of having confidence in the information reported by undertakings, it would be useful to know whether there will be any sanctions for a less-than-thorough ORSA or a weak level of detail in a return.
33. In the event that assurance is sought, any requirements proposed by CEIOPS in respect of the certification of information and the level of assurance provided should be consistent with the International Framework for Assurance Engagements.

## ***Annex 1***

34. Wherever practicable, information reported either privately to supervisors or publicly should be reconciled to statutory data, as this will help stakeholders including supervisors to be able to understand and use the information effectively.
35. Information about strategy (IP A.2) may be reported more fully if it is kept private, as some of this will be commercially sensitive.
36. The narrative information includes information which is quantitative in nature, such as the information on the number of reinsurers and top premium concentration ratios at IP C.7.2 (a). This means the suggestion that narrative information will only need to be updated for a full assessment under the SRP or if changed significantly (IP 3.9), will not be the case; it will need to be provided annually.
37. The information at B.1.2(c) on the uncertainty of technical provisions may be difficult for undertakings to provide and for readers to interpret.
38. The requirements seem to be excessively detailed in places. For example, there is a requirement to provide “details of processes and procedures in place to employ personnel with the skills knowledge and expertise necessary for the discharge of the responsibilities allocated to them.” Whilst the outcome, that the right people are in place, is an important one, we are not convinced that the underlying mechanisms for achieving this outcome need to be reported.

## **Annex 2**

39. We think that reporting some of the information will not add particular value, including the requirements to analyse technical provisions by member state and expenses by business location.

### **Additional Comments**

40. There are a number of additional areas where we would like CEIOPS to give further guidance:
- what approach should be taken by supervisors in extreme market conditions;
  - will there be a common scoring method for assessing firms (for example, like the FSA's impact and probability scoring); and
  - on how peer group assessments for governance would work across country borders. National differences in standards of governance have the potential to undermine harmonisation efforts, particularly if these differences are not well understood by supervisors

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