



EIOPA-BoS-14/253

28 January 2015

Final Report
on
Public Consultation No. 14/017 on
Guidelines on
system of governance

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1. Executive summary

Introduction

According to Article 16 of Regulation (EU) No. 1094/2010¹ ("EIOPA Regulation") EIOPA may issue Guidelines addressed to competent authorities or financial institutions. Before adoption of the final Guidelines EIOPA shall, where appropriate, conduct open public consultations and analyse the potential costs and benefits. In addition, EIOPA shall request the opinion of the Insurance and Reinsurance Stakeholder Group (IRSG) referred to in Article 37 of the EIOPA Regulation.

According to Articles 40 to 49, Article 93, Article 132 and Article 246 of Directive 2009/138/EC² ("Solvency II Directive") and according to Articles 258 to Article 275 of Commission Delegated Regulation (EU) No 2015/35 ("Commission Delegated Regulation 2015/35")³ EIOPA has developed Guidelines on system of governance.

As a result of the above, on 2 June 2014 EIOPA launched a public consultation on the draft Guidelines on system of governance. The Consultation Paper is also published on EIOPA's website⁴.

The Guidelines are addressed to competent authorities to:

- Set out the requirements for the sound and prudent management of undertakings without unduly restricting them in choosing how to organise themselves;
- Provide guidance on the regular review of the system of governance and the proper documentation.

Content

This Final Report includes the feedback statement to the Consultation Paper (EIOPA-CP-14/017) and the Guidelines. The Impact Assessment and the resolution of comments are published on EIOPA's website.

¹ OJ L 331, 15.12.2010, p. 48.

² OJ L 335, 17.12.2009, p. 1.

³ OJ L 12, 17.01.2015, p. 1.

⁴<https://eiopa.europa.eu/Pages/Consultations/Public-consultation-on-the-Set-1-of-the-Solvency-II-Guidelines.aspx>

Next steps

In accordance with Article 16 of the EIOPA Regulation, within 2 months of the issuance of these Guidelines, each competent authority shall confirm if it complies or intends to comply with these Guidelines. In the event that a competent authority does not comply or does not intend to comply, it shall inform EIOPA, stating the reasons for non-compliance.

EIOPA will publish the fact that a competent authority does not comply or does not intend to comply with these Guidelines. The reasons for non-compliance may also be decided on a case-by-case basis to be published by EIOPA. The competent authority will receive advanced notice of such publication.

EIOPA will, in its annual report, inform the European Parliament, the Council and the European Commission of the Guidelines issued, stating which competent authority has not complied with them, and outlining how EIOPA intends to ensure that concerned competent authorities follow its Guidelines in the future.

2. Feedback statement

Introduction

EIOPA would like to thank the Insurance and Reinsurance Stakeholder Group ("IRSG") and all the participants to the public consultation for their comments on the draft Guidelines. The responses received have provided important feedback to EIOPA in preparing a final version of these Guidelines both in respect of Guideline text and explanatory text. All of the comments made were given careful consideration by EIOPA. A summary of the main comments received and EIOPA's responses to them can be found in the sections below. The full list of all the comments provided and EIOPA's responses to them is published on EIOPA's website.

For the public consultation EIOPA has pointed out that it might be needed, after the publication of the final Commission Delegated Regulation 2015/35, to introduce further guidance on the independence of the internal audit function.

Comments by IRSG

2.1. General content of the Guidelines

- a. The IRSG proposed a more focused and shorter text for the Guidelines with clearer definitions, and the possibility for EIOPA to later develop a best practice document. IRSG also suggested that only issues strictly needed to ensure harmonisation before Solvency II starts should be included as Guidelines in order not to create significant additional work for all concerned and not to risk creating unnecessary restrictions for undertakings under Solvency II. It was seen as a risk that implementation could be regarded as a compliance exercise with undertakings following the 'check-lists' within the Guidelines and not having time to focus on embedding the sound principles.
- b. EIOPA does not think that ensuring compliance with the Guidelines takes up time that would otherwise be used to focus on a principle-compliant implementation. The Guidelines mainly include clarifications that undertakings would be expected to understand by themselves. The Guidelines only cover what EIOPA considers essential as a first step towards convergence and for that reason the Guidelines are not unnecessarily restrictive, but specify minimum expectations that every undertaking should be able to comply with in order to meet the governance requirements of Solvency II.

2.2. Remuneration committee

- a. The IRSG - as did other stakeholders - understood the Guidelines to require the introduction of a remuneration committee and objected that such a requirement would go beyond the Solvency II Directive.
- b. This Guideline only seeks to ensure that certain tasks are being performed in support of the remuneration policy of the undertaking. The text is very clear about not definitely requiring the establishment of a remuneration committee ("If no remuneration committee is established..."). The undertaking can either introduce a remuneration committee, where this is appropriate, or the administrative management or supervisory board ("AMSB") has to perform the task that would otherwise be performed by this committee.

2.3. Scope of the fit & proper requirements

- a. The IRSG remarked that the definition of other key functions, besides the four explicitly named key functions, as "functions of specific importance for the undertaking in view of its business and organisation" was too broad as it potentially extends the scope of key persons to almost all of an undertaking's top management. In the view of the stakeholders' group the four key functions are also the only key functions recognized by the Solvency II Directive as could be seen from the conjunction of Recital 33 and Article 42.
- b. EIOPA does not share the view that the risk management, the compliance, the internal audit and the actuarial function included in the system of governance are the only key functions possible. If a function is identified by the undertaking being of specific importance for the undertaking in view of its business or its organisation and having a similar level of responsibilities as the four key functions that are mentioned in the Solvency II Directive, such a function could be considered "key". Such key functions would be identified by the undertaking, but the determination of whether such functions should be considered key or not is open to challenge by the supervisory authority.

2.4. Outsourcing of a key function

- a. The IRSG was concerned that the additional regulatory assessment may prove not to be practical and could take the responsibility away from undertakings to ensure that fit and proper requirements are complied with. If a notification requirement is introduced, the IRSG asked that the "appropriate timeframe" for the supervisory response be made more explicit.
- b. EIOPA would like to stress the fact that supervisory authorities are also required to perform appropriate assessments of persons who effectively run the undertaking or are responsible for a key function according to Article 42 of the Solvency II Directive, does not diminish the responsibility of the undertaking concerned to perform an appropriate assessment itself, whether this is for a case where a key function is outsourced or not. EIOPA acknowledges that it would be desirable if a specific timeframe could be included in the Guidelines. This, however, was impossible as national rules and practices proved to be too different for any meaningful common timeline to be introduced.

Comments by other stakeholders

2.5. Timing of the consultation

- a. The Guidelines were consulted before regulatory technical standards ("RTS") and implementing technical standards ("ITS") as referred in the Solvency II Directive have been finalised. One stakeholder raised the question whether EIOPA could prove that it has the competence to consult on draft Guidelines prior to the finalisation of the L2 legislation as this would define which are the 'areas not covered by regulatory or implementing technical standards' and EIOPA may only issue Guidelines and recommendations for those areas.

- b. It is not necessary to await finalisation of the RTS and ITS to ensure that any potential overlap with the Guidelines is avoided. The empowerments for these technical standards laid down in the Solvency II Directive set out their scope, limiting the topics that RTS and ITS may cover. EIOPA ensured that the Guidelines do not concern any topic that are covered by the empowerments for RTS or ITS.

2.6. Scope of the Guidelines

- a. Several stakeholders maintained that there were many instances where the Guidelines - seeking to provide greater clarity - go beyond the provisions of the Solvency II Directive by providing overly narrow definitions. Some respondents supported a maximum reduction of the number of Guidelines on the grounds that some Member States were obliged by local law to implement the Guidelines thus making them legally binding. This would entail that some undertakings or parts of groups might be subject to stricter regulation than others which would distort the level playing field. Some respondents also considered that some of the Guidelines would be more appropriate as part of a good practice manual issued by EIOPA and updated on a regular basis.
- b. EIOPA is of the view that this critic is not justified for the following reasons. EIOPA's members intensively discussed legal issues while drafting the Guidelines and before consultations all Guidelines were reviewed by EIOPA Legal Services. Close cooperation between EIOPA and the European Commission provides a further level of assurance that the Guidelines are in accordance with the spirit and provisions of the Solvency II Directive and of the Commission Delegated Regulation 2015/35.

EIOPA does not share the concerns regarding the implementation of Guidelines into national law. Guidelines are legally non-binding, but where a supervisory authority, as part of the comply-or-explain mechanism, declares that it complies with the Guidelines, it has to ensure that undertakings also comply with the Guidelines. Therefore, in supervisory practice, the Guidelines have to be applied regardless of whether they are legally binding via implementation into national law or not if the supervisory authority has decided to comply with them.

Even though a good practice manual may lead to increased harmonization, it is not an appropriate tool to ensure an adequate level of convergence.

2.7. Explanatory text

- a. Concerning the explanatory text, some stakeholders saw a risk that although the explanatory text is not subject to the comply-or-explain mechanism, supervisory authorities could consider it as a guide for their day to day supervisory tasks with the result that the text could indirectly become part of the Guidelines. As a consequence they asked EIOPA to emphasise the purely illustrative nature of the explanatory text.
- b. The explanatory text is not purely illustrative. It ensures that the aim and purpose of the Guidelines is well understood. As such, it is not a problem if supervisory authorities follow the explanatory text in their day-to-day supervisory tasks. Adherence to the explanatory text only helps to make certain that the Guideline is being observed.

2.8. Proportionality

- a. As in former public consultations, some stakeholders proposed that the principle of proportionality should be further developed in the Guidelines.
- b. EIOPA can only reiterate that it is not possible to do so in the context of the Guidelines as the principle applies to the way undertakings implement the requirements, whereas the Guidelines aim to explain the expected outcome rather than specific solutions. The Guidelines cannot provide explanations as to what could be proportionate “simplified” solutions. In addition, explaining the circumstances under which such simplified solutions could be applied is impossible as no comprehensive “list” of conditions that need to be in place for a solution to be considered appropriate can ever be given.

2.9. Role of the AMSB

- a. A number of stakeholders felt that the division of duties between management and board should be left to the undertaking.
- b. The AMSB is ultimately responsible for the undertaking. This involves more than just being held accountable if things go wrong. It requires that the members of the AMSB are capable of performing and do perform certain tasks themselves as part of exercising their responsibility. This does not prohibit delegation from the AMSB to senior management in general, but merely reinforces the fact that ultimately, AMSB remains responsible.

2.10. Scope of the fit & proper requirements

- a. Several stakeholders other than IRSG also considered the scope of the fit and proper requirements, as set out in the introduction to the Guidelines, as too broad and going beyond the Solvency II Directive. These objections concerned additional aspects. For one, respondents claimed that “persons who effectively run the undertaking” does not encompass members of senior management as this would extend the fit and proper requirements considerably. Respondents also claimed that the application of the fit and proper requirements to all persons performing a key function instead of just to those persons who are responsible for a key function was not in line with the Solvency II Directive requirements.
- b. Experience has shown that the qualifications of the management are an important factor in the success or failure of insurance and reinsurance undertakings. Hence, it is the purpose of Article 42 of the Solvency II Directive to widen the scope of the persons who are subject to fit and proper requirements. Article 42 could easily have referred to the AMSB and the persons responsible for the risk management, internal audit, compliance and actuarial functions if it had been the intention of the legislator to limit the scope to these persons. It is correct that not all senior management should be included in the scope of Article 42. By referring to major decision-makers EIOPA ensures that only persons who influence how the undertaking is run are subject to fit and proper requirements. Regarding persons who are responsible for key functions, Recital 34 and Article 42 make it clear that persons who have or perform a key function are subject to fit and proper requirements but that only those persons responsible for key functions have to be notified to the

supervisory authority rather than other persons involved in performing the key functions.

2.11. Minimum information on notification for fit & proper assessment

- a. A number of respondents took exception to the Technical Annex requiring what is called "minimum information". They objected to the amount of information to be submitted which was considered to be overly burdensome. Calling the information "minimum" was seen as inappropriate as it suggested that further information should be required by supervisory authorities.
- b. EIOPA considers it important to ensure that there is a high level of harmonization with regard to the fit & proper assessment by supervisory authorities. Deficiencies in the quality of the managers of insurance and reinsurance undertakings have been identified as the most common problem when undertakings have failed in the past. It is therefore, firstly, imperative that the undertakings concerned themselves perform an appropriately detailed assessment of the fitness and propriety of all persons who perform key functions in the undertaking, and secondly, that the supervisory authority should have all available information to assist in assessing whether the person notified to the supervisory authority meets the personal and professional qualifications necessary to perform the relevant key function. The term "minimum" does not in this context refer to an expectation that supervisory authorities should have additional information requirements; it only denotes that supervisory authorities are not expected to require less information. The minimum information does not include information that EIOPA only considers relevant for supervisory authorities; undertakings are expected to have this information as part of their own assessment anyway.

2.12. Assessment of the fit and proper requirements by the supervisory authority

- a. A number of respondents asked EIOPA to clarify that the notification was not "prior" to a person being nominated for a key function and that no "approval" by the supervisory authority was required. Other stakeholders were of the same opinion as the IRSG and asked EIOPA to clarify what timeframe is considered "appropriate" for feedback on the notification from the supervisory authority.
- b. The notification requirements are an area where slight differences between Member States with regard to timing or the quality of the assessment do not materially affect the level playing field. The fact that the Solvency II Directive does not require "prior" notification cannot be interpreted as prior notification being not permissible. The Solvency II Directive is silent on when the notification has to take place, and Member States may require "prior" notification or not as they deem it necessary.

EIOPA is of the opinion that a person nominated for a key function is not subject to prior supervisory approval and therefore does not require this in its Guidelines. However, EIOPA Guidelines also ensure that the supervisory authority is able to take appropriate measures to prevent that a person is the responsible person for a key function if the supervisory authority finds such a person to be lacking in the necessary qualifications at any time.

Regarding the clarification about the “appropriate timeframe” see the section on IRSG comments above.

2.13. Prudent person principle

- a. Some stakeholders suggested that the prudent person principle is to be removed from the Guidelines for the time being and reintroduced in a good practice manual for investments at a later time when supervisory authorities have gained some experience with the application of the principle by different undertakings. In addition some other stakeholders queried some of the definitions used in the Guidelines and sought for greater clarity.
- b. EIOPA agrees that it would be premature to provide extensive Guidelines on the prudent person principle at this point in time. Accordingly, the Guidelines on the prudent person principle have been limited to very basic minimum requirements reminding undertakings that greater flexibility for investments is linked with firm responsibilities on the governance around the investment activities, and that the level of prudence required is not diminished under Solvency II. EIOPA expects that it may be necessary to draft further Guidelines at a later stage in order to ensure an appropriate level of convergence across Member States.

EIOPA has slightly redrafted these Guidelines in order to enhance clarity and understanding.

2.14. Outsourcing of a key function

- a. Most stakeholders were opposed to the specification by EIOPA that in case of the outsourcing of a key function, the person responsible for the notification requirement is the person at the outsourcing undertaking with oversight over the outsourcing. A number of arguments were put forward why this requirement was inappropriate. The requirement was seen as being contrary to the intended purpose of outsourcing and as creating systemic problems, especially for small and medium-sized undertakings on account of requirements of fitness and propriety and functional separation. Furthermore it was claimed that in practice this would entail numerous notification and fit and proper requirements for the persons with overall responsibility for the outsourced function at legal entity level in respect of a service provider within a group. For both smaller undertakings and groups outsourcing intra-group, this would lead to an increased risk of potential accumulation of functions and resulting sources of conflicts of interest or incompatibility of functions. Another argument brought forward was that the interpretation contradicted Recital 31 and 34 of the Solvency II Directive.
- b. The question, who is the person responsible for the key function in case of outsourcing, is only relevant with regard to the requirement to notify the supervisory authority. Even if it had been decided that a person at the service provider is to be considered responsible for the outsourced key function, the person with the oversight at the outsourcing undertaking would still be required to meet the fit and proper requirement as the oversight forms part of the key function. However, as EIOPA explained, since the required level of qualification follows from the specific tasks performed as part of a key function, this person does not

need to have the same qualification that is appropriate for the persons who actually perform the key function at the service provider.

Regarding functional separation, combining the oversight over different outsourced key functions does not affect the number of notifications compared to those cases where no outsourcing takes place. Where, for example in the case of intra-group outsourcing the group has different persons responsible for the oversight of outsourced functions performed by one and the same person at service provider level, a number of different notifications is required and not the same notification repeated several times. In this example, EIOPA is expecting the same number of notifications if no outsourcing would take place. The approach is a logical consequence of the fact that each undertaking has the final responsibility for its outsourced functions.

EIOPA does not see any contradiction with the outsourcing requirements of Solvency II Directive. The undertakings remain able to organise themselves as they see fit and to outsource key function if they consider this necessary. Outsourcing however, does not reduce requirements or the overall responsibility of the undertaking for the outsourced key function.

2.15. Role of the compliance function

- a. The Guidelines do not elaborate on the role of the compliance function. Some stakeholders wished for some more description on this function.
- b. Article 46 of the Solvency II Directive and Article 270 of the Commission Delegated Regulation 2015/35 describe the tasks of the compliance function. EIOPA does not consider it necessary to explain further what the compliance function should do at this point in time. Should it become evident in future that different concepts about the tasks of the compliance function prevail in practice and that these different practices are an obstacle to harmonization, EIOPA might further elaborate on this topic.

2.16. Regular rotation of the staff of the internal audit function

- a. A number of stakeholders said that Guideline 44 was too prescriptive, going beyond the principles-based regulation of the Solvency II Directive and difficult to apply for smaller undertakings.
- b. EIOPA has taken into account the comments. The wording of the Guideline was changed and text was added to the explanatory text to better reflect that rotation, when it is proportionate, is one of the measures to mitigate the risks of conflict of interests.

2.17. Responsible actuary

- a. Some respondents gave it as their view that the Solvency II Directive is about maximum harmonization and expressed surprise that, according to the introduction to the Guidelines, Member States may still choose to keep the requirement to have a Responsible Actuary. This was seen as creating an uneven playing field.
- b. While the Solvency II Directive is to a large extent about maximum harmonization, this is not the case for the whole Directive. There are still

a number of areas where Member States may keep or introduce stricter requirements as and where appropriate.

2.18. Procedures and documentation required in valuation Guidelines

- a. Stakeholders raised the concern that these Guidelines (notably Guideline 56 of the Consultation Paper) might go beyond what is required by the Commission Delegated Regulation 2015/35 and that complying with these Guidelines would be too burdensome. Some stakeholders suggested that these Guidelines be applicable only when entities do not issue financial statements under IFRS, some when entities use alternative valuation models or some in case of a material difference between valuation under Solvency II and valuation under financial statements.
- b. EIOPA considers that these Guidelines are in line with Articles 263 and 267 of the Commission Delegated Regulation 2015/35. Moreover, Article 267 thereof states very clearly that undertakings should document policies and procedures.

If undertakings already have such controls and procedures in place for the preparation of the annual accounts under IFRS, that should not be burdensome to implement and document them for the purpose of Solvency II.

For the entities that do not issue financial statements under IFRS, this Guideline is even more relevant.

For the sake of clarity, EIOPA reworded Guideline 56. This Guideline deals now with valuation procedures in general (meaning in all cases), whereas Guideline 59 deals with procedures specific to the cases where alternative valuation models are used.

2.19. Responsible entity

- a. Several stakeholders asked that the reference to a responsible entity, to be deleted because it was not consistent with the Solvency II Directive. Some other comments required clarification on the responsibility in case of a responsible entity which is different from the participating insurance or reinsurance undertaking, insurance holding company or mixed financial holding company.
- b. EIOPA agrees with this comment and deleted all references to "responsible entity". In order to avoid any misunderstanding, in all group related Guidelines the addressee is now the participating insurance or reinsurance undertaking, insurance holding company or mixed financial holding company.

2.20. Entities and undertakings

- a. Stakeholders required clarification on the use of entity or undertaking in the Guidelines concerning the groups.
- b. In the governance and ORSA Guidelines, the term "undertaking" refers to an insurance or reinsurance undertaking in the EEA and the term "entity" refers to any participating or related undertaking of the group which may or may not be an insurance or reinsurance undertaking. In Article 246 of the Solvency II Directive, there are three levels of requirements:

- The group should comply with governance requirements mutatis mutandis;
- All the (insurance or reinsurance) undertakings (in the EEA) in the group should develop their system of governance consistently in the group;
- The group risk management should cover all the risks in the group including those arising from entities of the group that are not insurance and reinsurance undertakings in the EEA.

Thus, each time, in the Guidelines that apply to groups it refers to governance requirements at individual level, this means in the undertaking. However, when these Guidelines refer to the risks in the group, the risks arising from all the entities of the group should be taken into account.

General nature of participants to the Public Consultation

EIOPA received comments from the Insurance and Reinsurance Stakeholder Group (IRSG) and nineteen responses from other stakeholders to the public consultation. All the comments received have been published on EIOPA's website.

Respondents can be classified into four main categories: European trade, insurance, or actuarial associations; national insurance or actuarial associations; (re)insurance groups or undertakings; and other parties such as consultants and lawyers.

IRSG opinion

The IRSG opinion on the draft set 1 of the Solvency II Guidelines on Pillar 1 and Internal Models, as well as the particular comments on the Guidelines at hand, can be consulted on EIOPA's website⁵.

Comments on the Impact Assessment

A separate Consultation Paper was prepared covering the Impact Assessment for the Set 1 of EIOPA Solvency II Guidelines. Where the need for reviewing the Impact Assessment has arisen following comments on the Guidelines, the Impact Assessment Report has been revised accordingly.

The revised Impact Assessment on the Set 1 of EIOPA Solvency II Guidelines can be consulted on EIOPA's website.

⁵<https://eiopa.europa.eu/about-eiopa/organisation/stakeholder-groups/opinions-feedback-from-the-eiopa-stakeholder-groups>

Annex I: Guidelines

1. Guidelines on system of governance

Introduction

- 1.1. According to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (hereinafter "EIOPA Regulation")⁶, EIOPA issues these Guidelines addressed to the supervisory authorities on how to proceed with the application of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (hereinafter "Solvency II")⁷.
- 1.2. These Guidelines are based on Articles 40 to 49, Article 93, Article 132 and Article 246 of Solvency II and on Articles 258 to Article 275 of Commission Delegated Regulation (EU) No 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC ("Commission Delegated Regulation 2015/35")⁸.
- 1.3. The requirements on the system of governance are aimed at providing for sound and prudent management of the business of undertakings without unduly restricting them in choosing their own organisational structure, as long as they establish an appropriate segregation of duties.
- 1.4. At least the four functions included in the system of governance, namely the risk management, the compliance, the actuarial and the internal audit function, are considered to be key functions and consequently also important or critical functions. Furthermore, persons are considered to be persons having key functions if they perform functions of specific importance for the undertaking in view of its business and organisation. These additional key functions, if any, are identified by the undertaking, but the determination of whether such functions should be considered key or not may be challenged by the supervisory authority.
- 1.5. These Guidelines provide further details on a number of issues regarding remuneration policy, including the composition of the remuneration committee.
- 1.6. The fit and proper requirements apply to all persons who effectively run the undertaking or have other key functions in order to ensure that all the persons having relevant functions in the undertaking are appropriately qualified. The scope of the requirements aims to avoid gaps where important persons for the undertaking are not covered, accepting at the same time that there may well be considerable overlap between persons from senior management who are considered to effectively run the undertaking and other key function holders.
- 1.7. The notification requirements only apply to persons who effectively run the undertaking or are key function holders as opposed to persons who have or perform a key function. In case of outsourcing of a key function or of

⁶ OJ L 331, 15.12.2010, p. 48.

⁷ OJ L 335, 17.12.2009, p. 1.

⁸ OJ L 12, 17.01.2015, p. 1.

outsourcing of a part of a function where this part is regarded as key, the person responsible is considered to be the one who has the oversight over the outsourcing at the undertaking.

- 1.8. The Guidelines on risk management takes as a starting point that an adequate risk management system requires an effective and efficient set of integrated measures which must fit into the organisation and operational activity of the undertaking. There is no single risk management system that is appropriate to all undertakings; the system must be tailored to the individual undertaking.
- 1.9. Although the own risk and solvency assessment (hereinafter "ORSA") is part of the risk management system, the corresponding Guidelines are set out separately.
- 1.10. While internal models are mentioned in connection with the responsibilities of the risk management function, on the whole, the Guidelines on the system of governance do not address specific internal model related issues.
- 1.11. Article 132 of Solvency II introduces the 'prudent person principle' which includes provisions on how undertakings should invest their assets. The absence of regulatory limits on investments does not mean that undertakings can take investment decisions without any regard to prudence and to the interests of policyholders. The requirements of Solvency II and of the Commission Delegated Regulation 2015/35 cover extensively some of the main aspects of the prudent person principle, such as asset-liability management, investment in derivatives, liquidity risk management and concentration risk management. Therefore, the intention of these Guidelines is not to further develop these aspects, but to focus on the remaining aspects of the prudent person principle.
- 1.12. With respect to the actuarial function, these Guidelines focus on what should be done by the actuarial function, rather than how it should be performed. As the purpose of having the actuarial function is to provide a measure of quality assurance through expert technical actuarial advice, it is especially important to establish specific technical guidance on the tasks, responsibilities and other aspects of the actuarial function.
- 1.13. Currently, the institution of the "responsible/appointed actuary" exists in some Member States. As the "responsible/appointed actuary" is not foreseen by Solvency II, it is up to the supervisory authorities concerned to decide on whether to keep the "responsible/appointed actuary" or not, and how it relates to the actuarial function. However, this issue is not addressed under these Guidelines.
- 1.14. The Guidelines on outsourcing are based on the principle that an undertaking has to ensure that it remains fully responsible for discharging all its obligations when outsourcing any function or activities. In particular, there are strict and rigorous measures an undertaking must meet if it outsources a critical or important function or activity. In particular, an undertaking has to give proper consideration to the content of the written agreement with the service provider.

- 1.15. Intra-group outsourcing is not necessarily different from external outsourcing. It may allow for a more flexible selection process, but it should not to be seen as automatically requiring less care and oversight than external outsourcing.
- 1.16. The Guidelines apply to both individual undertakings and mutatis mutandis at the level of the group. Additionally, for groups the group specific Guidelines apply.
- 1.17. The implementation of governance requirements at group level should be understood as having in place a robust governance system applied to one coherent economic entity (holistic view) comprising all entities that are part of the group.
- 1.18. Solvency II requires that all the insurance and reinsurance undertakings in a group have in place a risk management system and an internal control system and that this requirement is applied in a consistent manner in the group. However, from a group risk management and governance perspective, the group and the group supervisor have also to take into account the risks arising from other entities that are part of the group.
- 1.19. When the Guidelines refer to entities that are part of the group, in general, they refer to insurance and reinsurance undertakings, but also to all the other entities that are part of the group.
- 1.20. The governance requirements at group level take into account the corporate governance responsibilities of both, the administrative, management or supervisory body at group level, that is, the administrative, management or supervisory body of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company, and the administrative, management or supervisory body of legal entities that are part of the group.
- 1.21. For the purpose of these Guidelines, the following definitions have been developed:
 - 'persons who effectively run the undertaking' cover members of the administrative, management or supervisory body taking into account national law, as well as members of the senior management. The latter includes persons employed by the undertaking who are responsible for high level decision making and for implementing the strategies devised and the policies approved by the administrative, management or supervisory body;
 - 'persons having other key functions' include all persons performing tasks related to a key function;
 - 'key function holders' are the persons responsible for a key function as opposed to persons having, carrying out or performing a key function.
- 1.22. If not defined in these Guidelines the terms have the meaning defined in the legal acts referred to in the introduction.
- 1.23. The Guidelines shall apply from 1 January 2016.

Guideline 1 - The administrative, management or supervisory body

- 1.24. The administrative, management or supervisory body (hereinafter "AMSB") should have appropriate interaction with any committee it establishes as well as with senior management and with persons having other key functions in the undertaking, proactively requesting relevant information from them and challenging that information when necessary.
- 1.25. At group level the AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should have an appropriate interaction with the AMSB of all entities within the group that have a material impact on the risk profile of the group, requesting information proactively and challenging the decisions in the matters that may affect the group.

Guideline 2 – Organisational and operational structure

- 1.26. The undertaking should have organisational and operational structures aimed at supporting the strategic objectives and operations of the undertaking. Such structures should be adapted to changes in the strategic objectives, operations or in the business environment of the undertaking within an appropriate period of time.
- 1.27. At group level, the AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should assess how changes to the group's structure impact the financial position of the affected undertakings of the group and make the necessary adjustments in a timely manner.
- 1.28. The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should, in order to take appropriate measures, have an appropriate knowledge of the corporate organisation of the group, the business model of its different entities and the links and relationships between them and the risks arising from the group's structure.

Guideline 3 – Significant decisions

- 1.29. The undertaking should ensure that any significant decision of the undertaking involves at least two persons who effectively run the undertaking before the decision is being implemented.

Guideline 4 - Documentation of decisions taken at the level of the AMSB

- 1.30. The undertaking should appropriately document the decisions taken at the level of the AMSB of the undertaking and how information from the risk management system has been taken into account.

Guideline 5 - Allocation and segregation of duties and responsibilities

1.31. The undertaking should ensure that the duties and responsibilities are allocated, segregated and coordinated in line with the undertaking's policies and reflected in descriptions of tasks and responsibilities. The undertaking should ensure that all the important duties are covered and that unnecessary overlaps are avoided. Effective cooperation between personnel should be fostered.

Guideline 6 - Internal review of the system of governance

1.32. The AMSB of the undertaking should determine the scope and frequency of the internal reviews of the system of governance, taking into account the nature, scale and complexity of the business both at individual and at group level, as well as the structure of the group.

1.33. The undertaking should ensure that the scope, findings and conclusions of the review are properly documented and reported to its AMSB. Suitable feedback loops are necessary to ensure follow-up actions are undertaken and recorded.

Guideline 7 – Policies

1.34. The undertaking should align all policies required as part of the system of governance with each other and with its business strategy. Each policy should clearly set out at least:

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

1.35. In the policies that cover the key functions, the undertaking should also address the position of these functions within the undertaking, their rights and powers.

1.36. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the policies are implemented consistently across the group. In addition, it ensures that the policies of the entities of the group are consistent with the group policies.

Guideline 8 - Contingency plans

1.37. The undertaking should identify material risks to be addressed by contingency plans covering the areas where it considers itself to be vulnerable, and reviews, updates and tests these contingency plans on a regular basis.

Section 2: Remuneration

Guideline 9 - Scope of the remuneration policy

- 1.38. In its remuneration policy the undertaking should at least ensure that:
- a) remuneration awards do not threaten the undertaking's ability to maintain an adequate capital base;
 - b) remuneration arrangements with service providers do not encourage risk-taking that is excessive in view of the undertaking's risk management strategy.
- 1.39. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should adopt and implement a remuneration policy for the whole group. This should take into account the complexity and structures of the group in order to establish, develop and implement a consistent policy for the whole group that is in line with the group's risk management strategies. The policy should be applied to all relevant persons at group and individual entity level.
- 1.40. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure:
- a) an overall consistency of the group's remuneration policies by ensuring that they comply with the legal requirements of the undertakings which are part of the group and by verifying their correct application;
 - b) that all undertakings that belong to the group comply with the remuneration requirements;
 - c) that material risks at the level of the group linked to remuneration issues in the group entities are managed.

Guideline 10 - Remuneration committee

- 1.41. The undertaking should ensure that the composition of the remuneration committee enables it to exercise a competent and independent judgment on the remuneration policy and its oversight. If no remuneration committee is established, the AMSB should assume the tasks that would otherwise have been assigned to a remuneration committee in a way that avoids conflicts of interest.

Section 3: Fit and proper

Guideline 11 – Fit requirements

- 1.42. The undertaking should ensure that persons who effectively run the undertaking or have other key functions are 'fit' and take account of the respective duties allocated to individual persons to ensure appropriate diversity of qualifications, knowledge and relevant experience so that the undertaking is managed and overseen in a professional manner.
- 1.43. The AMSB should collectively possess appropriate qualification, experience and knowledge about at least:
- a) insurance and financial markets;
 - b) business strategy and business model;
 - c) system of governance;
 - d) financial and actuarial analysis;
 - e) regulatory framework and requirements.

Guideline 12 - Proper requirements

- 1.44. When assessing whether a person is 'proper', the undertaking should consider that the period of limitation of the relevant criminal or other offence is lapsed based on national law.

Guideline 13 - Fit and proper policies and procedures

- 1.45. The undertaking should have a policy on the fit and proper requirements, which includes at least:
- a) a description of the procedure for identifying the positions for which notifying is required and for the notification to the supervisory authority;
 - b) a description of the procedure for assessing the fitness and propriety of the persons who effectively run the undertaking or have other key functions, both when being considered for the specific position and on an on-going basis;
 - c) a description of the situations that give rise to a re-assessment of the fit and proper requirements;
 - d) a description of the procedure for assessing the skills, knowledge, expertise and personal integrity of other relevant personnel not subject to the requirements of Article 42 of Solvency II according to internal standards, both when being considered for the specific position and on an on-going basis.

Guideline 14 - Outsourcing of key functions

- 1.46. The undertaking should apply the fit and proper procedures in assessing persons employed by the service provider or sub 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 Solvency II that needs to be notified to the supervisory authority.

Guideline 15 - Notification

- 1.48. The supervisory authority should require as a minimum from the undertaking the information included in the Technical Annex to be submitted by means of a notification.

Guideline 16 - Assessment of the fit and proper requirements by the supervisory authority

- 1.49. The supervisory authority should assess the fit and proper requirements of the persons subject to notification requirements and give feedback on this to the undertaking concerned within an appropriate timeframe from the receipt of a complete notification.

Section 4: Risk management

Guideline 17 - Role of the AMSB in the risk management system

- 1.50. The AMSB should be ultimately responsible for ensuring the effectiveness of the risk management system, setting the undertaking's risk appetite and overall risk tolerance limits, as well as approving the main risk management strategies and policies.
- 1.51. The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the risk management system of the whole group is effective. This risk management system of the group should include at least:
- a) the strategic decisions and policies on risk management at group level;
 - b) the definition of group's risk appetite and overall risk tolerance limits;
 - c) the identification, measurement, management, monitoring and reporting of risks at group level.
- 1.52. The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that such strategic decisions and policies are consistent with the group's structure, size and the specificities of the entities that are part of the group.

Guideline 18 - Risk management policy

- 1.53. The undertaking should establish a risk management policy which at least:
- a) defines the risk categories and the methods to measure the risks;
 - b) outlines how the undertaking manages each relevant category, area of risks and any potential aggregation of risks;
 - c) describes the connection with the overall solvency needs assessment as identified in the ORSA, the regulatory capital requirements and the undertaking's risk tolerance limits;
 - d) specifies risk tolerance limits within all relevant risk categories in line with the undertaking's risk appetite;
 - e) describes the frequency and content of regular stress tests and the situations that would warrant ad-hoc stress tests.

Guideline 19 - Risk management function: tasks

- 1.54. The undertaking should require the risk management function to report to the AMSB on risks that have been identified as potentially material. The risk management function should also report on other specific areas of risks both on its own initiative and following requests from the AMSB.

Guideline 20 - Underwriting and reserving risk management policy

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

Guideline 21 – Operational risk management policy

- 1.56. In the risk management policy, the undertaking should cover at least the following with regard to operational risk:
- a) identification of the operational risks it is or might be exposed to and assessment of the way to mitigate them;
 - b) activities and internal processes for managing operational risks, including the IT system supporting them;
 - c) risk tolerance limits with respect to the undertaking's main operational risk areas.
- 1.57. The undertaking should have processes to identify, analyse and report on operational risk events. For this purpose, it should establish a process for collecting and monitoring operational risk events.
- 1.58. For the purposes of operational risk management, the undertaking should develop and analyse an appropriate set of operational risk scenarios based on at least the following approaches:
- a) the failure of a key process, personnel or system;
 - b) the occurrence of external events.

Guideline 22 - Reinsurance and other risk-mitigation techniques – risk management policy

- 1.59. In the risk management policy the undertaking should cover at least the following with regard to reinsurance and other risk mitigation techniques:

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

Guideline 23 - Strategic and reputational risk

1.60. The undertaking should manage, monitor and report the following situations:

- a) actual or potential exposure to reputational and strategic risks and the interrelationship between these risks and other material risks;
- b) key issues affecting its reputation, considering the expectations of stakeholders and the sensitivity of the market.

Guideline 24 - Asset-liability management policy

1.61. In its risk management policy the undertaking should cover at least the following information with regard to asset-liability management:

- a) a description of the procedure for identification and assessment of different natures of mismatches between assets and liabilities, at least with regard to terms and currency;
- b) a description of mitigation techniques to be used and the expected effect of relevant risk-mitigating techniques on asset-liability management;
- c) a description of deliberate mismatches permitted;
- d) a description of the underlying methodology and frequency of stress tests and scenario tests to be carried out.

Guideline 25 - Investment risk management policy

1.62. In its risk management policy the undertaking should cover at least the following information with regard to investments:

- a) the level of security, quality, liquidity and profitability the undertaking is aiming for with regard to the whole portfolio of assets and how it plans to achieve this;
- b) its quantitative limits on assets and exposures, including off-balance sheet exposures, that are to be established to help to ensure the undertaking achieves its desired level of security, quality, liquidity, profitability and availability for the portfolio;

- c) the level of availability the undertaking is aiming for with regard to the whole portfolio of assets and how it plans to achieve this
- d) consideration of the financial market environment;
- e) the conditions under which the undertaking can pledge or lend assets;
- f) the link between market risk and other risks in adverse scenarios;
- g) the procedure for appropriately valuing and verifying the investment assets;
- h) the procedures to monitor the performance of the investments and review the policy when necessary;
- i) how the assets are to be selected in the best interest of policyholders and beneficiaries.

Guideline 26 - Liquidity risk management policy

1.63. In its risk management policy the undertaking should cover at least the following information with regard to liquidity risk:

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

Section 5: The prudent person principle and the system of governance

Guideline 27 - Investment risk management

- 1.64. The undertaking should not solely depend on the information provided by third parties, such as financial institutions, asset managers and rating agencies. In particular, the undertaking should develop its own set of key risk indicators in line with its investment risk management policy and business strategy.
- 1.65. When making its investment decisions, the undertaking should take into account the risks associated with the investments without relying only on the risk being adequately captured by the capital requirements.

Guideline 28 – Assessment of non-routine investment activities

- 1.66. Before performing any investment or investment activity of a non-routine nature the undertaking should carry out an assessment of at least:
- a) its ability to perform and manage the investment or the investment activity;
 - b) the risks specifically related to the investment or the investment activity and the impact of the investment or the investment activity on the undertaking's risk profile;
 - c) the consistency of the investment or investment activity with the beneficiaries' and policyholders' interest, liability constraints set by the undertaking and efficient portfolio management;
 - d) the impact of this investment or investment activity on the quality, security, liquidity, profitability and availability of the whole portfolio.
- 1.67. The undertaking should have procedures that require that where such investment or investment activity entails a significant risk or change in the risk profile, the undertaking's risk management function communicates such a risk or change in the risk profile to the AMSB of the undertaking.

Guideline 29 – Security, quality, liquidity and profitability of the investment portfolios

- 1.68. The undertaking should regularly review and monitor the security, quality, liquidity and profitability of the portfolio as a whole by considering at least:
- a) any liabilities constraints, including policyholders' guarantees, and any disclosed policy on future discretionary benefits and, where relevant, reasonable policyholders' expectations;
 - b) the level and nature of risks that an undertaking is willing to accept;
 - c) the level of diversification of the portfolio as a whole;
 - d) the characteristics of the assets including:
 - (i) credit quality of counterparties;
 - (ii) liquidity;

- (iii) tangibility;
 - (iv) sustainability;
 - (v) existence and quality of collateral or other assets backing the assets;
 - (vi) gearing or encumbrances;
 - (vii) tranches;
- e) events that could potentially change the characteristics of the investments, including any guarantees, or affect the value of the assets;
- f) issues relating to the localisation and availability of the assets including:
- (i) non-transferability;
 - (ii) legal issues in other countries;
 - (iii) currency measures;
 - (iv) custodian risk;
 - (v) over-collateralisation and lending.

Guideline 30 - Profitability

1.69. The undertaking should establish targets for the returns it seeks from its investments taking into account the need to obtain a sustainable yield on the asset portfolios to meet reasonable policyholders' expectations.

Guideline 31- Conflicts of interests

1.70. The undertaking should describe in its investment policy how it identifies and manages any conflicts of interest that arise regarding investments, irrespective of whether they arise in the undertaking or in the entity which manages the asset portfolio. It should also document the actions taken to manage such conflicts.

Guideline 32 - Unit-linked and index-linked contracts

1.71. The undertaking should ensure that its investments of unit-linked and index-linked contracts are selected in the best interest of policyholders and beneficiaries taking into account any disclosed policy objectives.

1.72. In the case of unit-linked business the undertaking should take into account and manage the constraints related to unit-linked contracts, in particular liquidity or any contractual or legal transferability constraints.

Guideline 33 - Assets not admitted for trading on a regulated financial market

1.73. The undertaking should implement, manage, monitor and control procedures in relation to investments that are not admitted to trading on a regulated financial market or to complex products, which are difficult to value.

1.74. The undertaking should treat assets admitted to trading, but not traded or traded on a non-regular basis, similarly to those assets not admitted to trading on a regulated financial market.

Guideline 34 - Derivatives

1.75. When using derivatives, the undertaking should implement the procedures in line with its investment risk management policy to monitor the performance of these derivatives.

1.76. The undertaking should demonstrate how the quality, security, liquidity or profitability of the portfolio is improved without significant impairment of any of these features where derivatives are used to facilitate efficient portfolio management.

1.77. The undertaking should document the rationale and demonstrate the effective risk transfer obtained by the use of the derivatives where derivatives are used to contribute to a reduction of risks or as a risk mitigation technique.

Guideline 35 - Securitised instruments

1.78. Where the undertaking invests in securitised instruments, it should ensure that its interests and the interests of the originator or sponsor concerning the securitised assets are well understood and aligned.

Section 6: Own fund requirements and the system of governance

Guideline 36 – Capital management policy

- 1.79. The undertaking should develop a capital management policy which includes a description of the procedures to:
- a) ensure that own-fund items, both at issue and subsequently, are classified according to the features in Articles 71, 73, 75 and 77 of the Commission Delegated Regulation 2015/35;
 - b) monitor tier by tier the issuance of own fund items according to the medium-term capital management plan, and ensure before issuance of any own fund items that it can satisfy the criteria for the appropriate tier on a continuous basis;
 - c) monitor that own-funds items are not encumbered by the existence of any agreements or connected transactions, or as a consequence of a group structure, which would undermine their efficacy as capital;
 - d) ensure that the actions required or permitted under the contractual, statutory or legal provisions governing an own-fund item are initiated and completed in a timely manner;
 - e) ensure that ancillary own-fund items can be, and are, called in a timely manner when necessary;
 - f) identify and document any arrangements, legislation or products that give rise to ring-fenced funds, and ensure that appropriate calculations and adjustments in the determination of the solvency capital requirement and own funds are made;
 - g) ensure that the contractual terms governing own-fund item items are clear and unambiguous in relation to the criteria for classification into tiers;
 - h) ensure that any policy or statement in respect of ordinary share dividends is fully taken into account in consideration of the capital position and the assessment of the foreseeable dividends;
 - i) identify and document the instances in which distributions on tier 1 own-fund items might be cancelled on a discretionary basis;
 - j) identify, document and enforce the instances in which distributions on an own-funds item need to be deferred or cancelled in accordance with Articles 71(1)(l) and 73(1)(g) of the Commission Delegated Regulation 2015/35;
 - k) identify the extent to which the undertaking relies on own-fund items subject to transitional measures;
 - l) ensure that the manner in which items included in own funds under the transitional measures operate in times of stress, and in particular how the items absorb losses is assessed and, if necessary, taken into account in the ORSA.

Guideline 37 – Medium-term capital management plan

1.80. The undertaking should develop a medium-term capital management plan which is monitored by the AMSB, and which includes at least considerations of:

- a) any planned capital issuance;
- b) the maturity of own-fund items, incorporating both the contractual maturity and any earlier opportunity to repay or redeem, relating to the undertaking's own fund items;
- c) the result of the projections made in the ORSA;
- d) how any issuance, redemption or repayment, or other variation in the valuation of own-funds items affects the application of the limits on tiers;
- e) how applying the distribution policy will affect own funds; and
- f) the impact of the end of the transitional period.

Section 7: Internal controls

Guideline 38 – Internal control environment

- 1.81. The undertaking should promote the importance of performing appropriate internal controls by ensuring that all personnel are aware of their role in the internal control system. The control activities should be commensurate to the risks arising from the activities and processes to be controlled.
- 1.82. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure a consistent implementation of the internal control systems across the group.

Guideline 39 – Monitoring and reporting

- 1.83. The undertaking should establish monitoring and reporting mechanisms within the internal control system which provide the AMSB with the relevant information for the decision-making processes.

Section 8: Internal audit function

Guideline 40 – Independence of the internal audit function

- 1.84. The undertaking should ensure that the internal audit function does not perform any operational functions and is free from undue influence by any other functions including key functions.
- 1.85. When performing an audit and when evaluating and reporting the audit results, the undertaking should ensure that the internal audit function is not subject to influence from the AMSB that can impair its operational independence and impartiality.

Guideline 41 – Conflicts of interest within the internal audit function

- 1.86. The undertaking should take adequate measures in order to mitigate the risk of any conflicts of interest.
- 1.87. The undertaking should therefore ensure that internally recruited auditors do not audit activities or functions they previously performed during the timeframe covered by the audit.

Guideline 42 - Internal audit policy

- 1.88. The undertaking should have an internal audit policy which covers at least the following areas:
 - a) the terms and conditions according to which the internal audit function can be called upon to give its opinion or assistance or to carry out other special tasks;

- b) if relevant, internal rules setting out the procedures the person responsible for the internal audit function needs to follow before informing the supervisory authority;
 - c) where appropriate, the criteria for the rotation of staff assignments.
- 1.89. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the internal audit policy at the level of the group describes how the internal audit function:
- a) coordinates the internal audit activity across the group;
 - b) ensures compliance with the internal audit requirements at the group level.

Guideline 43 – Internal audit plan

- 1.90. The undertaking should ensure that the internal audit plan:
- a) is based on a methodical risk analysis, taking into account all the activities and the complete system of governance, as well as expected developments of activities and innovations;
 - b) covers all significant activities that are to be reviewed within a reasonable period of time.

Guideline 44 - Internal audit documentation

- 1.91. The undertaking should keep a record of its work in order to allow for an assessment of the effectiveness of the work of the internal audit function, and to document the audits in a way that allows for retracing the audits undertaken and the findings they produced.

Guideline 45 – Internal audit function tasks

- 1.92. The undertaking should require that the internal audit function, in the report to the AMSB, includes the envisaged period of time to remedy the shortcomings, and information on the achievement of previous audit recommendations.

Section 9: Actuarial function

Guideline 46 - Tasks of the actuarial function

- 1.93. The undertaking should take appropriate measures to address the potential conflicts of interests, if the undertaking decides to add additional tasks or activities to the tasks and activities of the actuarial function.
- 1.94. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should require that the actuarial function gives an opinion on the reinsurance policy and the reinsurance program for the group as a whole.

Guideline 47 - Coordination of the calculation of technical provisions

- 1.95. The undertaking should require the actuarial function to identify any inconsistency with the requirements set out in Articles 76 to Article 83 of Solvency II for the calculation of technical provisions and propose corrections as appropriate.
- 1.96. The undertaking should require the actuarial function to explain any material effect of changes in data, methodologies or assumptions between valuation dates on the amount of technical provisions.

Guideline 48 – Data quality

- 1.97. The undertaking should require the actuarial function to assess the consistency of the internal and external data used in the calculation of technical provisions against the data quality standards as set in Solvency II. Where relevant, the actuarial function provides recommendations on internal procedures to improve data quality so as to ensure that the undertaking is in a position to comply with the Solvency II framework.

Guideline 49 – Testing against experience

- 1.98. The undertaking should ensure that the actuarial function reports any material deviations from actual experience to the best estimate to the AMSB. The report should investigate the causes of the deviations and, where applicable, propose changes in the assumptions and modifications to the valuation model in order to improve the best estimate calculation.

Guideline 50 – Underwriting policy and reinsurance arrangements

- 1.99. The undertaking should require the actuarial function, when providing its opinion on the underwriting policy and the reinsurance arrangements, to take into consideration the interrelations between these and the technical provisions.

Guideline 51 – The actuarial function of an undertaking using an internal model

1.100. The undertaking should require the actuarial function to contribute to specifying which risks within their domain of expertise are covered by the internal model. The actuarial function should also contribute to how dependencies between these risks and dependencies between these risks and other risks are derived. This contribution is based on a technical analysis and should reflect the experience and expertise of the function.

Section 10: Valuation of assets and liabilities other than technical provisions

Guideline 52 - Valuation of assets and liabilities other than technical provisions

1.101. In its policy and procedures for valuation of assets and liabilities the undertaking should cover at least the following:

- a) the methodology and criteria to be used for the assessment of active and non-active markets;
- b) the requirements to ensure adequate documentation of the valuation process and of the accompanying controls, including those for data quality;
- c) the requirements on the documentation of the valuation approaches used regarding:
 - (i) their designs and the way they are implemented;
 - (ii) the adequacy of data, parameters and assumptions;
- d) the process for the independent review and verification of the valuation approaches;
- e) the requirements for the regular reporting to the AMSB for matters that are relevant for its governance on valuation.

Guideline 53 – Data quality control procedures

1.102. The undertaking should implement data quality control procedures to identify deficiencies and to measure, monitor, manage and document their data quality. These procedures should include:

- a) completeness of data;
- b) appropriateness of data, both from internal and external sources;
- c) independent review and verification of data quality.

1.103. The policies and procedures implemented by the undertaking should address the need to periodically review market data and inputs against alternative sources and experience.

Guideline 54 – Documentation when using alternative valuation methods

1.104. Where alternative methods for valuation are used, the undertaking should document:

- a) a description of the method, purpose, key assumptions, limitations and output;
- b) the circumstances under which the method would not work effectively;
- c) description and analysis of the valuation process, and the controls linked with the method;
- d) an analysis of valuation uncertainty linked with the method;
- e) a description of back-testing procedures performed on the results and, where possible, a comparison against comparable models or other benchmarks, which should be carried out when the valuation method is first introduced and regularly thereafter;
- f) a description of the tools or programs used.

Guideline 55 - Independent review and verification of valuation methods

1.105. The undertaking should ensure that an independent review of the valuation method, following Article 267 (4)(b) of the Commission Delegated Regulation 2015/35 takes place before the implementation of a new method or a major change, and on a regular basis thereafter.

1.106. The undertaking should determine the frequency of the review in line with the significance of the method for the decision-making and risk management processes.

1.107. The undertaking should apply the same principles for the independent review and verification of both internally developed valuation methods or models and for vendor provided valuation methods or models.

1.108. The undertaking should have processes in place to report the results of the independent review and verification, as well as the recommendations for remedial actions to the appropriate management level of the undertaking.

Guideline 56 - Oversight by the AMSB and other persons who effectively run the undertaking

1.109. The AMSB and other persons who effectively run the undertaking should be able to demonstrate an overall understanding of the valuation approaches and the uncertainties involved in the valuation process to allow a proper oversight of the risk management process concerning valuation.

Guideline 57 – Request to the undertaking by the supervisory authority, for an external independent valuation or verification

1.110. The supervisory authority should consider requesting an independent valuation or verification from the undertaking at least when there is a risk of

misstatements in the valuation of material assets or liabilities, with possible material consequences for the undertaking's solvency situation.

Guideline 58 – Independence of the external expert

1.111. The undertaking should be able to demonstrate to the supervisory authority that the external valuation or verification has been performed by independent experts with the relevant professional competence, due care and relevant experience.

Guideline 59 – Information to be provided to the supervisory authority on the external valuation or verification

1.112. The undertaking should provide the supervisory authority with all relevant information requested on external valuation or verification. The undertaking should include in this information, at least, the experts' written opinion on the valuation of the relevant asset or liability.

Section 11: Outsourcing

Guideline 60 - Critical or important operational functions and activities

1.113. The undertaking should determine and document whether the outsourced function or activity is a critical or important function or activity on the basis of whether this function or activity is essential to the operation of the undertaking as it would be unable to deliver its services to policyholders without the function or activity.

Guideline 61 - Underwriting

1.114. When an insurance intermediary, who is not an employee of the undertaking, is given authority to underwrite business or settle claims in the name and on account of an undertaking, the undertaking should ensure that the activity of this intermediary is subject to the outsourcing requirements.

Guideline 62 - Intra-group outsourcing

1.115. If critical or important functions or activities are outsourced within the group, the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should document which functions relate to which legal entity and ensure that the performance of the critical or important functions or activities concerned at the level of the undertaking is not impaired by such arrangements.

Guideline 63 - Outsourcing written policy

1.116. The undertaking that outsources or considers outsourcing should cover in its policy the undertaking's approach and processes for outsourcing from the inception to the end of the contract. This in particular should include:

- a) the process for determining whether a function or activity is critical or important;
- b) how a service provider of suitable quality is selected and how and how often its performance and results are assessed;
- c) the details to be included in the written agreement with the service provider taking into consideration the requirements laid down in the Commission Delegated Regulation 2015/35;
- d) business contingency plans, including exit strategies for outsourced critical or important functions or activities.

Guideline 64 - Written notification to the supervisory authority

1.117. In its written notification to the supervisory authority of any outsourcing of critical or important functions or activities the undertaking should include a description of the scope and the rationale for the outsourcing and the service provider's name. When outsourcing concerns a key function, the information

should also include the name of the person in charge of the outsourced function or activities at the service provider.

Chapter II: Group governance specific requirements

Guideline 65 – Responsibilities for setting internal governance requirements

1.118. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should set adequate internal governance requirements across the group appropriate to the structure, business model and risks of the group and of its related entities, and should consider the appropriate structure and organization for risk management at group level, setting a clear allocation of responsibilities at all entities that are part of the group.

1.119. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should not impair the responsibilities of the AMSB of each entity in the group when setting up its own system of governance.

Guideline 66 – System of governance at group level

1.120. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should:

- a) have in place appropriate and effective tools, procedures and lines of responsibility and accountability enabling it to oversee and steer the functioning of the risk management and internal control systems at individual level;
- b) have in place reporting lines within the group and effective systems for ensuring information flows in the group bottom up and top-down;
- c) document and inform all the entities that are part of the group about the tools used to identify, measure, monitor, manage and report all risks to which the group is exposed;
- d) take into account the interests of all the entities belonging to the group and how these interests contribute to the common purpose of the group as a whole over the long term.

Guideline 67 – Risks with significant impact at group level

1.121. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should consider in its risk management system the risks both at individual and group level and their interdependencies, in particular:

- a) reputational risk and risks arising from intra-group transactions and risk concentrations, including contagion risk, at the group level;

- b) interdependencies between risks stemming from conducting business through different entities and in different jurisdictions;
- c) risks arising from third-country entities;
- d) risks arising from non-regulated entities;
- e) risks arising from other regulated entities.

Guideline 68 –Risk concentrations at group level

1.122.The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that there are processes and procedures in place to identify, measure, manage, monitor and report risk concentrations.

Guideline 69 - Intra-group transactions

1.123.The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the risk management system of the group and the individual undertakings include processes and reporting procedures for identifying, measuring, monitoring, managing and reporting of intra-group transactions, including significant and very significant intra-group transactions as referred in Solvency II.

Guideline 70 – Group risk management

1.124.The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should support in its risk management at the level of the group by appropriate processes and procedures to identify, measure, manage, monitor and report the risks that the group and each individual entity are or might be exposed to.

1.125.The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the structure and organization of the group risk management do not impair the undertaking's legal ability to fulfil its legal, regulatory and contractual obligations.

Compliance and Reporting Rules

- 1.1. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, competent authorities and financial institutions shall make every effort to comply with guidelines and recommendations.
- 1.2. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.3. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.
- 1.4. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

Final Provision on Reviews

The present Guidelines shall be subject to a review by EIOPA.

Technical Annex: Minimum information to be provided to the supervisory authority concerning the fit & proper assessment

Contact information

- Name of the undertaking
- Undertaking's registration number
- Contact person:
 - a) First name
 - b) Surname
 - c) Title
 - d) Telephone number
 - e) E-mail address
 - f) Fax number

Fact being notified

- First appointment
- Change in previous information
- Change of position

Description of the position being notified

- Name of the position
- Scope of the responsibilities
- Date of the appointment
- Length of appointment, if applicable
- Executive functions or not
- Any other information the undertaking deems relevant for the assessment

Information on the person subject to notification

- First name
- Surname
- Any previous names
- Personal address
- Telephone number
- Date of birth

- Place of birth
- Nationality
- Information on any previous assessment/notification process by a supervisory authority of the financial sector within the EEA:
 - a) Name of the supervisory authority
 - b) Country
 - c) Date
- Information on previous employments, qualified assignments or appointments as a member of an administrative, management or supervisory body:
 - a) Company name and registration number
 - b) Nature and scope of the operations
 - c) The registered office of the undertaking
 - d) Position
- Any other positions held:
 - a) Company name and registration number
 - b) Nature and scope of the operations
 - c) The registered office of the undertaking
 - d) Position
- Description of the level of knowledge, competence and experience of the person to perform the task, including:
 - a) Skills, knowledge (university degree, training or diploma)
 - b) Professional relevant experience
- Information on potential conflicts of interest with details, if applicable
 - a) Qualifying ownership or any other form of substantial influence in the undertaking
 - Any other companies in which the notified person has a direct or indirect qualifying ownership:
 - a) Company name and registration number
 - b) Nature and scope of the operations
 - c) The registered office of the company
 - d) Possession in percentage
- Close relatives with ownership shares in the undertaking that notifies or in any other company which has ownership shares in that company
- Close relatives with any other financial relations to companies mentioned above
- Any other commitments that may give rise to conflict of interest with explanations as to the circumstances and a statement how the notified person intends to deal with potential conflicts of interest

- Conviction in a domestic or foreign court within the last X years [number of years according to national law] with explanation of circumstances, if applicable
- Pending criminal proceedings
- Membership in a board of directors in an operating undertaking that has not been granted a release from liability
- Dismissal from a position in a financial institution, company or from employment as a senior executive or termination of an engagement as a board member or auditor in another operating undertaking
- Participation in an arbitration board
- Bankruptcies or the equivalent abroad
- Rejection of an application, exclusion or limitation in any other way in terms of the right to conduct operations or a profession which requires authorisation, registration or such of the competent authority, organisation or equivalent body
- Supervisory sanctions against the person notified or a company where the person had a key function
- Any other information relevant to the assessment by the supervisory authority

Documents to be submitted

- Extract from the judicial record or an equivalent document issued by a competent judicial or administrative authority related to the above referred information, if available

Declarations

- Declaration signed by the appropriately authorized person [according to national law/practice the management or supervisory body or the person responsible for this in the undertaking with the position of the person(s) in the undertaking given] that the assessment was performed in accordance with the laws, regulations and undertaking's fit and proper policy and the person subject to notification was considered as fit and proper for the job
- Declaration that the information submitted in the notification is correct and complete: date, name of signatories in block letters, signatures.

2. Explanatory text

Section 1: General governance requirements

Guideline 1 - The administrative, management or supervisory body

The administrative, management or supervisory body (hereinafter "AMSB") should have appropriate interaction with any committee it establishes as well as with senior management and with persons having other key functions in the undertaking, proactively requesting relevant information from them and challenging that information when necessary.

At group level the AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should have an appropriate interaction with the AMSB of all entities within the group that have a material impact on the risk profile of the group, requesting information proactively and challenging the decisions in the matters that may affect the group.

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

Guideline 2 – Organisational and operational structure

The undertaking should have organisational and operational structures aimed at supporting the strategic objectives and operations of the undertaking. Such structures should be adapted to changes in the strategic objectives, operations or in the business environment of the undertaking within an appropriate period of time.

At group level, the AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should assess how changes to the group's structure impact the financial position of the affected undertakings of the group and make the necessary adjustments in a timely manner.

The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should, in order to take appropriate measures, have an appropriate knowledge of the corporate organisation of the group, the business model of its different entities and the links and relationships between them and the risks arising from the group's structure.

- 2.3. Sound and prudent management of the business implies among other things a consistent application of risk management and internal control practices

throughout the entire organisational structure of the undertaking. In order to support this goal, consideration ought to be given to drawing up and implementing a code of conduct for all staff, including the AMSB and senior management. Apart from the general code of conduct, everybody in the undertaking also has to be familiar with more detailed codes applicable to their own areas of expertise.

- 2.4. It is important that the undertaking ensures that it has an organisational culture that enables and supports the effective operation of its system of governance. This requires an appropriate “tone at the top” with the AMSB and senior management providing appropriate organisational values and priorities.
- 2.5. The undertaking needs to ensure that each key function has an appropriate standing within the organisational structure. This requires that their responsibilities and the authority they have to exercise their tasks are clearly set out.
- 2.6. The operational structure supports the main functions of the organisational structure. It identifies the business processes involving material risks and sets out how they should be executed, including responsibilities and information flows, to ensure that these processes are adequately monitored and controlled.
- 2.7. The undertaking has to document its internal organisational and operational structures and keep this documentation up to date and keep them for an appropriate time frame, taking into account prescribed record retention periods.
- 2.8. The assessment of the appropriateness of the organisational and operational structure is required both at individual and group level. Inquiries addressed by the group supervisor, in cooperation with the college of supervisors, on the appropriateness of the organizational and operational structure may be expected where changes occur in the group’s structures, as well as on interconnections and significant transactions between group entities.
- 2.9. To assess how changes to the group’s structure impact the financial position of the affected undertakings and the group itself, the group and the affected undertakings can perform an ORSA, especially when the changes in the group structure are considered to induce a significant change in the risk profile of the group or the affected undertakings.

Guideline 3 – Significant decisions

The undertaking should ensure that any significant decision of the undertaking involves at least two persons who effectively run the undertaking before the decision is being implemented.

- 2.10. Significant decisions as opposed to day-to-day decisions do not concern the spate of usual decisions to be taken at the top level of the undertaking in the running of the business, but are rather decisions that are unusual or that will or could have a material impact on the undertaking. This could be e.g. decisions that affect the strategy of the undertaking, its business activities or its business conduct, that could have serious legal or regulatory

consequences, that could have major financial effects or major implications for staff or policyholders or that could potentially result in repercussions for the undertaking's reputation.

Guideline 4 - Documentation of decisions taken at the level of the AMSB

The undertaking should appropriately document the decisions taken at the level of the AMSB of the undertaking and how information from the risk management system has been taken into account.

Guideline 5 - Allocation and segregation of duties and responsibilities

The undertaking should ensure that the duties and responsibilities are allocated, segregated and coordinated in line with the undertaking's policies and reflected in descriptions of tasks and responsibilities. The undertaking should ensure that all the important duties are covered and that unnecessary overlaps are avoided. Effective cooperation between personnel should be fostered.

- 2.11. An adequate segregation of responsibilities ensures that the persons performing tasks are not simultaneously also responsible for monitoring and controlling the adequacy of this performance.
- 2.12. In principle, incompatible functions, i.e. tasks if performed by the same persons could give rise to conflicts of interest. That means that in principle these tasks have to be clearly separated and not be performed by the same person or persons, unless any conflicts are addressed appropriately. This separation needs to be observed on all levels of the undertaking, including the AMSB to the extent that certain tasks may be allocated to specific members. All key functions explicitly mentioned in Solvency II have to be operationally independent. This means key functions have to retain the responsibility for taking the decisions necessary for the proper performance of their duties without interference from others. This requires that the functions are integrated into the organisational structure in a way that ensures that there is no undue influence, control or constraint exercised on the functions with respect to the performance of their duties and responsibilities by other operational or key functions, senior management or the AMSB.
- 2.13. While it is not incompatible with operational independence for a person or unit to perform more than one key function, segregation of the responsibilities of the key functions as set out in Solvency II is the most effective way to safeguard operational independence. Hence an undertaking that does not want to keep key functions separate from each other has to demonstrate that in view of its risk profile it is proportionate for it to do so and that it has effective processes and procedures in place to ensure that operational independence is not compromised.
- 2.14. The segregation of key functions does not automatically provide for operational independence and other measures may also be necessary.

- 2.15. Operational independence implies that the key functions are able to report their results and any concerns and suggestions for addressing these they may have directly to the AMSB without restrictions as to their scope or content from anybody else. This does not however preclude that the reports are subject to comments by relevant functions within the undertaking before they are passed on.
- 2.16. The AMSB is ultimately responsible for deciding how to react to the results, concerns and recommendations presented to it by the key functions. For example, it could resolve not to act or act differently from suggestions in the findings of a key function.
- 2.17. The AMSB does not exert influence to suppress or tone down key function results in order that there is no discrepancy between the findings of key functions and the AMSB's actions.
- 2.18. At group level the role and responsibilities of each undertaking in the group in respect to the group's overall strategic objectives and operations have also to be clearly defined in the group's policies.
- 2.19. An undertaking in a group structure must follow its own governance responsibilities and set its own strategies and policies, consistently with group strategies and policies. Any group-level decisions or procedures have to be evaluated to ensure that they do not put the individual entity in breach of applicable legal or regulatory provisions or prudential rules.
- 2.20. In order to ensure an effective system for providing the transmission of information in accordance with subparagraph 2 of Article 41 (1) of Solvency II, undertakings are required to introduce clear reporting lines that provide for the prompt transfer of information to all persons who need it.

Guideline 6 - Internal review of the system of governance

The AMSB of the undertaking should determine the scope and frequency of the internal reviews of the system of governance, taking into account the nature, scale and complexity of the business both at individual and at group level, as well as the structure of the group.

The undertaking should ensure that the scope, findings and conclusions of the review are properly documented and reported to its AMSB. Suitable feedback loops are necessary to ensure follow-up actions are undertaken and recorded.

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

Guideline 7 – Policies

The undertaking should align all policies required as part of the system of governance with each other and with its business strategy. Each policy should clearly set out at least:

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

In the policies that cover the key functions, the undertaking should also address the position of these functions within the undertaking, their rights and powers.

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the policies are implemented consistently across the group. In addition, it ensures that the policies of the entities of the group are consistent with the group policies.

- 2.23. The undertaking may combine the written policies required by Solvency II as it sees fit in line with its organisational structure and processes.
- 2.24. Written policies are subject to prior approval by the AMSB not only for the original policy proposal but also for any subsequent changes, unless these are minor.
- 2.25. A proper implementation of the written policies requires ensuring that all relevant staff members are familiar with and observe the policies for their respective area of activities. It also requires that any changes to the policies are promptly communicated to them.
- 2.26. The review requirement applies to all written policies undertakings have to implement in order to comply with Solvency II, i.e. it not only covers the policies explicitly referred to in Article 41(3) but also e.g. the "sub-policies" according to Article 44(2), the ORSA policy, the Solvency and Financial Condition Report ("SFCR") policy and the model change policy.
- 2.27. Any review of the written policies has to be appropriately documented. The documentation needs to record who conducted the review and to include any suggested recommendations and the decisions subsequently taken by the AMSB in respect of those recommendations as well as the reasons for them.
- 2.28. It is required that all undertakings of a group have consistent policies. This means that at the level of individual undertakings, the policies have to take into account the specificities of each undertaking as well as the group policies. In case other entities, that are not insurance or reinsurance undertakings, in the group have also internal policies (and this is not a requirement of the Directive), the group will ensure the consistency of those policies with the group policies.

Guideline 8 - Contingency plans

The undertaking should identify material risks to be addressed by contingency plans covering the areas where it considers itself to be vulnerable, and reviews, updates and tests these contingency plans on a regular basis.

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

Section 2: Remuneration

Guideline 9 - Scope of the remuneration policy

In its remuneration policy the undertaking should at least ensure that:

- a) remuneration awards do not threaten the undertaking's ability to maintain an adequate capital base;
- b) remuneration arrangements with service providers do not encourage risk-taking that is excessive in view of the undertaking's risk management strategy;

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should adopt and implement a remuneration policy for the whole group. This should take into account the complexity and structures of the group in order to establish, develop and implement a consistent policy for the whole group that is in line with the group's risk management strategies. The policy should be applied to all relevant persons at group and individual entity level.

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure:

- a) an overall consistency of the group's remuneration policies by ensuring that they comply with the legal requirements of the undertakings which are part of the group and by verifying their correct application;
- b) that all undertakings that belong to the group comply with the remuneration requirements;
- c) that material risks at the level of the group linked to remuneration issues in the group entities are managed.

2.32. The existence of incentives to attract and retain competent, experienced and skilled human resources can be an essential part of an undertaking's business strategy. Remuneration policy not only helps to ensure that an undertaking has staff with the necessary skills and qualifications, it can also provide incentives that align staff's decision-making and risk-taking behaviour with the undertaking's business objectives and risk management strategy.

2.33. Limitations imposed by collective bargaining arrangements, statutorily determined amounts of redundancy pay-outs and other national legislation as for example termination payments need to be structured to reflect the principles and performance criteria used for the compensation of the individual over the whole period of activity at the undertaking. In this way they will be better aligned with the objectives and implementation of other aspects of the remuneration policy, and avoid rewarding failure.

2.34. For the purpose of determining what constitutes "failure" in Article 275 (2)(f) of the Commission Delegated Regulation 2015/35, the remuneration policy will consider the overall assessment of an individual's performance, not just the performance of a particular business unit or entity, including cases where

the undertaking is facing or is likely to face a difficult or irregular situation that may affect its financial performance.

- 2.35. The overall design of the remuneration policy is expected to be aligned with:
- a) the overall business strategy;
 - b) the risk policy and risk tolerance limits;
 - c) the system of governance, including the management of conflicts of interest that may arise:
 - (i) for the individuals establishing the remuneration policy and approving and reviewing the remuneration policy and remuneration contracts;
 - (ii) for those remunerated for selling or underwriting significant new business that may affect the risk profile of the undertaking;
 - (iii) for asset managers.
- 2.36. The policy also includes the methodology for identifying staff that may have a material impact on the undertaking's risk profile.
- 2.37. Where variable remuneration is tied to an individual's performance, it needs to be based upon a balanced set of indicators which also include adherence to effective risk management and compliance. This will help ensure that remuneration incentives are aligned with an undertaking's overall business and risk management strategies and objectives.
- 2.38. The undertaking has to consider including as part of the review of the remuneration policy an assessment of whether the established practice(s) reaches its objectives. In particular, that all agreed plans or programs are being covered, that the remuneration pay-outs are appropriate and all relevant current and future risks and uncertainties are taken into account; that the policy is not undermined by actions of the staff; and that the solvency position, risk profile, long-term objectives and goals of the undertaking are adequately reflected.

Guideline 10 - Remuneration committee

The undertaking should ensure that the composition of the remuneration committee enables it to exercise a competent and independent judgment on the remuneration policy and its oversight. If no remuneration committee is established, the AMSB should assume the tasks that would otherwise have been assigned to a remuneration committee in a way that avoids conflicts of interest.

- 2.39. When determining whether a remuneration committee is required, an undertaking considers various factors, including the size, nature and scope of its business, its internal organisation and the resulting complexity of the remuneration policy and its link to the undertaking's risk profile.
- 2.40. The remuneration committee or the person designated to assume its tasks needs to have access to all the data and information necessary to advise on the design and maintenance of an effective remuneration policy. To secure

proper governance, the committee ensures proper involvement of the persons responsible for the key functions.

2.41. When deciding on the composition of the committee the undertaking considers the tasks of the remuneration committee or the person designated to assume its tasks which includes, but is not limited to:

- a) supporting the AMSB on the design of the undertaking's overall remuneration policy;
- b) preparation of decisions regarding remuneration;
- c) reviewing the policy regularly to ensure it remains appropriate during changes to the undertaking's operations or business environment;
- d) identifying potential conflicts of interest and the steps taken to address them; and
- e) Providing adequate information to the AMSB regarding the performance of the remuneration policy.

Section 3: Fit and proper

Guideline 11 – Fit requirements

The undertaking should ensure that persons who effectively run the undertaking or have other key functions are 'fit' and take account of the respective duties allocated to individual persons to ensure appropriate diversity of qualifications, knowledge and relevant experience so that the undertaking is managed and overseen in a professional manner.

The AMSB should collectively possess appropriate qualification, experience and knowledge about at least:

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

2.42. The undertaking has to assess the fitness and propriety as set out in these Guidelines regarding all persons who effectively run the undertaking as well as all persons carrying out a key function. In addition, when the undertaking is appointing an individual to be responsible for a key function or to effectively run the undertaking, they formally notify the supervisory authority and provide the information needed to assess whether the individual is fit and proper.

2.43. The fitness assessment is not limited to the moment of employment but includes arranging for further professional training as necessary, so that staff is also able to meet changing or increasing requirements of their particular responsibilities.

2.44. The members of the AMSB are not each expected to possess expert knowledge, competence and experience within all areas of the undertaking. However, the collective knowledge, competence and experience of the AMSB as a whole have to provide for a sound and prudent management of the undertaking.

2.45. When changes occur within the AMSB, e.g. replacement of one of the members of the AMSB, the undertaking is expected to be able to demonstrate at all times that the collective knowledge of the members of the AMSB is maintained at an adequate level.

2.46. 'Insurance and Financial Markets knowledge' means an awareness and understanding of the wider business, economic and market environment in which the undertaking operates and an awareness of the level of knowledge of and needs of policyholders.

2.47. 'Business strategy and business model knowledge' refers to a detailed understanding of the undertaking's business strategy and model.

2.48. 'System of Governance knowledge' means the awareness and understanding of the risks the undertaking is facing and the capability of managing them. Furthermore, it includes the ability to assess the effectiveness of the

undertaking's arrangements to deliver effective governance, oversight and controls in the business and, if necessary, oversee changes in these areas.

- 2.49. 'Financial and actuarial analysis knowledge' means the ability to interpret the undertaking's financial and actuarial information, identify key issues, put in place appropriate controls and take necessary measures based on this information.
- 2.50. 'Regulatory framework and requirements knowledge' means awareness and understanding of the regulatory framework in which the undertaking operates, in terms of both the regulatory requirements and expectations, and the capacity to adapt to changes to the regulatory framework without delay.

Guideline 12 - Proper requirements

When assessing whether a person is 'proper', the undertaking should consider that the period of limitation of the relevant criminal or other offence is lapsed based on national law.

- 2.51. Relevant criminal offences include any offence under the laws governing banking, financial, securities or insurance activity, or concerning securities markets or securities or payment instruments, including, but not limited to laws on money laundering, market manipulation, or insider dealing and usury as well as any offences of dishonesty such as fraud or financial crime. They also include any other criminal offences under legislation relating to companies, bankruptcy, insolvency, or consumer protection.
- 2.52. Any other criminal offences currently being tried or having been tried in the past may also be relevant, as they can cast doubt on the integrity of the person.
- 2.53. Relevant disciplinary or administrative offences include any offences made under an activity of the financial sector, including offences under legislation relating to companies, bankruptcy, insolvency, or consumer protection.
- 2.54. When assessing the propriety of the person other circumstances than court decisions and on-going judicial proceedings, which may cast doubt on the repute and integrity of the person, may also be considered. These could include current investigations or enforcement actions, the imposition of administrative sanctions for non-compliance with provisions governing banking, financial, securities or insurance activity, securities markets, securities or payment instruments or any financial services legislation.
- 2.55. Notwithstanding the above, having previous infringements does not automatically result in the person not being assessed as proper for the duties he/she is to perform. It is recognised that, while criminal, disciplinary or administrative convictions or past misconduct are significant factors, the assessment of the fit and proper requirements is to be done on a case-by-case basis. Hence, consideration needs to be given to the type of misconduct or conviction, the level of appeal (definitive vs. non-definitive convictions), the lapse of time since the misconduct or conviction, and its severity, as well as the person's subsequent conduct.
- 2.56. All persons are expected to avoid, to the extent possible, activities that could create conflicts of interest or the appearance of conflicts of interest.

2.57. The proportionality principle does not result in different standards in the case of the propriety requirement, for persons who effectively run the undertaking or have other key functions, since the repute and integrity of the persons should always be on the same adequate level irrespective of the nature, scale and complexity of the risks inherent to the business or of the undertaking's risk profile.

2.58. Proper considerations are relevant for all employees of an undertaking. However, any assessment needs to take into account their level of responsibility within the undertaking and will differ proportionately, according to whether or not, for example, they are persons who effectively run the undertaking or have other key functions.

Guideline 13 - Fit and proper policies and procedures

The undertaking should have a policy on the fit and proper requirements, which includes at least:

- a) a description of the procedure for identifying the positions for which notifying is required and for the notification to the supervisory authority;
- b) a description of the procedure for assessing the fitness and propriety of the persons who effectively run the undertaking or have other key functions, both when being considered for the specific position and on an on-going basis;
- c) a description of the situations that give rise to a re-assessment of the fit and proper requirements;
- d) a description of the procedure for assessing the skills, knowledge, expertise and personal integrity of other relevant personnel not subject to the requirements of Article 42 of Solvency II according to internal standards, both when being considered for the specific position and on an on-going basis.

2.59. The undertaking may have to check whether the fit and proper requirements as set in its fit and proper policy are still appropriate given the way the undertaking has evolved.

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

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

Guideline 14 - Outsourcing of key functions

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

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 Solvency II that needs to be notified to the supervisory authority.

- 2.61. If an undertaking outsources a key function, the undertaking also needs to assess that all persons performing that function at the service provider are fit and proper. As appropriate, the undertaking can use a service provider's assessment of the fitness and propriety of the relevant staff to help in its own assessment.
- 2.62. The fitness of the person with overall responsibility for the outsourced key function at the undertaking is assessed taking into account that, while the oversight role carries ultimate responsibility for the key function, the level of knowledge required would not need to be as in depth as that of the relevant person(s) at the service provider. But at a minimum the person with overall responsibility for the outsourced key function at the undertaking has to possess enough knowledge and experience regarding the outsourced key function to be able to challenge the performance and results of the service provider.
- 2.63. When outsourcing a key function, an undertaking also needs to consider all the other issues mentioned in the outsourcing Guidelines.

Guideline 15 - Notification

The supervisory authority should require as a minimum from the undertaking the information included in the Technical Annex to be submitted by means of a notification.

- 2.64. The notification of the persons who effectively run the undertaking or key function holders is expected to be undertaken in writing and submitted to the supervisory authority without undue delay.
- 2.65. The undertaking is expected to supplement the information included in the Technical Annex with any additional documents considered necessary to complement the information or required by the supervisory authority.
- 2.66. In order to improve the harmonisation of supervisory practices, a minimum level of information is to be provided by undertakings for the purposes of fit and proper notifications. An undertaking also needs to provide the rationale for appointing or replacing the individual concerned. The form that the submission of information should take is left to Member States. The fit and proper notification itself is complete when the supervisory authority has received all the information required (minimum information included in

Annex) and any complementary documents and information; however, the supervisory authority may at any time during the assessment require additional information or explanations from the undertaking and if necessary, an interview is to be conducted with the individual.

2.67. When notifying the supervisory authority the undertaking is expected to fulfil the requirements laid down in Solvency II. Depending on the discussion between the supervisory authority and the undertaking the provision of information can include but is not limited to:

- a) on the positions that effectively run the undertaking with the analysis and reasons for selecting them and the names of the persons performing them;
- b) on the functions the undertaking considers key with the analysis and reasons for selecting them and the names of the persons responsible for them;
- c) when changes occur regarding the positions and functions defined above based on new evaluations done by the undertaking;
- d) when one of the persons who effectively run the undertaking or a person who is responsible for any key function is going to be or has been appointed (timing is dependent on national specific requirements); and
- e) when a person who effectively runs the undertaking, or is responsible for a key function is replaced because the undertaking considers that the person no longer fulfils the fit and proper requirements.

Guideline 16 - Assessment of the fit and proper requirements by the supervisory authority

The supervisory authority should assess the fit and proper requirements of the persons subject to notification requirements and give feedback on this to the undertaking concerned within an appropriate timeframe from the receipt of a complete notification.

2.68. The appropriate assessment period and process will be determined by each supervisory authority. Feedback could be in the form that silence within a pre-defined period means no objection, provided that the national legislation concerned allows it.

2.69. In cases where there has already been an assessment by other supervisory authorities, in the same or another jurisdiction, the supervisory authority concerned communicates with those supervisors as part of the assessment procedure.

2.70. The supervisor is expected to make appropriate use of information available from the appropriate law enforcement authorities. The supervisor may also check available records and databases, for example on institutions registered by the chamber of commerce and on bankruptcies.

2.71. On the basis of the information collected, the supervisor will assess if the person meets the fit and proper requirements. Where this information gives rise to doubts about the person's fitness and propriety, the supervisor will undertake further investigation. The assessment period and process will be dependent on each supervisory authority but nevertheless has to be

conducted within an appropriate timeframe from the receipt of a complete application.

- 2.72. A person considered suitable for a particular position within an undertaking may not be suitable for another position with different responsibilities or for a similar position within another undertaking. Conversely, a person considered unsuitable for a particular position in a particular undertaking may be considered suitable under different circumstances.
- 2.73. Ultimately, if the supervisory authority concludes, with adequate justification, that the person to be appointed/already appointed does not comply with the relevant fit and proper requirements, the supervisory authority has the power to require the undertaking not to appoint, or to replace, the person in question. A supervisor is expected to reassess the fitness and propriety of an individual if facts, circumstances or actions give rise to such a measure.

Section 4: Risk management

Guideline 17 - Role of the AMSB in the risk management system

The AMSB should be ultimately responsible for ensuring the effectiveness of the risk management system, setting the undertaking's risk appetite and overall risk tolerance limits, as well as approving the main risk management strategies and policies.

The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the risk management system of the whole group is effective. This risk management system of the group should include at least:

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

The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that such strategic decisions and policies are consistent with the group's structure, size and the specificities of the entities that are part of the group.

- 2.74. While risk management is the responsibility of the undertaking's AMSB as a whole, the undertaking is expected to designate at least one member of the AMSB to oversee the risk management system on its behalf.
- 2.75. Risk management is a continuous process that is used in the implementation of the undertaking's business strategy and allows for an appropriate understanding of the nature and significance of the risks to which it is exposed, including its sensitivity to those risks and its ability to mitigate them.
- 2.76. Within an undertaking there has to be a coordinated and integrated approach to risk management and a common "risk language" across the organisation.
- 2.77. It is the responsibility of the undertaking to choose the way it defines and describes its risk appetite and overall risk tolerance limits. Nevertheless risk appetite and overall risk tolerance limits have to reflect the following characteristics:
 - a) Risk appetite addresses the attitude of the AMSB toward the main categories of risks. It needs to be clear and detailed enough to express and reflect the strategic high level objectives of the AMSB. It may include a quantitative assessment in terms of risk and capital. The AMSB will give appropriate directions concerning the definition of risk appetite;
 - b) "Risk tolerance limits" expresses the restrictions the undertaking imposes on itself when taking risks. It takes into account:
 - (i) the relevant constraints that effectively limit the capacity to take risks. These constraints can go beyond the framework of solvency as defined in Solvency II;

- (ii) the risk appetite;
- (iii) other relevant information (e.g. current risk profile of the undertaking, interrelationship between risks).

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

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

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

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

2.82. The risk management system of entities belonging to groups is necessarily linked to the group's business strategy and operations. The risk management strategy is underpinned by an integrated framework of responsibilities and functions driven from group level down to individual levels. The AMSB of the entities within the group, each within the scope of its duties, are responsible for implementing the risk management strategies and policies established by the AMSB of the entity responsible for fulfilling the requirements at group level.

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

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

Guideline 18 - Risk management policy

The undertaking should establish a risk management policy which at least:

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

- 2.85. The risk management policy covers all material risks, including emerging risks⁹, quantifiable or non-quantifiable and reputational and strategic risks where relevant.
- 2.86. The risk management policy has to consider not only each relevant category and area of risks but also potential accumulation and interactions of risks. Where relevant, the risk management policy will also consider indirect effects of risks (e.g. indirect exposure to liquidity risks with regard to gearing, margin calls on derivatives or stock lending positions).
- 2.87. In addition to specific stress tests prescribed under the supervisory regime, the undertaking is expected to employ stress tests as tools in its risk assessment process. The risk management policy sets out the frequency and content of these stress tests.
- 2.88. The regular risk-specific stress tests are tailored by the undertaking to its risk profile. To this purpose the undertaking has to identify possible short and long term risks and possible events or future changes in economic conditions that could have an unfavourable effect on its overall financial standing and determine their capital impact.
- 2.89. An undertaking may also make use of reverse stress testing, which identifies circumstances and that would threaten the viability of the undertaking, and describe the precautions it is taking.
- 2.90. The undertaking will have to choose adequate scenarios to serve as basis for its risk assessment process. The scenario analyses are based on an analysis of the worst (i.e. most severe but plausible) cases the undertaking could face and take into account any material second order effect that may arise. The risk management policy sets out the frequency and content of these stress tests and scenario analyses.
- 2.91. Although each individual undertaking within a group is responsible for its risk management policy, a general steer is expected to be provided by the responsible entity. In providing its steering, the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company is expected to take into consideration the impact on and the compatibility with the individual undertaking's risk management strategies and policies bearing in mind possible discrepancies between the group perspective and local market specificities.

Guideline 19 - Risk management function: tasks

The undertaking should require the risk management function to report to the AMSB on risks that have been identified as potentially material. The risk management function should also report on other specific areas of risks both on its own initiative and following requests from the AMSB.

- 2.92. Article 44(5) of Solvency II requires the risk management function to take on additional tasks that relate to the use of partial or full internal models: namely its design and implementation. By contrast Solvency II does not

⁹ Emerging risks are newly developing or changing risks which are difficult to quantify and which may have a major impact on the undertaking.

explicitly assign any specific task with regard to internal models to the actuarial function although the actuarial function is required to contribute to the effective implementation of the risk management system, which includes the internal model. This, however, does not preclude the risk management function from calling upon expertise from other functions in particular the actuarial function. Hence there needs to be in place a communication loop to pass the detailed actuarial perspective to the risk management function and in return receive the insights on the internal model.

- 2.93. The risk management function also needs to liaise closely with users of the outputs of the internal model.
- 2.94. If the undertaking uses an internal model, it should provide for its integration into a comprehensive risk management system so that it is able to monitor that the internal model is and remains appropriate to the undertaking's risk profile.
- 2.95. Appropriate communication channels ensure that the risk management function is able to call upon expertise from other functions as needed and liaise with the users of the internal model in order to fulfil its tasks under Article 44 (5) of Solvency II.
- 2.96. A close co-operation between the actuarial function and the risk management function as specified in Article 269 (2) (c) of the Commission Delegated Regulation 2015/35 is needed in relation to the tasks required by Article 44(5) of Solvency II in order to provide detailed actuarial information on the internal model to the risk management function. It is the task of the risk management function to assess the internal model as a tool of risk management and as a tool to calculate the undertaking's solvency capital requirement ("SCR").
- 2.97. Documentation of the internal model, and any subsequent changes to it, is maintained by the risk management function so that these are explained in the context of the risk management system.
- 2.98. According to Article 44(5)(d) of Solvency II the information about the performance of the internal model that the risk management function is required to give to the AMSB needs to be documented. These reports will be tailored to the needs of the AMSB, enabling its members to understand all the relevant facts and their implications, providing a reliable basis for necessary management decisions, as well as enabling the AMSB to fulfil its role of being responsible for the ongoing appropriateness of the design and operations of the internal model.

Guideline 20 - Underwriting and reserving risk management policy

In its risk management policy, the undertaking should cover at least the following with regard to underwriting and reserving risk:

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

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

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

2.100. The undertaking ensures that all policies and procedures established for underwriting are applied by all distribution channels of the undertaking.

2.101. The undertaking needs to take into account the constraints related to investments in the design of new products. For example:

- a) an undertaking planning to sell a new life product with a minimum guaranteed rate has to take into account the return available on the market.
- b) an undertaking planning to sell a new property and casualty contract has to take into account the liquidity constraints that could be linked to the contract.

Guideline 21 – Operational risk management policy

In the risk management policy, the undertaking should cover at least the following with regard to operational risk:

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

The undertaking should have processes to identify, analyse and report on operational risk events. For this purpose, it should establish a process for collecting and monitoring operational risk events.

For the purposes of operational risk management, the undertaking should develop and analyse an appropriate set of operational risk scenarios based on at least the following approaches:

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

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

2.103. It is important to note that because operational risks tend to interact with the other risk types they will not be assessed in isolation, but rather be considered alongside the assessment of the other risk types.

2.104. Operational risk may materialize through personnel execution errors, frauds, and processing failures as well as through the direct and indirect consequences of natural or man-made disasters such as terrorist attacks, fire, flood, earthquake and pandemics. These natural or man-made disasters are the low frequency/high impact events are type of operational risks which need to be considered when looking at scenario analysis. As their impact may be potentially catastrophic, the undertaking pays particular attention to them and develops early warning systems that allow for an effective and timely intervention.

2.105. For the development of scenarios, the undertaking takes into account that the different types of operational risk that are defined in Article 13(33) of Solvency II are not strictly separated and that using the two starting points (start from a failure of internal process, system or personnel on one hand or external causes on the other hand) to develop the scenario set will give better chances to have a more comprehensive list of relevant scenarios.

Very severe and unlikely but not impossible scenarios must also be considered.

- 2.106. To perform this analysis the undertaking can use pre-defined categories of operational risks and lists of its key processes. However, each undertaking is free to define a categorisation that better suits its specificities.
- 2.107. The analysis of stress tests and scenarios for the operational risk framework might differ from other types of stress or scenario analysis (e.g. financial), as the definition of the different stages of the scenario (cause, failure of process, impacts) will be a key element of the analysis and monitoring of the risks. The main reason for this is that the controls and corrective measures that the undertaking will put in place will have an effect on the scenario itself.
- 2.108. In the case of operational risk, prevention and corrective actions take precedence over the precise measure. Identifying operational risks is very closely linked to prevention, mitigation and corrective measures.
- 2.109. The continuous monitoring and control of operational risks implies that all personnel are aware of the importance of this type of risk.
- 2.110. The controls and mitigation actions need to be reviewed periodically taking into account the evolution of the operational risk and knowledge of operational risk evolutions.
- 2.111. Examples of mitigation actions are:
 - a) insurance (liability insurance, key person insurance, fire insurance, etc.);
 - b) automation of processes; and
 - c) back up of data.
- 2.112. The undertaking is also expected to put in place key risk indicators.
- 2.113. For the purposes of operational risk events analysis, an undertaking may also consider how external data could supplement its collection of internal operational risk events data to produce more reliable estimates of operational risk events.
- 2.114. On each concerned event, at least the following information is needed:
 - a) The cause of the event;
 - b) The consequences of the event; and
 - c) The actions taken or not on account of the event.
- 2.115. When defining the perimeter (e.g. materiality threshold) of the events that will be collected, the undertaking would have to keep in mind that:
 - a) Operational risk can be both related to high frequency/low severity events or to low frequency/high impact events; and
 - b) Some events that have had no negative impact (e.g. near misses) may be very useful to be analysed to monitor more material operational risks.

Guideline 22 - Reinsurance and other risk-mitigation techniques – risk management policy

In the risk management policy the undertaking should cover at least the following with regard to reinsurance and other risk mitigation techniques:

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

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

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

2.118. When undertakings use special purposes vehicle ("SPV"), the following principles have to be considered:

- a) the fully funded requirement must be actively monitored by the undertaking through its system of governance; and
- b) any remaining risk (credit, market, liquidity, operational risk or 'burn-through' that may occur if the insured cost were to exceed the maximum amount payable by the SPV) from the SPV must be fully taken into account in the undertaking through its risk management system and also taken into account within the calculation of its regulatory capital requirements. The undertaking must be particularly aware of any residual insurance risk arising from the SPV if there were losses in excess of those envisaged at the time of authorisation. These losses above the funding provided would revert back to the undertaking.

Guideline 23 - Strategic and reputational risk

The undertaking should manage, monitor and report the following situations:

- a) actual or potential exposure to reputational and strategic risks and the interrelationship between these risks and other material risks;
- b) key issues affecting its reputation, considering the expectations of stakeholders and the sensitivity of the market.

2.119. The following risks, not explicitly mentioned in Article 44 of Solvency II, are considered due to the potential impact their materialisation could have on the business of the undertaking:

- a) strategic risk and
- b) reputational risk.

2.120. Strategic risk is a function of the incompatibility between two or more of the following components: the undertaking's strategic goals, the business strategies developed, the resources deployed to achieve these goals, the quality of implementation and the economic situation of the markets the undertaking operates in.

2.121. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The undertaking's internal characteristics are evaluated against the impact of economic, regulatory, and other environmental factors including: positions vis-à-vis competitors, suppliers and customers and their possible evolutions, opportunities of entry for new competitors, products or technologies.

2.122. The business strategy of the undertaking will incorporate its risk management practices. In this sense, the undertaking will have a process for setting strategic high-level objectives and translating these into detailed shorter-term business and operation plans.

Guideline 24 - Asset-liability management policy

In its risk management policy the undertaking should cover at least the following information with regard to asset-liability management:

- a) a description of the procedure for identification and assessment of different natures of mismatches between assets and liabilities, at least with regard to terms and currency;
- b) a description of mitigation techniques to be used and the expected effect of relevant risk-mitigating techniques on asset-liability management;
- c) a description of deliberate mismatches permitted;
- d) a description of the underlying methodology and frequency of stress tests and scenario tests to be carried out.

2.123. Asset-liability management (ALM) is the management of a business in such a way that decisions on assets and liabilities are coordinated in order to

manage the exposure to the risk associated with the variation of their economic values.

- 2.124. Along with the investment strategy, an ALM strategy describes how financial and insurance risks will be managed in an asset-liability framework in the short, medium and long term. Where appropriate the investment strategy and the ALM-strategy could be integrated in a combined investment/ALM-strategy. The respective written policies are expected to reflect the implementation of these strategies.
- 2.125. When choosing from the different ALM techniques available for measuring risk exposure, an undertaking relies on measurement tools that are consistent with the risk characteristics of the lines of business and its risk tolerance limits.
- 2.126. In order to provide for the effective management of assets and liabilities, the undertaking needs to ensure appropriate and continuing liaison between the different areas within its business involved in the ALM, such as off-balance sheet exposures or introduction of new products.
- 2.127. The management of the term structure of the portfolio is mainly done according to the term structure of the liabilities. A range of more or less sophisticated techniques can be used, e.g. duration, convexity, maturity buckets, according to the nature, size and complexity of the portfolio. Size is the factor that most limits the leeway on the management of term structure.

Guideline 25 - Investment risk management policy

In its risk management policy the undertaking should cover at least the following information with regard to investments:

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

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

Guideline 26 - Liquidity risk management policy

In its risk management policy the undertaking should cover at least the following information with regard to liquidity risk:

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

- 2.132. The purpose of liquidity risk management is to ensure that obligations to policyholders can be met whenever they fall due. The required degree of liquidity in the investment portfolio can differ amongst undertakings according to the nature of the insurance business, especially the possibility to foresee the amount and the time of the insurance payments.
- 2.133. An appropriate buffer for liquidity shortfalls is understood as having enough liquid assets and not as holding additional capital.
- 2.134. Short term liquidity, or cash management, includes the day-to-day cash requirements under normal business conditions. Liquidity considerations

over the long term need to be assessed in a way which takes into consideration the possibility of various unexpected and potentially adverse business conditions where asset values may not be realised for current market values, including situations where accelerated sales of assets reduce expected returns. There are also liquidity considerations that arise from policyholder behaviour, such as unexpected or accelerated payments to policyholders as a result of surrenders, large claims, or the exercise of policy options.

- 2.135. At group level, the management of liquidity risk needs to be adequately supported by clear agreements governing the usage of excess funds, supervision of each entity's financial position and regular stress and transferability testing.

Section 5: The prudent person principle and the system of governance

Guideline 27 - Investment risk management

The undertaking should not solely depend on the information provided by third parties, such as financial institutions, asset managers and rating agencies. In particular, the undertaking should develop its own set of key risk indicators in line with its investment risk management policy and business strategy.

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

2.136. The prudent person principle for managing investments has the following characteristics:

- a) Due diligence and process: The prudent person principle is as much a behavioural standard as an assessment of judgments and investment decisions. Prudence is to be found in the process by which investment strategies are developed, adopted, implemented, and monitored in light of the purposes for which funds are managed, as well as in the outcomes.
- b) Care, skill and delegation: The undertaking, while performing investment management has an adequate understanding of the risks associated with its investments, its investment risk management policy, the necessary level of "familiarity" with the liability and regulatory constraints to appropriately carry out its responsibilities. Similarly, the undertaking must have or acquire the care and skill sufficient to the tasks of investment management for which it is responsible. To obtain a sufficient level of skills satisfying the prudent person principle, the undertaking may obtain advice from relevant experts and delegate various activities to those with the requisite skill. When employing an expert:
 - (i) the undertaking is responsible for assuring that the expert actually has the skills for which he or she is being employed and, therefore, will adequately investigate the expert's qualifications and experience.
 - (ii) the undertaking also ensures that employed experts acquire sufficient familiarity with the specific nature and needs of the managed portfolios by providing them with complete, accurate and sufficient information so that they can appropriately formulate requested advice or carry out delegated tasks.
 - (iii) the undertaking assesses whether the hired parties have any conflicts of interest that could provide inappropriate incentives to act contrary to its interests.
- c) Duty to monitor: Even when delegating tasks, the undertaking remains responsible for monitoring and reviewing the activities delegated to assure that they have been appropriately and prudently carried out. This would include the monitoring and reviewing of investment managers based upon

the investment risk section of the risk management policy and review procedure.

- d) Duty to protect policy holders and beneficiaries interest: The undertaking protects the policy holders' and beneficiaries' interests considering that risks such as legal risk, reputation risks, commercial risks, and operational risks resulting from a lack of care may also impair its solvency. A special emphasis on this point is made on unit-linked business.
 - e) Principle of diversification: The investments in portfolios managed by the undertakings are suitably diversified. It requires both diversification among appropriate asset classes and within each asset classification, in order to avoid the unwarranted concentration of investment and the associated accumulation of risk in the portfolios.
- 2.137. Each portfolio contains investment related risks which can endanger the solvency position. The undertaking needs to be able to identify measure, monitor, manage and control these risks. The composition of the portfolio of assets is at any time the result of a well-structured, disciplined and transparent investment process which consists of the following components:
- a) the investment risk management policy has to be implemented by an investment manager with the appropriate skills and resources;
 - b) continuous independent control of the investment activity by the employees entrusted with this task by comprehensive and precise systems for identifying, measuring, monitoring, managing and controlling the investment risks and their aggregation on different levels;
 - c) appropriate procedures for the measurement and evaluation of the investment result; and
 - d) appropriate reporting procedures.

Guideline 28 – Assessment of non-routine investment activities

Before performing any investment or investment activity of a non-routine nature the undertaking should carry out an assessment of at least:

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

The undertaking should have procedures that require that where such investment or investment activity entails a significant risk or change in the risk profile, the undertaking's risk management function communicates such a risk or change in the risk profile to the AMSB of the undertaking.

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

Guideline 29 – Security, quality, liquidity and profitability of the investment portfolios

The undertaking should regularly review and monitor the security, quality, liquidity and profitability of the portfolio as a whole by considering at least:

- a) any liabilities constraints, including policyholders' guarantees, and any disclosed policy on future discretionary benefits and, where relevant, reasonable policyholders' expectations;
- b) the level and nature of risks that an undertaking is willing to accept;
- c) the level of diversification of the portfolio as a whole;
- d) the characteristics of the assets including:
 - (i) credit quality of counterparties;
 - (ii) liquidity;
 - (iii) tangibility;
 - (iv) sustainability;
 - (v) existence and quality of collateral or other assets backing the assets;
 - (vi) gearing or encumbrances;
 - (vii) tranches;
- e) events that could potentially change the characteristics of the investments, including any guarantees, or affect the value of the assets;
- f) issues relating to the localisation and availability of the assets including:
 - (i) non-transferability;
 - (ii) legal issues in other countries;
 - (iii) currency measures;
 - (iv) custodian risk;
 - (v) over-collateralisation and lending.

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

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

2.144. The elements described in the Guideline are to be considered prior to other considerations that could be misleading if considered in isolation, for example the past evolution of the quotation of the asset considered,

reputation of an asset manager. A comprehensive knowledge of these characteristics is the basis for a good understanding of the assets comprising the portfolio of the undertaking.

- 2.145. A proper diversification of the portfolio is a good method to increase the embedded prudence in a portfolio. However, the effects of diversification have to be properly assessed and managed.
- 2.146. Security, quality, liquidity and profitability are to be considered in the selection of the investments and the design of their terms and on an on-going basis. This will be considered for all the components of any investment management action (e.g.: security lending and repo, gearing).
- 2.147. Any investment or investment management action will be made according to the general goals and constraints of the portfolio management and stated investment objectives and, at the minimum, will not endanger the security, quality, liquidity and profitability of the portfolio.
- 2.148. The features of security, quality, liquidity and profitability of the portfolio cover also the impact of assets that are indirectly held.
- 2.149. Lending assets can diminish the availability of these assets and, thus, of the whole portfolio. This availability can be partially restored with collateral, for example. When receiving collateral for security lending and repos, the undertaking will pay attention to its adequacy, their acceptability as part of a risk mitigation technique, and verify that the credit risk on the collateral is not unduly correlated with that of the counterparty to the lending or repo transaction. The undertaking will also set internal limits, concerning at least the number, the amount and the duration of lendings and repos, relating to such investments and justify these investments by reference to its business strategy and its risk and liquidity management.

Guideline 30 - Profitability

The undertaking should establish targets for the returns it seeks from its investments taking into account the need to obtain a sustainable yield on the asset portfolios to meet reasonable policyholders' expectations.

- 2.150. Where the undertaking invests in assets which at the time of the acquisition have a very low guaranteed or no basic interest yield at all, or if the overall yield of which is essentially to be generated from another yield source, such as from a share portfolio for structured products, the undertaking needs to consider the risk it is capable of sustaining when determining the extent to which it is prepared to invest in such assets.

Guideline 31- Conflicts of interests

The undertaking should describe in its investment policy how it identifies and manages any conflicts of interest that arise regarding investments, irrespective of whether they arise in the undertaking or in the entity which manages the asset portfolio. It should also document the actions taken to manage such conflicts.

- 2.151. Conflicts of interest may arise when undertakings have an incentive to invest in assets, which do not correspond to the objectives of the contracts

held in their portfolio and/or the best interests of all their policyholders or beneficiaries; this may take various forms, for instance:

- a) In case of guaranteed rates for only certain types of contracts, incentive to invest in assets with higher return but also higher risk that might lead, in case of losses on those assets, to lower returns for contracts without a guaranteed rate; and
- b) Incentive or obligation of the parent undertaking to invest in a way that would interfere with the undertaking's compliance with the requirements in Article 132 of Solvency II are not allowed. For example, the undertaking may be pressured to invest in bonds of the parent undertaking, which may carry higher risks, for example lower diversification or liquidity, than assets with a similar return, or which increase the risk of contagion if the asset became impaired. In that scenario the parent would possibly be unable to recapitalise the insurer, and hence this may be contrary to the interests of policyholders and beneficiaries.

Guideline 32 - Unit-linked and index-linked contracts

The undertaking should ensure that its investments of unit-linked and index-linked contracts are selected in the best interest of policyholders and beneficiaries taking into account any disclosed policy objectives.

In the case of unit-linked business the undertaking should take into account and manage the constraints related to unit-linked contracts, in particular liquidity or any contractual or legal transferability constraints.

- 2.152. In relation to unit-linked contracts, the undertaking is expected to consider the liquidity risk with reference to its liabilities arising from the obligations and representations to policyholders and beneficiaries. In particular this includes the assessment of the ability for policyholders and beneficiaries to redeem their unit-linked investments, taking into account the immediacy with which they must discharge their obligations (i.e. the notice period).
- 2.153. The operation of unit-linked and index-linked contracts requires for ALM reasons that the underlying assets of the contracts are sufficiently liquid that the purchase and sales of those assets can be realised consistently with the premium payment and redemptions on the contracts.
- 2.154. If it is not possible to sell particular assets in time or at a fair price to meet surrender payments, the undertaking needs to consider the interests of the remaining unit holders and whether there is a need to sell other liquid assets. A consequential risk is that the residual investment portfolio of the fund becomes unbalanced, in a way that it no longer conforms to the investment mandate and/or the risk profile disclosed to policyholders. The undertaking therefore needs to take into account the broader impact on the linked fund or portfolio.
- 2.155. The undertaking needs to ensure that no additional risk results from the unit-linked contracts in a way that could hurt other policyholders and beneficiaries, e.g. when the undertaking uses derivatives to limit the maximum possible loss.

Guideline 33 - Assets not admitted for trading on a regulated financial market

The undertaking should implement, manage, monitor and control procedures in relation to investments that are not admitted to trading on a regulated financial market or to complex products, which are difficult to value.

The undertaking should treat assets admitted to trading, but not traded or traded on a non-regular basis, similarly to those assets not admitted to trading on a regulated financial market.

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

Guideline 34 - Derivatives

When using derivatives, the undertaking should implement the procedures in line with its investment risk management policy to monitor the performance of these derivatives.

The undertaking should demonstrate how the quality, security, liquidity or profitability of the portfolio is improved without significant impairment of any of these features where derivatives are used to facilitate efficient portfolio management.

The undertaking should document the rationale and demonstrate the effective risk transfer obtained by the use of the derivatives where derivatives are used to contribute to a reduction of risks or as a risk mitigation technique.

- 2.158. With respect to assets other than those covered by Article 132(4) of Solvency II, derivatives are only allowed for the purposes of efficient portfolio management or the reduction of risks.
- 2.159. When the undertaking uses derivative products or any other financial instrument with similar characteristics or effects, it needs to put in place procedures to evaluate the strategy to use these types of products and the principles of risk management to be applied to them.
- 2.160. Where the undertaking uses derivatives that can generate losses significantly above the amount initially committed it is expected to assess the resulting structure of the whole portfolio whether it does create a

situation where the possible loss could be excessive with regard to the portfolio constraints.

- 2.161. The use of derivative as a hedging tool is expected to be done in a way that does not create any additional risks that have not been assessed previously.
- 2.162. Examples where derivatives are used for hedging and would create new risks:
- a) If the undertaking invests in a mutual fund in which the foreign currency risk is hedged (in the mutual fund) by a derivative with a margin call and the covered assets are not liquid, it can create a liquidity risk in the mutual fund even though economically the risk is hedged;
 - b) If the undertaking wants to hedge a security with a negative value using a collar, it can create risks in the income statement even though economically the risk of an asset impairing is hedged; and
 - c) If the undertaking wants to hedge against a rise in interest rates, it may buy caps from investment banks, which can create an increased counterparty risk even though economically the risk is hedged.
- 2.163. With respect to assets covered by Article 132(3) of Solvency II, derivatives may also be used as an investment strategy.
- 2.164. When derivatives, used as part of the assets or liabilities held in respect of benefits for which policyholders bear the investment risks, are used as an investment strategy rather than to contribute to a reduction of investment risk or to facilitate efficient portfolio management, then the undertaking reflects the higher risks posed by such transactions within its systems and controls.

Guideline 35 - Securitised instruments

Where the undertaking invests in securitised instruments, it should ensure that its interests and the interests of the originator or sponsor concerning the securitised assets are well understood and aligned.

- 2.165. The undertaking ensures that the originator does not conclude deals solely because it expects to have essentially a brokerage activity on these deals.
- 2.166. The undertaking has a clear vision of the purpose followed by the originator, in particular the undertaking ensures that, at least, the assets are not securitised because the conditions on the market have become more risky for these assets.
- 2.167. Below are possible actions the undertaking could take to ensure that the alignment is in place, it could:
- a) perform due diligence including a risk analysis of the proposed securitised investments;
 - b) ensure that the originator has explicitly provided the undertaking with the documentation governing the investment that the originator will retain, on an ongoing basis, a net economic interest which, in any event, should not be less than a relevant and pre-determined share;

- c) ensure that the originator meets the following criteria: the originator or, where appropriate, the sponsor finances the transaction, based on sound and well-defined criteria, and clearly establishes the process for approving, amending, renewing and refinancing assets securitised to exposures to be securitised if they apply to exposures which are not currently securitised;
- d) check that the originator or, where appropriate, the sponsor has in place effective systems to manage the on-going administration and monitoring of its assets, risk-bearing portfolios and exposures;
- e) check that the originator or, where appropriate, the sponsor adequately diversifies each asset portfolio based on its target market and overall credit strategy;
- f) ensure that the originator or, where appropriate, the sponsor makes readily available access to all relevant data necessary for the undertaking to comply with any legal requirements set;
- g) check that the originator or, where appropriate, the sponsor has a written policy on asset risk that includes its risk appetite and provisioning policy and how it measures, monitors and controls that risk;
- h) ensure that the originator or, where appropriate, the sponsor discloses the level of its retained net economic interest as well as any matters that could undermine the maintenance of the minimum required net economic interest.

Section 6: Own fund requirements and the system of governance

Guideline 37 – Medium-term capital management plan

The undertaking should develop a medium-term capital management plan which is monitored by the AMSB, and which includes at least considerations of:

- a) any planned capital issuance;
- b) the maturity of own-fund items, incorporating both the contractual maturity and any earlier opportunity to repay or redeem, relating to the undertaking's own fund items;
- c) the result of the projections made in the ORSA;
- d) how any issuance, redemption or repayment, or other variation in the valuation of own-funds items affects the application of the limits on tiers;
- e) how applying the distribution policy will affect own funds; and
- f) the impact of the end of the transitional period.

2.168. The AMSB should take an active role in monitoring the development and maintenance of the medium-term capital management plan. The frequency with which the AMSB will need to consider the plan will depend on the specific circumstances of the undertaking, including but not limited to:

- a) the stability of the undertaking's business model and projections;
- b) the frequency of planned capital issuance, repayments and redemptions, and other factors affecting own funds including the performance during the year;
- c) the extent to which own funds exceed the SCR and the assessment of capital needs identified when the ORSA was performed;
- d) the extent to which available own funds exceed, or are close to, the limits applying when determining eligible own funds.

Section 7: Internal controls

Guideline 38 – Internal control environment

The undertaking should promote the importance of performing appropriate internal controls by ensuring that all personnel are aware of their role in the internal control system. The control activities should be commensurate to the risks arising from the activities and processes to be controlled.

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure a consistent implementation of the internal control systems across the group.

2.169. Internal control combines the following aspects:

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

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

2.171. The undertaking is expected to ensure that its written policies on internal control are approved by the AMSB and that they include the means by which the senior management implements the internal control system and keeps it suitable and effective.

2.172. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company ensures a consistent implementation of the internal control activities across the group. At group level, the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company ensures that within the group's internal control system risk concentration and intra-group transactions are adequately assessed, monitored and reported and taken into account for inter-linkages and interdependencies between the group undertakings.

2.173. An appropriate internal control system includes internal controls at different levels of the organisational and operational structures, for different time periods and with different levels of detail, as needed.

2.174. Control activities could, depending on the particular circumstances of the undertaking, include approvals, authorisations, verifications, reconciliations, management reviews, and other appropriate measures applicable to each business area and unit, physical controls, compliance checks with agreed exposure limits and operating principles or instructions and follow-up procedures on non-compliance.

2.175. Internal controls could inter alia comprise:

- a) the applicable data protection requirements;
- b) appropriate security controls;
- c) access controls to hardware, systems and data, maintaining the integrity of records and information and thereby protecting the interests of policyholders.

2.176. Internal controls include the task of identifying and managing any areas of potential conflicts of interest appropriately.

Guideline 39 – Monitoring and reporting

The undertaking should establish monitoring and reporting mechanisms within the internal control system which provide the AMSB with the relevant information for the decision-making processes.

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

Section 8: Internal audit function

Guideline 40 – Independence of the internal audit function

The undertaking should ensure that the internal audit function does not perform any operational functions and is free from undue influence by any other functions including key functions.

When performing an audit and when evaluating and reporting the audit results, the undertaking should ensure that the internal audit function is not subject to influence from the AMSB that can impair its operational independence and impartiality.

- 2.182. Internal audit is an independent function established within the undertaking to examine and evaluate the functioning, effectiveness and efficiency of the internal control system and all other elements of the system of governance. Internal audit assists members of the AMSB in their duty to have an adequate and effective internal control system in place. Internal audit provides the AMSB with analysis, appraisals, recommendations and information concerning the activities reviewed.
- 2.183. Certain undertakings have established separate functions in charge of controlling or monitoring a specific activity or entity of the undertaking. Such functions are part of the internal control system and therefore do not

release the internal audit from examining those specific activities or entities. However, for the sake of efficiency, the internal audit may, in carrying out its tasks, use the information reported by the various functions. The operational independence of the internal audit function implies that it is given an appropriate standing within the organization and carries out its assignments without undue interferences and with impartiality.

- 2.184. While the internal audit function may, under the cumulative conditions set out in Article 271 of the Commission Delegated Regulation 2015/35, be performed in accumulation with one or more of the other three explicitly named key functions, namely the compliance, the risk management and the actuarial function, it must not ever be combined with any operational functions.
- 2.185. The undertaking has to ensure that the internal audit function is free from influences from the operational functions and from other key functions that could compromise the internal audit function's ability to undertake its duties in an objective, fair and independent manner.
- 2.186. The performance of the internal audit function by the same person or persons which perform the compliance, risk management or actuarial function is only possible where the undertaking has a risk profile that does not entail large or complex risks, i.e. where the undertaking only writes standard lines of business on a limited scale and where the undertaking is not invested in complex investment products.
- 2.187. As a general rule the internal audit function cannot be performed by the same person or persons who perform the other key function because this gives rise to conflicts of interest since the other key functions are subject to the scrutiny of the internal audit function. However, in those exceptional cases where combining other key functions with the internal audit function is allowed, the undertaking needs to be able to demonstrate to the supervisory authority, on request, that such conflicts of interest are properly dealt with and no concerns remain that the objectivity and independence of the internal audit function is compromised.
- 2.188. As regards costs an undertaking where the same person or persons perform the internal audit function and the compliance, risk management or actuarial function has to be able to provide evidence to the supervisory authority that any other solution would increase its current total administrative costs to an extent that it in view of those total administrative costs it would be unreasonable to expect the undertaking to bear them.
- 2.189. The AMSB can request that specific areas are included in the internal audit without impairing the operational independence of the internal audit function.

Guideline 41 – Conflicts of interest within the internal audit function

The undertaking should take adequate measures in order to mitigate the risk of any conflicts of interest.

The undertaking should therefore ensure that internally recruited auditors do not audit activities or functions they previously performed during the timeframe covered by the audit.

- 2.190. With these measures it is intended that the internal audit function is in a position to perform its assignments with complete objectivity, taking into account the proportionality principle. The undertakings needs to consider several measures to mitigate the risk of any conflicts of interest, such as: rotate staff assignments, second signature, peer review or other forms of review.
- 2.191. This presupposes that the internal audit is not involved in the operational organization of the undertaking or in developing, introducing or implementing organisational or internal control measures.
- 2.192. However, the need for impartiality does not exclude the possibility to request from the internal audit function an opinion, on specific matters related to the internal control principles to be complied with.
- 2.193. Indeed, such consultative function constitutes a secondary task which cannot impede the basic tasks or the responsibility and appraisal independence of the internal audit function.
- 2.194. In deciding on the frequency of the rotation in its internal audit policy the undertaking has to balance the need for developing expertise with that for maintaining adequate operational independence.
- 2.195. The internal audit function has to be able to exercise its assignment on its own initiative within the undertaking. It needs to be free to express its findings and appraisals and to disclose them.

Guideline 42 - Internal audit policy

The undertaking should have an internal audit policy which covers at least the following areas:

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

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the internal audit policy at the level of the group describes how the internal audit function:

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

- 2.196. The policy is drawn up by the internal audit function and approved by the AMSB.
- 2.197. The Directive does not require that the supervisory authority is informed on audit findings, however if national law provides for this or if the undertaking decides to allow for this, the relevant internal rules need to be part of the internal audit policy.

Guideline 43 – Internal audit plan

The undertaking should ensure that the internal audit plan:

- a) is based on a methodical risk analysis, taking into account all the activities and the complete system of governance, as well as expected developments of activities and innovations;
- b) covers all significant activities that are to be reviewed within a reasonable period of time.

- 2.198. Each assignment is adequately prepared. Its objectives as well as an outline of the work that is considered necessary to attain is described in an audit plan.
- 2.199. The audit plan is a relatively flexible tool that needs to be adapted and completed according to the findings. It covers the activities that are to be reviewed within a reasonable period of time, meaning according to the audit cycle principle.

Guideline 44 - Internal audit documentation

The undertaking should keep a record of its work in order to allow for an assessment of the effectiveness of the work of the internal audit function, and to document the audits in a way that allows for retracing the audits undertaken and the findings they produced.

- 2.200. All audit procedures that are part of the assignment have to be documented, including underlying working papers, for a period of time as may be specified by national law or the supervisory authority. These need to reflect the examinations that have been made and emphasise, and wherever necessary support, the evaluations in the report.
- 2.201. The evidence of the work of the internal audit function must be drawn up according to a well determined method. Such a method must, in particular, allow for the verification whether the assignment was duly performed and to check the manner in which it was performed.
- 2.202. The internal audit function maintains a record of the assignments performed and of the reports issued together with the working papers.

Guideline 45 – Internal audit function tasks

The undertaking should require that the internal audit function, in the report to the AMSB, includes the envisaged period of time to remedy the shortcomings, and information on the achievement of previous audit recommendations.

- 2.203. A written report of each assignment is issued as quickly as possible.
- 2.204. The written report has to be transmitted to the auditee and the auditee's hierarchy and possibly as an executive summary to the AMSB.
- 2.205. The internal audit function indicates the relative importance of the deficiencies found or recommendations made.
- 2.206. The report covers at least any deficiencies with regard to the efficiency and suitability of the internal control system, as well as major shortcomings with regard to the compliance with internal policies, procedures and processes. It includes recommendations on how to remedy inadequacies and also specifically addresses how past points of criticism and past recommendations have been followed up.
- 2.207. The internal audit function develops appropriate procedures to verify and consequently record and report on how the recommendations are implemented.
- 2.208. The AMSB is expected to regularly discuss the organisation, audit plan, audit programme, adequacy of resources to ensure the proper performance of the activities of the internal audit function and summary of recommendations and their implementation.
- 2.209. The internal audit function indicates in the report also who is to remedy inadequacies identified, in order to follow up the audit recommendations. The final decision as to which recommendations to implement and who is responsible rests with the AMSB.

Section 9: Actuarial function

Guideline 46 - Tasks of the actuarial function

The undertaking should take appropriate measures to address the potential conflicts of interests, if the undertaking decides to add additional tasks or activities to the tasks and activities of the actuarial function.

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should require that the actuarial function gives an opinion on the reinsurance policy and the reinsurance program for the group as a whole.

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

Guideline 47 - Coordination of the calculation of technical provisions

The undertaking should require the actuarial function to identify any inconsistency with the requirements set out in Articles 76 to Article 83 of Solvency II for the calculation of technical provisions and propose corrections as appropriate.

The undertaking should require the actuarial function to explain any material effect of changes in data, methodologies or assumptions between valuation dates on the amount of technical provisions.

- 2.213. Both the task of ensuring the appropriateness of the methodologies and of the underlying models used, including the assumptions made in the calculation of technical provisions, and the assessment of the sufficiency and quality of the data used in the calculation of technical provisions are requirements of the coordination of the calculation.
- 2.214. In order to carry out this task, the actuarial function uses methodologies that allow for a complete analysis regarding those requirements.
- 2.215. The methodologies used to calculate the technical provisions should be validated by validation tools, such as back-testing against past experience, giving due considerations to changes over time.
- 2.216. The work required to ensure that an assumption is appropriate has to be proportionate to the impact of a variation in the assumption on the best estimate and to the materiality of the impact for the undertaking.
- 2.217. There may be deficiencies in the specific tasks carried out by the actuarial function, as set out in Article 48 of Solvency II. Such deficiencies identified may relate to data, technical procedures, methodologies or to knowledge or expertise.

Guideline 48 – Data quality

The undertaking should require the actuarial function to assess the consistency of the internal and external data used in the calculation of technical provisions against the data quality standards as set in Solvency II. Where relevant, the actuarial function provides recommendations on internal procedures to improve data quality so as to ensure that the undertaking is in a position to comply with the Solvency II framework.

- 2.218. When assessing the appropriateness of the undertaking's segmentation of its insurance obligations into homogeneous risk groups, the actuarial function needs to take any data limitations into account. Limitations may include insufficient granularity and quantity of data.
- 2.219. The appropriate level of granularity is the level that allows the identification of trends affecting the different drivers of risk and ensures that there is sufficient data to enable the implementation of the methodologies and any statistical analysis.
- 2.220. The actuarial function has the task of consulting any relevant market data to perform the modelling of these liabilities and ensuring that these data are appropriately integrated into the model.
- 2.221. The actuarial function performs a process of comparison and validation of technical provisions based on experience and identifies solutions on how to deal with any material differences detected, which may imply revisions of assumptions and methodologies.
- 2.222. If there is any material uncertainty about the accuracy of the data, the actuarial function report needs to:
- a) describe the uncertainty; and
 - b) explain any approach taken in light of the uncertainty in the calculation of technical provisions.

Guideline 49 – Testing against experience

The undertaking should ensure that the actuarial function reports any material deviations from actual experience to the best estimate to the AMSB. The report should investigate the causes of the deviations and, where applicable, propose changes in the assumptions and modifications to the valuation model in order to improve the best estimate calculation.

- 2.223. Proposals to change assumptions and to modify valuation models in order to improve best estimates have to be evidence-based.
- 2.224. If a case-by-case approach is used in accordance with Article 82 of Solvency II in the calculation of the best estimate, the actuarial function has to describe the rationale for the assumptions used and to explain how the best estimate has been calculated in a manner compliant with Articles 76 to 86 of Solvency II.

Guideline 50 – Underwriting policy and reinsurance arrangements

The undertaking should require the actuarial function, when providing its opinion on the underwriting policy and the reinsurance arrangements, to take into consideration the interrelations between these and the technical provisions.

- 2.225. The underwriting policy, taking into account claims handling, the reinsurance arrangements and the technical provisions are interdependent features according to the nature of an undertaking's business. Changes in underwriting policy and practice, for example, may not only affect the calculation of technical provisions, but also the adequacy of reinsurance arrangements. Consequently, the actuarial function is expected to identify any important interrelationships between underwriting policy, reinsurance and technical provisions when carrying out its responsibilities as described in Article 48 of Solvency II.
- 2.226. The skills and experience of the actuarial function can provide a different perspective from the underwriters' or reinsurance teams' perspectives. This perspective, when communicated to the AMSB, will help to ensure that it is fully informed. The opinions on the underwriting policy and reinsurance arrangements include, when necessary, recommendations regarding appropriate strategies to be followed by the undertaking in this matter.
- 2.227. The opinion on the overall underwriting policy may include amongst others the following issues:
 - a) whether the product pricing is consistent with the underwriting policy for acceptance of risks;
 - b) an opinion on the principal risk factors influencing the profitability of business to be written during the next year, including the potential impact on future profitability of external factors such as inflation, legal risk, changes in business volumes and changes in the market environment;
 - c) an opinion on the likely financial impact of any material planned changes in terms and conditions of contracts;

- d) the degree of variability surrounding the estimate of expected profitability;
 - e) the consistency of this degree of variability with the risk appetite of the undertaking.
- 2.228. Commenting on the overall underwriting policy does not require expressing views on every single policy, but rather on the undertaking's underwriting in general. The scope of the view expressed is determined by what is relevant information for the AMSB in reviewing the undertaking's underwriting policies.
- 2.229. The opinion on the adequacy of the undertaking's reinsurance arrangements may include amongst others the following issues:
- a) the consistency of the undertaking's reinsurance arrangements with its risk appetite;
 - b) the effect of reinsurance on the estimation of technical provisions net of reinsurance recoverable; c) an indication of the effectiveness of the undertaking's reinsurance arrangements in mitigating the volatility of its own funds.
- 2.230. The opinion on the adequacy of reinsurance arrangements needs to include an assessment of how the reinsurance coverage could respond under a number of stressed scenarios. These scenarios may include situations such as the following: exposure of the undertaking's portfolio of business to catastrophic claims experience, aggregations of risks, reinsurance defaults and potential reinsurance exhaustion.
- 2.231. The actuarial function provides information to the AMSB to enable it to take decisions concerning the underwriting policy and reinsurance arrangements. The opinions of the actuarial function on the overall underwriting policy and reinsurance arrangements need to include descriptions and examinations of other possible options.

Guideline 51 – The actuarial function of an undertaking using an internal model

The undertaking should require the actuarial function to contribute to specifying which risks within their domain of expertise are covered by the internal model. The actuarial function should also contribute to how dependencies between these risks and dependencies between these risks and other risks are derived. This contribution is based on a technical analysis and should reflect the experience and expertise of the function.

- 2.232. Article 44 (5) of Solvency II sets out that the risk management function is responsible for a number of areas of the internal model. Despite the fact that the risk management function is responsible for the design, implementation, testing and validation of the internal model, it is expected that the actuarial function assists in these tasks. The assistance of the actuarial function in the internal modelling is desirable also because of the close connection and consistency between the valuation of the assets, liabilities and the calculation of the loss Probability Distribution Forecast

(PDF). During the calculation of the SCR, amongst others, the uncertainties of the technical provisions are measured, via life underwriting risk module or non-life underwriting risk module.

- 2.233. The design of the internal model is a task that is performed with the contribution provided by the actuarial function, for instance, regarding the scope of the internal model and the complexity of the model.
- 2.234. The level of data quality that is required to perform the modelling of the different risks is a particular factor that needs to be taken into consideration. The actuarial function, as responsible for the analysis of the sufficiency and the quality of the internal and external data to be used in the calculation of technical provisions, is in a position to express an opinion on whether it is appropriate to explore a specific area of modelling in the framework of the internal model, regarding the limitations of data that may apply.
- 2.235. The actuarial function, following its task of coordination of the calculation of technical provisions, assists the risk management function in defining the level of technical complexity that should be associated with the model. The level of complexity will depend, for instance, on the level of completeness of the data, the nature and complexity of the risks and its importance among the other risks.
- 2.236. The assistance of the actuarial function to risk management is particularly important in the modelling of underwriting risks and it is necessary to ensure consistency between the assumptions set to calculate technical provisions and the assumptions inherent to the calculation of the solvency capital requirement.
- 2.237. The actuarial function also has a role in the implementation of the internal model and may also be a user of it. The outputs of the internal model are used by the actuarial function to support the analyses carried out by the function.
- 2.238. In the process of the internal model's implementation, the mutual communication between the actuarial function and the risk management function is needed so that the insights gained by the two functions with regard to the internal model are shared between them. This feedback could lead to the detection of shortcomings and to proposals on how to improve the model.
- 2.239. Parts of the validation tasks may include collecting and analysing information, for example providing an analysis of the actual experience against expected experience. It may be that there are systems in place within the sphere of responsibility of the actuarial function which have already been set up to collect this information.
- 2.240. In this case it may be sensible for the actuarial function to be involved in performing some of the tasks in the validation process so the undertaking can streamline processes and facilitate an efficient allocation of tasks.

Section 10: Valuation of assets and liabilities other than technical provisions

Guideline 52 - Valuation of assets and liabilities other than technical provisions

In its policy and procedures for valuation of assets and liabilities the undertaking should cover at least the following:

- a) the methodology and criteria to be used for the assessment of active and non active markets;
- b) the requirements to ensure adequate documentation of the valuation process and of the accompanying controls, including those for data quality;
- c) the requirements on the documentation of the valuation approaches used regarding:
 - (i) their designs and the way they are implemented;
 - (ii) the adequacy of data, parameters and assumptions;
- d) the process for the independent review and verification of the valuation approaches;
- e) the requirements for the regular reporting to the AMSB for matters that are relevant for its governance on valuation.

2.241. An undertaking consistently needs to apply an appropriate methodology and criteria to determine whether markets are active based on the criteria defined within international accounting standards, as endorsed by the Commission in accordance with Regulation (EC) No. 1606/2002. Methodologies, and the resulting assessments, need to be adequately documented.

2.242. The system of governance addresses the characteristics and complexity of the valuation process. The undertaking needs to give special consideration to financial assets and liabilities that are difficult to value or for which the undertaking's valuation is inherently uncertain. In general, more extensive governance procedures would be required when using an alternative valuation method rather than quoted market prices.

2.243. The valuation policies and procedures, when alternative methods are used, need to address the risk of:

- a) inadequate inputs, e.g. questionable data quality, flawed assumptions;
- b) invalid internal logic of the valuation method, e.g. lack of sound methodology or mathematical techniques, inconsistency with market practice, programming errors; and
- c) inappropriate application of results, e.g. through misunderstanding of the model's limitations.

- 2.244. The evaluation whether the assumptions are reasonable and appropriate has to take into consideration the prevailing good practice with regard to the selection of assumptions for similar purposes.
- 2.245. The undertaking needs to consider carefully if its IT-system matches the complexity of its valuation method and the required internal controls.
- 2.246. A key element in ensuring data integrity is the ability to generate an audit trail, which documents sequentially the relevant steps that have been taken. An audit trail is a valuable tool to identify strengths and weaknesses in systems, processes or procedures.
- 2.247. An audit trail requires that the undertaking establishes a reliable and transparent chronological record of the elements and steps in the process that impact the valuations: the "who", "what", "when" and "where" of the different inputs and steps in the process are recorded.
- 2.248. The internal controls and the way in which the steps are recorded to support the audit trail have to be proportionate to the complexity of the validation process and the possible impact in the decision making process.
- 2.249. A first pre-requisite is a thorough understanding of the valuation methods that are used. This applies to all levels of the organisation that have a role in the valuation of assets and liabilities.

Guideline 53 – Data quality control procedures

The undertaking should implement data quality control procedures to identify deficiencies and to measure, monitor, manage and document their data quality. These procedures should include:

- a) completeness of data;
- b) appropriateness of data, both from internal and external sources;
- c) independent review and verification of data quality.

The policies and procedures implemented by the undertaking should address the need to periodically review market data and inputs against alternative sources and experience.

- 2.250. The data used as an input for the valuation process has to be fit for purpose. It may be necessary to adjust market data to better represent the characteristics of the asset or the liability. In this case, proper procedures and justification are needed.
- 2.251. Data completeness and appropriateness need to be assessed through a series of checks. Any relevant analysis performed by internal audit, external audit or other parties needs to be taken into account.
- 2.252. If this identifies data deficiencies, the undertaking needs to document them, identify the possible impact, and assess if and how the data quality can be improved.
- 2.253. When using alternative valuation methods, undertakings need to make sure that inputs capture the characteristics and risks of the asset or liability.
- 2.254. Reliability of inputs is achieved by a combination of internal controls, including procedures which ensure that:

- a) inputs are only made by authorised users;
- b) inputs have not been compromised by subsequent changes;
- c) all changes to the inputs are monitored.

2.255. This relates to valuation data as well as to the parameters and assumptions used in the valuation method.

Guideline 54 – Documentation when using alternative valuation methods

Where alternative methods for valuation are used, the undertaking should document:

- a) a description of the method, purpose, key assumptions, limitations and output;
- b) the circumstances under which the method would not work effectively;
- c) description and analysis of the valuation process, and the controls linked with the method;
- d) an analysis of valuation uncertainty linked with the method;
- e) a description of back-testing procedures performed on the results and, where possible, a comparison against comparable models or other benchmarks, which should be carried out when the valuation method is first introduced and regularly thereafter;
- f) a description of the tools or programs used.

2.256. The documentation for each alternative valuation method needs to include an operating manual or similar document that describe the procedures used to operate, maintain and update the valuation method. This manual needs to be sufficiently detailed to enable a qualified third-party to operate and maintain the valuation method independently.

Guideline 55 - Independent review and verification of valuation methods

The undertaking should ensure that an independent review of the valuation method, following Article 267 (4)(b) of the Commission Delegated Regulation 2015/35 takes place before the implementation of a new method or a major change, and on a regular basis thereafter.

The undertaking should determine the frequency of the review in line with the significance of the method for the decision-making and risk management processes.

The undertaking should apply the same principles for the independent review and verification of both internally developed valuation methods or models and for vendor provided valuation methods or models.

The undertaking should have processes in place to report the results of the independent review and verification, as well as the recommendations for remedial actions to the appropriate management level of the undertaking.

2.257. The independent review and verification process can be undertaken internally or externally.

- 2.258. The responsibility for design and implementation of the valuation approaches has to be separated from the responsibilities to perform the independent review and verification.
- 2.259. When using external valuation methods or models, the undertaking has to understand the methodologies used, the assumptions underlying the model, the outputs generated and the sensitivities implied by the model.
- 2.260. The independent review and verification of vendor models includes a review of any vendor information that describes the theory and logic supporting the model and an assessment of whether the theory and logic are generally accepted and supportable.
- 2.261. The task of the independent review and verification usually lies within the risk management function.
- 2.262. The independent review and verification reports are expected to provide information on:
- a) the quality of the valuation methods;
 - b) any known design weaknesses in valuation methods used;
 - c) any concerns relating to the accuracy and appropriateness of the inputs, such as data, parameters and assumptions used;
 - d) comparisons with previous reports.

Guideline 56 - Oversight by the AMSB and other persons who effectively run the undertaking

The AMSB and other persons who effectively run the undertaking should be able to demonstrate an overall understanding of the valuation approaches and the uncertainties involved in the valuation process to allow a proper oversight of the risk management process concerning valuation.

- 2.263. Supported by the appropriate key functions, a proper oversight will include:
- a) periodical monitoring of the effectiveness of the approved policies and procedures, including those on the independent review and verification;
 - b) a review of reports on independent review and verification, documentation and internal control;
 - c) intervening, as appropriate, to ensure proper valuation risk management.

Guideline 57 – Request to the undertaking by the supervisory authority, for an external independent valuation or verification

The supervisory authority should consider requesting an independent valuation or verification from the undertaking at least when there is a risk of misstatements in the valuation of material assets or liabilities, with possible material consequences for the undertaking's solvency situation.

- 2.264. The Commission Delegated Regulation 2015/35 gives supervisory authorities the opportunity to require an external independent valuation or verification of the value of material assets and liabilities. The above

guideline is not intended to restrict this ability, but rather to highlight a specific case where such an independent valuation or verification promotes convergence of supervisory practices.

2.265. The risk of a material misstatement is increased, inter alia, when:

- a) there is an inactive market for the asset or liability;
- b) the auditor of the undertaking has raised concerns regarding aspects of the preparation of the undertaking's general purposes financial statements;
- c) the valuation of the asset or liability has not moved in line with the expectations of the supervisory authority, e.g. the valuation has remained constant over a considerable period of time, the valuation has not moved in line with similar type assets or liabilities in the market etc.

2.266. Even where an undertaking's valuation of an asset or liability has some or all of the characteristics outlined, this does not necessarily mean that the valuation used by the undertaking is incorrect.

2.267. When considering requesting an independent valuation or verification, supervisory authorities have to take into account an opinion that has been provided by an external auditor. When items are recognised in the general purposes financial statements at their economic value, i.e. no adjustment needed for the Solvency II balance sheet, or when the Solvency II balance sheet is externally audited, the audit of those statements may imply sufficient verification. However, the supervisory authority may deem a separate independent valuation or verification still necessary in some circumstances.

2.268. The external independent verification consists of the review by an external independent party of the valuation performed internally by the undertaking.

2.269. The responsibility for a proper valuation remains with the undertaking's management. The expert enables the supervisory authority to make further judgments about the undertakings' valuation if necessary.

2.270. Verification requires that the expert assesses the adequacy and the relevance of the methods, assumptions and inputs used by the undertaking for the valuation of the items under review. The verification also requires the expert to give an opinion on the result of the valuation.

2.271. The undertaking needs to make the documentation needed to perform his duties available to the expert, including:

- a) policies and procedures established on significant valuation methodologies;
- b) assumptions and data entered into the methods;
- c) the results of the undertaking's independent review and verification activities.

Guideline 58 – Independence of the external expert

The undertaking should be able to demonstrate to the supervisory authority that the external valuation or verification has been performed by independent experts with the relevant professional competence, due care and relevant experience.

- 2.272. As the external valuation or verification is performed by external experts, the concept of independence has some specific characteristics, which differ from the concept of independence in other parts of this guidance.
- 2.273. Independence requirements mean that there are no potential conflicts of interests between the expert and the undertaking. Therefore, independence comprises of:
- a) 'Independence of Mind' - The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an expert to act with integrity and exercise objectivity and professional scepticism;
 - b) 'Independence in Appearance' - The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that an expert's integrity, objectivity or professional scepticism have been compromised.
- 2.274. The principle of integrity imposes an obligation to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.
- 2.275. The principle of objectivity imposes an obligation on experts not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others. For example, an expert cannot accept an engagement to verify a valuation if he contributed in any way to that valuation.
- 2.276. The principle of professional competence and due care imposes the following obligations on all professional experts:
- a) to maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service;
 - b) to act diligently in accordance with applicable technical and professional standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation, when providing professional services.
- 2.277. Knowledge and skills relate to the nature and level of expertise of an expert in the field to be evaluated. Experts need to have a recognised and relevant professional qualification regarding the subject of valuation and having recent experience in the valuation of the fields considered.
- 2.278. As part of assessing the knowledge and competence, undertakings may also consider:

- a) knowledge of the expert's qualifications, membership of a professional body or industry association, license to practice, or other form of external recognition;
 - b) experience and knowledge of the type and category of item to be evaluated;
 - c) reputation and information delivered by others who are familiar with that expert's work;
 - d) published papers or books written by that expert.
- 2.279. In order to assess the relevant professional qualification of organisations, the undertaking has to be able to demonstrate that the evaluations are carried out by individuals that satisfy the requirements of competence, capability and objectivity. The undertaking has to be able to demonstrate to the supervisor its assessment of the external expert. If an undertaking is not able to do so, the supervisor may need to ask for a new review by another expert.
- 2.280. Experts need to have the ability to exercise their competence in the given circumstances. Factors that influence this capability may include, for example, geographic location and the availability of time and resources.
- 2.281. If an undertaking, during or after the process of external valuation or verification, becomes aware of any facts which may jeopardize the independence of the experts, it assesses if that expert still fulfils the independence requirement. It communicates to the supervisory authority the fact that the assessment has been made and its results, including whether another valuation or verification by a different expert is needed.

Guideline 59 – Information to be provided to the supervisory authority on the external valuation or verification

The undertaking should provide the supervisory authority with all relevant information requested on external valuation or verification. The undertaking should include in this information, at least, the experts' written opinion on the valuation of the relevant asset or liability.

- 2.282. In most circumstances, if there are no other legal, statutory requirements or contractual arrangements governing the expert's work, the communication between the supervisory authority and the expert are channelled through the undertaking. The undertaking is responsible for providing the supervisory authority with the relevant information.
- 2.283. The expert performing external, independent valuation or verification has to document the appraisal work appropriately. Where appropriate, the supervisory authority may request an appraisal report.

Section 11: Outsourcing

Guideline 60 - Critical or important operational functions and activities

The undertaking should determine and document whether the outsourced function or activity is a critical or important function or activity on the basis of whether this function or activity is essential to the operation of the undertaking as it would be unable to deliver its services to policyholders without the function or activity.

- 2.284. A service provider is a third party and may be a supervised entity, an entity from the same group as the undertaking or not and it may be located inside the European Union as well as outside.
- 2.285. In principle, any functions and activities of an undertaking can be outsourced, but the AMSB retains ultimate responsibility for discharging its obligations.
- 2.286. While an outsourcing arrangement may be performed directly by the service provider, the service provider may sub-outsource to another provider if this is permitted by the contract agreed with the undertaking. While an undertaking will not be a party to the sub-outsourcing agreement, it ensures that it is informed by the service provider of any sub-outsourcing, because the undertaking remains fully responsible for the activity or function outsourced and must ensure the service provided is satisfactorily performed.
- 2.287. An undertaking needs to decide whether an arrangement falls within the definition of outsourcing. Generally, for example, where an undertaking provides insurance services to its policyholders and certain elements of the delivery of those services are contracted to a third party, the arrangement is likely to be an outsourcing unless the policyholder has a direct contractual relationship with the third party for the delivery of those services. Any reliance on a third party for functions enabling the undertaking to provide those insurance services is also likely to be outsourcing.
- 2.288. However, not every provision of a function or service to an undertaking by a service provider will fall within the definition of outsourcing. Hiring a specialist consultant, for example, to provide one-off technical advice or one-off support for an undertaking's compliance, internal audit, accounting, risk management or actuarial functions does not normally constitute outsourcing. However, it may become outsourcing if an undertaking subsequently relies on that consultant to manage an internal function or service, e.g. when it is installed or becomes fully operational.
- 2.289. While it is not possible to determine a bright line it can be expected that, in broad terms, the more substantial or frequent the advice or service provided by a third party for an undertaking is, the more likely it is to fall within the definition of outsourcing.
- 2.290. In determining whether an outsourced function or activity is critical or important the undertaking has to take into account any definition or list of such functions or activities provided under national law or national administrative interpretation. Where functions or activities are partially

outsourced it is relevant whether these outsourced parts are per se critical or important.

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

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

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

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

Guideline 61 - Underwriting

When an insurance intermediary, who is not an employee of the undertaking, is given authority to underwrite business or settle claims in the name and on account of an undertaking, the undertaking should ensure that the activity of this intermediary is subject to the outsourcing requirements.

2.293. Underwriting is a main activity of any undertaking. As such, underwriting is a critical or important operational function or activity. It is common in most Member States to have insurance intermediaries involved in the underwriting process. These are subject to Directive 2002/92/EC (hereinafter "IMD")¹⁰. However, where an insurance intermediary is mandated to write insurance business or to settle claims on behalf of the undertaking, this is an outsourced service and, as such, the arrangement is caught by the Solvency II outsourcing requirements.

2.294. The typical intermediation activities of an insurance intermediary, i.e. introducing, proposing or carrying out other preparatory work for the conclusion of insurance contracts, or concluding such contracts, or assisting

¹⁰OJ L 9, 15.01.2003, p. 3.

in the administration and performance of such contracts, in particular in the event of a claim, as set out in the IMD, are not subject to the outsourcing requirements.

- 2.295. In the case of outsourcing of underwriting activities, the application of the outsourcing requirements needs to be analysed taking into consideration the specific requirements applicable under the IMD.

Guideline 62 - Intra-group outsourcing

If critical or important functions or activities are outsourced within the group, the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should document which functions relate to which legal entity and ensure that the performance of the critical or important functions or activities concerned at the level of the undertaking is not impaired by such arrangements.

- 2.296. In case of intra-group outsourcing, the degree of flexibility may vary according to whether the service provider is, for example, in the same country as the undertaking or in a different geographical region.
- 2.297. Nevertheless, the undertaking needs to assess whether and to what extent it should rely on functions and activities provided by a service provider in its group.
- 2.298. Where the service provider is a legal entity from the same group as the outsourcing undertaking, the examination of the service provider may be less detailed provided that, on one hand, the undertaking's AMSB has greater familiarity with the service provider and, on the other hand, the undertaking has sufficient control over, or can influence the actions of, the service provider.
- 2.299. A written agreement has to be established, stipulating the duties and responsibilities of both parties. However, this could assume the form of a service level agreement since the arrangement is probably not subject to formal negotiations (unlike an outsourcing to an external service provider).
- 2.300. While the supervisory review process may take into account a group as a whole and the extent to which an entity within the group provides a service or function for other undertakings in the same group, the obligations remain with the individual undertaking as it is the authorised entity. While an undertaking may assign to another group member the carrying out of services or functions, it cannot absolve itself of responsibility for them and still has to manage the outsourcing arrangement robustly with, for example, suitable business contingency plans.

Guideline 63 - Outsourcing written policy

The undertaking that outsources or considers outsourcing should cover in its policy the undertaking's approach and processes for outsourcing from the inception to the end of the contract. This in particular should include:

- a) the process for determining whether a function or activity is critical or important;
- b) how a service provider of suitable quality is selected and how and how often its performance and results are assessed;
- c) the details to be included in the written agreement with the service provider taking into consideration the requirements laid down in the Commission Delegated Regulation 2015/35;
- d) business contingency plans, including exit strategies for outsourced critical or important functions or activities.

2.301. On (b), the policy sets out the due diligence process to be carried out prior to deciding on an outsourcing arrangement. The matters to be covered include the financial and technical ability of the service provider and its capacity to perform the outsourcing; its control framework; and any conflict of interests, e.g. between service provider and undertaking or arrangements with competitors.

2.302. On (c), the policy also needs to address the conditions under which sub-outsourcing by a service provider is possible. In any case, if the sub-outsourced function is critical or important for the undertaking the sub-outsourced service needs to be approved by the undertaking.

2.303. The examination of an applicant service provider allows the undertaking to understand the main risks that might arise from the outsourcing, to identify the most suitable strategies for the mitigation or management of these risks and to ensure that the service provider has the ability, capacity and any authorisation required by law to perform the outsourced activities reliably and professionally. The conclusions are to be documented and reviewed by the undertaking at any time it considers relevant.

2.304. On (d), irrespective of the service provider's governance obligation to establish suitable contingency plans for the function outsourced by the undertaking, the undertaking needs to consider in its own contingency planning how, if needed, the outsourced can be taken over by a new service provider, or bring it back in-house, as appropriate.

2.305. The undertaking's AMSB approves all outsourced services of critical or important functions or relevant activities and regularly receives review reports on the performance of these outsourcing arrangements when they are operational.

2.306. An undertaking remains fully responsible for all outsourced functions and activities, which implies that it needs to include in its system of governance a process for monitoring and reviewing the quality of the service provided. It is not sufficient for the service provider itself to have internal controls and a risk management system that covers the services performed. In order to

ensure effective control of outsourced activities and manage the risks associated with the outsourcing, the undertaking needs to maintain the competence and ability within the undertaking to assess whether the service provider delivers according to contract.

- 2.307. As part of good management practice, an undertaking is expected to effectively monitor whether its service provider is in compliance with all the terms of their written agreement. If the service provider does not effectively carry out the functions or activities in compliance with the terms of the outsourcing agreement, appropriate actions must be taken. If, for example, a service provider is unwilling to cooperate with the undertaking's supervisory authorities, the undertaking will have to terminate the outsourcing agreement. In this context, where a service provider is located outside the EU, the undertaking needs to pay particular attention to whether the service provider's regulator or local laws and regulations might restrict access to information about the outsourced activity or function or to the service provider's premises.

Guideline 64 - Written notification to the supervisory authority

In its written notification to the supervisory authority of any outsourcing of critical or important functions or activities the undertaking should include a description of the scope and the rationale for the outsourcing and the service provider's name. When outsourcing concerns a key function, the information should also include the name of the person in charge of the outsourced function or activities at the service provider.

- 2.308. The written notification of any outsourcing of a critical or important function which is also a key function is to include the name of the person who at the service provider is in charge for the outsourced function in order to enable the supervisory authority to approach the service provider directly as appropriate and necessary.
- 2.309. Where a key function is outsourced, the supervisory authority expects the undertaking to be able to demonstrate, at the request of the supervisory authority, that this person has been assessed as being fit and proper.
- 2.310. A notification of the supervisor is needed for the outsourcing of critical or important functions or activities, irrespective of whether the third party service provider is authorised or not. Examples include where an undertaking has an underwriting outsourcing arrangement with an insurance intermediary subject to the IMD or it outsources functions to an insurance undertaking within its group.
- 2.311. The requirement for an undertaking to notify its supervisory authority in a timely manner prior to outsourcing any critical or important functions or activities presents an opportunity for the supervisory authority to discuss concerns with the undertaking, in case the outsourcing appears not to comply with the provisions of Solvency II and the Commission Delegated Regulation 2015/35 and the opportunity to object to the outsourcing if supervisory concerns cannot be dispelled.
- 2.312. 'In a timely manner' constitutes a period of time sufficient for the supervisory authority to examine the proposed outsourcing before it comes

into force. This could be at least six weeks before the outsourcing is due to come into effect.

2.313. 'Subsequent material developments that entail further notification requirements' are all developments that are relevant for supervisory purposes, i.e. any circumstances that may give supervisors reasons to reassess the undertaking's compliance with Solvency II or the Commission Delegated Regulation 2015/35 or adversely affect the undertaking's ability to deliver its services to policyholders. This could, in particular, apply to material changes in the outsourcing arrangements, including any sub-outsourcings; a new service provider or major problems with the performance of the existing service provider, such as non-performance on account of business disruption, non-compliance with applicable laws and regulations, serious and repeated infringements of guidelines, inadequate risk management, insufficient granting of access to data and information or data or anything else that causes significant dissatisfaction to the undertaking or policyholders about the service.

Chapter II: Group governance specific requirements

Guideline 65 – Responsibilities for setting internal governance requirements

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should set adequate internal governance requirements across the group appropriate to the structure, business model and risks of the group and of its related entities, and should consider the appropriate structure and organization for risk management at group level, setting a clear allocation of responsibilities at all entities that are part of the group.

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should not impair the responsibilities of the AMSB of each entity in the group when setting up its own system of governance.

- 2.314. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company responsible for the fulfilment of governance requirements at group level, is usually the parent undertaking. Depending on the structure and organisation of the group, the group supervisors, if necessary, in accordance with the rules laid down in Solvency II (Articles from 246 to 258), could request the group to identify another entity, other than the participating insurance or reinsurance undertaking or insurance holding company or mixed financial holding company, for the fulfilment of the governance requirements that is able to undertake effective measures to apply governance requirements.
- 2.315. Even if some or all of the governance requirements do not apply at the individual level for some entities belonging to an insurance group, namely holdings and other non-regulated entities, all governance requirements are applied to the coherent economic entity that in a holistic way aggregate all entities that are part of the group (group level).

Guideline 66 – System of governance at group level

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should:

- a) have in place appropriate and effective tools, procedures and lines of responsibility and accountability enabling it to oversee and steer the functioning of the risk management and internal control systems at individual level;
- b) have in place reporting lines within the group and effective systems for ensuring information flows in the group bottom up and top-down;
- c) document and inform all the entities that are part of the group about the tools used to identify, measure, monitor, manage and report all risks to which the group is exposed;
- d) take into account the interests of all the entities belonging to the group and how these interests contribute to the common purpose of the group as a whole over the long term.

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

2.317. The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company for fulfilling the governance requirements at group level ensures that the different group entities, including the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company, receive enough information for all of them to get a clear perception of the general aims and risks of the group. Any flow of significant information between entities relevant to the group's operational functioning should be documented and made accessible promptly, when requested, to the AMSB at group level, to the control functions and supervisors, as appropriate.

2.318. The AMSB of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company for fulfilling the governance requirements at group level ensures it keeps itself informed about the risks the groups' structure causes. This includes information on major risk drivers and regular reports assessing the group's overall structure and evaluating individual entity's activities compliance with the approved strategy.

2.319. In discharging its corporate governance responsibilities, the AMSB of the participating insurance or reinsurance undertaking, the insurance holding

company or the mixed financial holding company for fulfilling the governance requirements at group level:

- a) establishes a governance structure that contributes to the effective oversight of the entities that are part of the group, taking into account the nature, scale and complexity of the different risks to which the group and its components are exposed;
- b) ensures the overall consistency of the group's governance structure taking into account the structures and activities of the different entities that are part of the group;
- c) sets and reviews the general strategies and policies of the group;
- d) has appropriate means to control that each of the entities that are part of the group complies with all applicable corporate governance requirements;
- e) ensures that the reporting systems in the group are clear, transparent and appropriate in order to guarantee adequate and timely communications within the group.

Guideline 67 – Risks with significant impact at group level

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should consider in its risk management system the risks both at individual and group level and their interdependencies, in particular:

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

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

Guideline 68 – Risk concentrations at group level

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that there are processes and procedures in place to identify, measure, manage, monitor and report risk concentrations.

2.321. The group needs to ensure that risk concentrations information is being collected on a consistent basis across the group. Processes and reporting requirements must be integrated into coherent assessments focused on the ORSA and building upon the group's own internal risk management.

Guideline 69 - Intra-group transactions

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the risk management system of the group and the individual undertakings include processes and reporting procedures for identifying, measuring, monitoring, managing and reporting of intra-group transactions, including significant and very significant intra-group transactions as referred in Solvency II.

2.322. The governance system needs to assure a sound management of intra-group transactions: proper information systems and management reporting mechanisms must be in place to allow supervisory authorities to monitor IGT and their management.

2.323. Consideration needs to be given to any unusual or excessive activity in individual locations or legal entities, on accurate measurement and accounting and on profit distribution which has to be properly addressed in the context of the ORSA.

Guideline 70 – Group risk management

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should support in its risk management at the level of the group by appropriate processes and procedures to identify, measure, manage, monitor and report the risks that the group and each individual entity are or might be exposed to.

The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should ensure that the structure and organization of the group risk management do not impair the undertaking's legal ability to fulfil its legal, regulatory and contractual obligations.

2.324. This guideline needs to be read in conjunction with Guideline 17 (Role of the AMSB in the risk management system).

2.325. The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company for fulfilling the governance requirements at group level is expected to assess how and to what extent all risks within the group are effectively identified, measured, managed and monitored. This assessment will be supported by appropriate documentation on the structure, organization and centralization of the group risk management system.