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Regulatory Newsflash
Circular on the prudential expectations of the National Bank of Belgium concerning governance in the insurance and reinsurance business

1. Introduction

On 5 July 2016, the National Bank of Belgium (NBB) published Circular NBB_2016_31 on the prudential expectations concerning governance in the insurance and the reinsurance business (NL / FR) and an accompanying annex (NL / FR), entering into force on the same day.
With this circular, the NBB aims to achieve four objectives:

1. First and foremost, the NBB wants to **provide a complete overview** of the legal texts regulating the governance requirements applicable to (re)insurance undertakings. Since the governance regime for (re)insurance undertakings predominantly originates from the 2009 Solvency II directive and its related legislation and guidance, the circular incorporates several (transpositions) of these relevant texts. Specifically, the following texts are integrated in the circular:

a) The Law of 13 March 2016 regarding the statute and supervision of insurance and reinsurance companies (hereafter: the "Solvency II Law")

b) The explanatory memorandum of the Solvency II Law

c) The Solvency II Delegated Regulation

d) The related regulations, circulars and communications of the NBB

2. In addition, the circular seeks to **transpose additional level 3 guidance on Solvency II** into Belgian law in the form of the "guidelines on system of governance" of the European Insurance and Occupational Pensions Authority (EIOPA) of 14 September 2015. These guidelines are closely aligned to the Circular 2013_20 of the NBB on the requirements concerning the governance system in the context of the preparatory measures for Solvency II (NL / FR).

3. **The NBB also aims to update its own existing guidance** on the governance of (re)insurance undertakings by replacing any circulars that are no longer aligned with the governance requirements imposed by the Solvency II Law. The following circulars have therefore been revoked:

   a) Circular PPB-2007-6-CPB-CPA on the prudential expectations concerning corporate governance (NL / FR / EN)

   b) Circular CBFA_2008_13 of 5 June 2008 on risk management (NL / FR)

   c) Circular CBFA_2009_33 of 19 November 2009 concerning the actuarial function (NL / FR)

   d) Circular PPB-2006-1-CPA of 6 February 2006 on outsourcing (NL / FR)

   e) Circular CBFA_2009_34 of 26 November 2009 on a proper remuneration policy (NL / FR / EN)

   f) Circular CBFA_2009_26 of 24 June 2009 on the reporting by the effective management on the evaluation of the internal control system (NL / FR)

4. Lastly, the NBB also employs this circular to **provide new guidance** on its prudential recommendations and expectations regarding the application of the Solvency II Law.

2. Prudential expectations

The circular contains fifteen chapters and provides, per chapter, an overview of the applicable legal framework. The sub-chapters elaborate on the specific governance requirements, reflecting the legal requirements contained in the Solvency II Law, the EIOPA guidelines and the additional recommendations and expectations of the National Bank of Belgium. The following paragraphs outline several of the most impacting changes included in the circular.

a) Governance structure

The most significant changes to the governance requirements applicable to (re)insurance undertakings introduced by the Solvency II Law and further clarified and detailed in the Circular, concern the Board of Directors. These changes impact the composition of the Board of Directors and reinforce the responsibilities of the Board of Directors in relation to the corporate governance policies of the company, specifically regarding risk management.

Firstly, the requirements relating to the composition of the Board have been adapted. Although the required number of independent directors depends on the size and the complexity of the undertaking, both the Solvency II Law and the NBB provide additional guidance. As such, only minor undertakings will be exempt from appointing an independent director – even though the NBB still considers this as a best practice. Larger undertakings will need to have at least two independent directors.

Furthermore, a clear policy on the selection of members of the Board of Directors and the Executive Committee has to be drawn up. Besides the “fit and proper” requirements, this policy should also take other factors into consideration, such as the number of directors, their age and gender, the accumulation of mandates, the duration and rotation of mandates and possible conflicts of interest. The circular emphasizes the importance of reassessing these requirements and introduces several (re)insurance specific areas of expertise that need to be present in the Board of Directors. An additional policy on the nomination, reappointment, dismissal and deposition of directors will be required to complement the selection policy.

The Board plays an important part in the risk management of the undertaking. The Board needs to determine the risk appetite and risk tolerance limits of the undertaking, and validate several risk policies. To support the Board in these tasks, (re)insurance undertakings are now obliged to establish a risk committee next to the existing audit committee. This risk committee can however be merged with the audit committee into one single committee as far as the legal criteria for both committees are met by the resulting single committee and the NBB is notified of the fulfilment of these requirements and the practical modalities of the single committee.(meeting frequency, planning,…).

The circular also demands that the Chief Risk Officer (CRO) is a member of the Executive Committee, similar to what the Banking Law requires for credit institutions. Based on the Solvency II-law, specific exceptions can be granted by the NBB. The same requirements and exceptions apply for credit institutions.

Another significant change imposed by the Solvency II regime is the compulsory installation of a remuneration committee. As the other committees, the remuneration committee will have a role as advisor to the Board on the remuneration policies of the undertaking. Moreover, it prepares the Board decisions regarding remuneration and it directly supervises the remuneration of the heads of the independent control functions.

b) Risk management system

The importance of proper risk management is stressed by the elaboration of requirements for a risk management system and by strengthening the role of the independent control function responsible for risk management.

The risk management system is further refined and detailed in the new circular, which now includes a complete overview of the risk management function in a (re)insurance undertaking. Mechanisms unique to the (re)insurance business such as ORSA ("Own Risk and Solvency Assessment"), are now covered by the circular.

Based on the existing basic principles, the execution and implementation of the risk management system have been further elaborated. One of the major changes is the compulsory establishment of a risk committee (see above point a), complemented by additional measures such as the drafting of additional policies (such as a decision making policy).

c) Actuarial function

The new circular redefines the tasks of the actuarial function, both detailing and elaborating existing obligations. These obligations are supplemented by several additional tasks arising from transitional measures included in the Solvency II regime concerning risk-free interest rates and technical provisions. Moreover, the actuarial function should contribute to the efficient implementation of the risk management system, specifically concerning the calculation of capital requirements and ORSA. It is also notable that the circular now explicitly forbids that the actuarial function would check and verify its own work. This was not made entirely clear in the previous (now revoked) circular on the actuarial function, and by consequence, some actuarial departments combined both responsibilities.

Furthermore, and similar to the other independent control functions, the actuarial function reports at least annually directly to the Board of Directors on tasks that have been undertaken and informs the Executive Committee accordingly (instead of the preliminary reporting via the Executive Committee). However, the NBB advises to foresee more frequent reporting to the Board (eventually via the risk committee), for instance in response to significant events that require an intervention of the actuarial function such as the launch or modification of a new product, or the closing of a new reinsurance treaty.

In any case, the actuarial function should immediately notify the Board of any risk-related developments that may negatively affect the undertaking.

d) Reporting

In addition, the requirements for the reporting on governance have been revised. The annex of the Circular includes a structure for the yearly report regarding the assessment of the efficiency of the governance system (replacing the old report of the effective management concerning the evaluation of the internal control system). Besides the IC reporting, the primary prudential reporting consists of the governance memorandum, the Solvency and Financial Condition Report (SFCR) and the Regular Supervisory Report (RSR). The governance memorandum will serve as a cornerstone for these reports. The required governance information in the SFCR and RSR will be based on the information in the governance memorandum. The risk and compliance functions are responsible to guarantee the coherence between these reports.

The report on the efficiency of the governance system and the updated governance memorandum – incorporating the necessary changes to the governance system imposed by Solvency II – should be submitted to the NBB by the end of May 2017.

e) Other notable changes

Several existing governance requirements are further tightened causing the revocation of other circulars. These include the requirements for outsourcing, remuneration policies, guidelines on the financial management of the undertaking and on continuity and crisis management.

3. Impact

The impact of the new and/or changed requirements will differ for individual (re)insurance undertakings. In particular, undertakings that are not part of a bankassurance group and consequently, have not yet been subject to similar obligations as well as companies who are not able to benefit from the exceptions for “minor” undertakings will be affected the most. Given the introduction of new requirements and the dissimilarities with the requirements for credit institutions (see below), (re)insurance undertakings will at the very least need to adapt existing policies. In some cases however, the impact of the Solvency II regime will be more material, requiring the drafting of new policies or even modifications of the governance structure of the company such as the appointment of additional independent directors, the establishment of additional board committees, etc.

If a company fails to adhere to the provisions included in the circular, the NBB has several sanctions at its disposal to enforce compliance. These sanctions range from simple recovery measures to enforcement measures, and even include the rescission of the license. Hence, non-compliance with the Solvency II regime exposes (re)insurance undertakings to considerable risks.

4. Differences compared to credit institutions

Whilst the governance requirements outlined in this circular are similar to the regime imposed on banks and credit institutions by the Banking Law, several key differences should be noted. These differences impact several areas of the governance regime. In the following paragraphs, some of the most prominent discrepancies are summarized.

a) Organization of the management structure

A notable difference concerns the organization of the Board of Directors and its committees.

The members of the Executive Committee of credit institutions also need to be members of the Board, whereas (re)insurance undertakings only need three members of the Executive Committee to be included in the Board of Directors.

Other discrepancies concern the Board committees of insurance and reinsurance undertakings. Contrary to credit institutions and banks, they are not required to establish a nomination committee – although this is still considered as a best practice by the NBB.

Furthermore, expanded exemptions on the obligation to include audit, risk and remuneration committees in the Board of Directors offer greater flexibility to (re)insurance undertakings. As mentioned above, (re)insurance undertakings are allowed to merge their audit and risk committee into a single committee, if specific conditions are met. The merger of these committees is not a novel idea, as it was already a possibility for *minor* banks and credit institutions.

In addition, the remuneration committee can be omitted even in (re)insurance companies that do not qualify as minor undertakings – if the Board and the Executive Committee are sufficiently supported by the internal organization of the undertaking to take up these tasks themselves. An equivalent exception is available to credit institutions, although limited to minor credit institutions.

b) Other notable differences

Further differences between the Solvency II governance requirements and the requirements applicable to credit institutions mostly result from the adaptation of the governance regime to the unique characteristics of the (re)insurance business. This may imply either a tightening or an attenuation of the requirements compared to those applicable to credit institutions.

For instance, the guidelines on the Own Risk and Solvency Assessment ("ORSA") or the role of the actuarial function are included to accommodate for the specific traits of a (re)insurance undertaking.

The modifications to the regime applicable to (re)insurance undertakings may sometimes provide more flexibility than the corresponding requirements for credit institutions, as illustrated in the abovementioned paragraph.

In other cases, the introduction of the Solvency II regime may lead to (re)insurance undertakings being subject to more stringent requirements than those applicable for credit institutions. As mentioned above, the compliance function (together with the risk function) of (re)insurance undertakings will be more heavily taxed in its reporting duties than that of credit institutions, since Solvency II obliges the compliance function to ensure the consistency between the included SFCR and RSR and the governance memorandum.

5. Conclusion

Circular NBB_2016_31 provides insurance and reinsurance undertakings with an overview of the governance requirements imposed by the Solvency II regime.

The impact on the (re)insurance sector can differ significantly between companies depending on their current organization and (group) structure. In any case, existing policies and reporting will need to be reviewed and adapted and a large number of insurance companies will need to revisit and modify their current governance structure in line with the detailed requirements of the circular.

It is therefore necessary to correctly assess the impact of this new governance regime on every individual (re)insurance undertaking and to ensure a correct implementation of the provisions laid out in this circular. The time frame to do so is short, since the circular entered into force on 5 July 2016 (date of publication). However, first reporting on the efficiency of the governance system and the adapted governance memorandum are expected by the NBB by 31 May 2017 (reporting related to 2016).

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