



16 January 2009

Mr. Carlos Montalvo Rebuelta
Secretary General
CEIOPS
Westhafen Tower
Westhafenplatz 1
D-60327 Frankfurt Am Main

Ref.: *CEIOPS-IGSRR-24/08*

Our Ref.: INS/HvD/SS/LF/SR

Dear Mr. Montalvo,

Re: FEE Comments on CEIOPS Issues Paper “Implementing Measures on System of Governance”

- (1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the CEIOPS Issues Paper “Implementing Measures on System of Governance” (the “Issues Paper”).
- (2) Our general comments, together with more specific comments on certain Sections of the Issues Paper, are set out below.

General comments

- (3) We welcome the Issues Paper. However, we consider that certain parts thereof do not go into sufficient detail in order to serve as implementation guidance. Therefore, it would be useful if it contained further clarification on some aspects as we have indicated below and if the proposals would address in greater detail the related articles in the Framework Directive Proposal (“FWD”).
- (4) We believe that if the purpose of the Issues Paper is to provide a basis for the Level 2 implementing measures, it would not be appropriate to include new concepts or terminology (as explained in more detail below at Section 6).
- (5) In addition, it would be helpful if the Issues Paper and resulting Level 2 implementing measures and potential Level 3 guidance could make clear how the terminology used of “administrative or management body and the organisation of internal supervision” relates to unitary and two-tier board systems. Much of the Issues Paper appears to be written in the context of a unitary board system. For this reason, we think that further consideration is required as to how well certain aspects would translate to the two-tier system of governance.



Section 4: General Governance Requirements

- (6) We note that there is no explicit mention of the external audit, while for example in some jurisdictions statutory auditors are required to report on weaknesses in the internal control and risk management systems with respect to accounting processes. Consequently, external auditors can act as a source of information for the internal review of the system of governance. It would be helpful to include an explicit reference to the external audit or external auditor in this respect.
- (7) Regarding the requirement that “the system of governance shall be subject to regular internal review” (as detailed on page 6 of the Issues Paper), it would be useful to be more explicit regarding what “internal review” refers to, for example whether this may be conducted by the Internal Auditors or outsourced, and the Audit Committee might oversee such a review where appropriate.
- (8) The Issues Paper states that “the fulfilment of the internal audit function, however, cannot be combined with other operational duties or functions” (as detailed on page 8 of the Issues Paper under paragraph 4.6). “Operational” is not clearly defined. In particular, it is not clear whether “operational” refers to both the responsibility for operating certain functions and oversight of these functions. In addition, we note that it may be impractical not to allow for some combination of functions in the case of smaller organisations. Therefore, we question whether this requirement may be too restrictive.
- (9) We understand that the list under Preliminary views on CEIOPS’ advice on Level 2 implementing measures (in paragraph 4.11 on page 9 of the Issues Paper) is intended to set out elements of organisational structure. However, many of the items in the list are processes and cultural aspects (core values) rather than structural matters. We would recommend to make a clear distinction between the items in the list that can be achieved by a proper organisational structure and the items that relate to the undertaking’s culture and “corporate story” (like core values, belief systems, strategic boundaries, etc.).
- (10) In addition, we note that the “internal review” referred to earlier in the Issues Paper is not included in this list. It would be helpful to include building an appropriate internal review process in this list and to provide additional guidance on this element.
- (11) Regarding the provision on ensuring that “members of the administrative or management body possess sufficient professional qualifications” (paragraph 4.11 (c) on page 9 of the Issues Paper), it would be helpful if the text would refer not only to “professional qualifications” but also to “skills”.
- (12) Regarding the provision that the “relevant responsibilities, goals, processes and reporting procedures to be applied, (...) should be in line with the undertaking’s overall **business strategy**” (paragraph 4.13 on page 10 of the Issues Paper), we believe that it would be helpful to explicitly make the link between the system of governance as a whole and how it is exercised on the one hand and business strategy on the other hand. In this context, the COSO ERM framework may provide useful guidance.



Section 5: Fit and proper requirements

- (13) Regarding the statement “Key functions are those considered important and critical in the system of governance and include risk management, compliance, internal audit and actuarial functions” (paragraph 5.12 on page 12 of the Issues Paper), we wonder whether it should not be compulsory to have a minimum level of expertise and/or experience in these specific areas reflected in the system of governance.

Section 6: Risk Management System

- (14) We suggest that it would be useful for this section to be tested against the **COSO ERM framework**.
- (15) Section 6 explores various risks to be considered but does not include either currency risk or sovereign risk, including the operational risk dictated by intervention of regulators or legislation. It would help if these were explicitly mentioned.
- (16) Regarding the statement “The undertaking shall define its investment policy based on the rules and procedures that a **wise, prudent** and **expert** manager would apply...” (paragraph 6.81 on page 25 of the Issues paper), we do not consider these terms are clearly defined. We suggest referring to the known concept of “sound and prudent”.
- (17) Regarding the “performance of the internal model” (as detailed in paragraph 6.90 on page 26 of the Issues Paper) that it “should be tailored to the requirements of the administrative or management body”, we find that, it is unclear what is meant and what should be done. It would be useful to clarify this “performance” further. We note that the performance of the internal model can be measured by backtesting and depends on how it allows for a learning effect.
- (18) In our opinion the term “Risk management” referred to in the statement that “Risk management shall be responsible for the way in which an internal model is integrated with the internal risk management system and the day-to-day functions of an undertaking” (paragraph 6.93 on page 27 of the Issues Paper) is not clearly defined, in particular whether it refers to “function” or “activity”. It would be helpful to be more specific.

Section 7: Internal Control

- (19) Reference is made to the “efficiency of operations” (in paragraph 7.32 on page 31 of the Issues Paper) in the context of the provision that the internal control system shall secure the undertaking’s compliance with these. We believe it would be useful to clarify further what aspects of the “efficiency” should be considered. For example whether it is business efficiency or operational efficiency.



Section 8: Internal audit

- (20) It would be helpful to include a definition of the role of internal audit. Important factors in considering the effectiveness of internal audit are the reporting lines of the internal audit function (it should be to the board, or board committee level), its independence from the operational management, the resources it is given, its skills and the way in which the individuals within the function are rewarded and remunerated.
- (21) In addition, we believe that clarifications on the cooperation between internal audit and external audit and whether internal audit can be outsourced would also be useful. In our view, outsourcing of the internal audit function should not be prohibited, so long as the function remains within an appropriate framework and the top levels of management retain responsibility for implementing and following up on its findings.

Section 9: Actuarial Function

- (22) In our opinion clarification on the cross-oversight of the internal audit, Risk Management and Actuarial Function and the link of this oversight with external audit would be helpful.
- (23) A reference is made to “standards set by the International Actuarial Association (IAA), the Group Consultatif Actuariel Européen or national actuarial associations” (see Note 15 on page 35 of the Issues Paper). We question whether the range of standard setters is not too wide in this regard. It is our understanding, that the IAA will no longer issue standards in that sense, rather it will prepare papers which describe certain approaches. Member organisations can promulgate those papers as standards, or actuaries can state that they apply the described approach.
- (24) The wording of paragraph 9.20 on page 37 of the Issues Paper appears to suggest that the actuarial function is not an operational function. However, the status of the report that is to be issued at least annually, which states any shortcomings and gives recommendations, depends upon the independence of the actuarial function from operational activities. In our opinion this is also valid for the model for cooperation between the actuarial function and the (internal) audit function.

Section 10: Outsourcing

- (25) We understand that it is assumed that the outsourcing is within the EU. However, it may be appropriate to consider also the risks associated when outsourcing takes place outside the EU and to consider sovereign risk in respect of any outsourced activities.
- (26) In addition, it would be appropriate to address explicitly issues that may arise when the provider of outsourced services is in the same group (for instance pricing “at arms length” to protect policyholder’s rights in the surplus in Participating Business).



Other Matters

- (27) The Issues Paper does not address the overall and ultimate responsibility for internal models and senior management responsibility for this. Ultimate responsibility for the model lies with the Board in a unitary board structure and with Management under a two-tier structure. Responsibility for approval of internal models for regulatory purposes must lie with the supervisor. We believe clarification in the Issues Paper would be helpful.
- (28) We would welcome the opportunity to explore further with CEIOPS the extent to which auditors might be used to provide external assurance on internal models, though note that models are tools and, as such, are of secondary importance to the output of models and how well they reflect the underlying business.

For further information on this letter, please contact Ms Saskia Slomp from the FEE Secretariat.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', written over a horizontal line.

Hans van Damme
President