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Communication

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Insurance - Update of the overarching circular on governance

Scope

- Insurance or reinsurance companies under Belgian law, with the exception of small insurance companies under Belgian law as referred to in Articles 275 and 276[1] or local insurance companies under Belgian law as referred to in Article 294 of the Law of 13 March 2016 on the legal status and supervision of insurance or reinsurance companies (hereinafter the "Solvency II Law");
- Branches of third-country companies pursuing an insurance or reinsurance activity in Belgium, with the understanding that due account is taken of the absence of a legal person and of certain corporate bodies and mechanisms in the Belgian branch; and
- Entities responsible[2] for an insurance or reinsurance group under Belgian law within the meaning of Articles 339, 2° and 343 of the Solvency II Law or for a financial conglomerate under Belgian law within the meaning of Articles 340, 1° and 343 of the Solvency II Law.

Summary/Objectives

Through this Communication, the National Bank of Belgium (Bank) informs insurance and reinsurance companies of the update of the overarching circular on governance NBB_2016_31.

The main changes from the previous version are:

i. indication of how to reconcile the new rules of the Companies and Associations Code with prudential governance requirements;
ii. simplification of the rules on the distribution of tasks between members of the management committee;
iii. revision of Chapter 7 on outsourcing to reinforce the operational resilience of insurance and reinsurance companies and to assign a specific monitoring responsibility to the compliance and internal audit functions;

1 Provisions referring in particular to Article 272 of the Solvency II Law, which provides for conditions relating to premium income, total technical provisions, insurance activities covering liability, credit, surety and reinsurance risk and activities abroad.

2 And more precisely insurance or reinsurance companies under Belgian law which are participating undertakings in at least one insurance or reinsurance company from the European Economic Area or from a third country, insurance or reinsurance companies under Belgian law of which the parent company is a mixed insurance holding company or a mixed financial holding company from the European Economic Area or from a third country, and insurance holding companies or mixed financial holding companies under Belgian law that are parent companies of an insurance or reinsurance company under Belgian law, insofar as these are subject to the provisions of the Solvency II Law.

iv. *revision of Chapter 8 on remuneration to clarify the prudential expectations to be met by Identified Staff receiving significant variable remuneration, in accordance with the recommendations proposed by EIOPA;*
v. *update of Chapter 10 on IT infrastructure to emphasise cyber security and compliance with the new rules on cloud outsourcing; and*
vi. *introduction of certain recommendations on sustainable finance.*

For an overview of these changes, please refer to the website of the Bank, which in particular contains a version in review mode of the overarching circular on governance, in which changes from the previous version (of September 2018) are shown in track changes.

The new recommendations on outsourcing and remuneration apply from 2021.

Dear Sir,
Dear Madam,

The entry into force of the Companies and Associations Code, the new Guidelines on cloud outsourcing and remuneration published by EIOPA[3] and other regulatory developments require an update of Circular NBB_2016_31 setting out the expectations of the National Bank of Belgium (hereinafter "Bank") with regard to governance for the insurance and reinsurance sector (hereinafter "overarching circular on governance").

The main changes to this Circular relate to the following aspects:

i. indication of how to reconcile the new rules of the Companies and Associations Code with prudential requirements in relation to the decision-making structures: management structure, independence criteria, expectations regarding the social status of directors and members of the management committee, conflicts of interest etc.;
ii. simplification of the rules on the distribution of tasks between members of the management committee;
iii. clarification of recommendations on outsourcing;
iv. reinforcement of remuneration rules;
v. strengthening of the rules on IT infrastructure; and
vi. introduction of new recommendations on sustainable finance.

The purpose of this Communication is to present these different developments, highlighting the changes from the version of September 2018.

1. Modifications following the entry into force of the Companies and Associations Code

The adoption and entry into force of the Companies and Associations Code[4] (hereinafter "CAC") do not fundamentally change the governance framework for insurance and reinsurance companies. However, some of the Bank's expectations were revised to integrate the new rules of the CAC and to clarify how to reconcile these rules with prudential requirements. The main modifications can be summarised as follows:

a) The current management structure, which consists of a board of directors and a management committee, is being maintained. As indicated in Section 1.1.1, unlike the "fully-fledged" two-tier structure provided for in the CAC, the management structure which consists of a board of directors and a management committee is a specific two-tier structure that is distinct in two ways: on the one hand, the powers of the management committee are delegated by the board of

3 European Insurance and Occupational Pensions Authority.

4 Law of 23 March 2019 introducing the Companies and Associations Code and containing various provisions (Belgian Official Gazette of 4 April 2019, pp. 33 239 to 33 530).

directors and, on the other, at least two or three members of the management committee are directors, which means that there is overlapping between the board of directors and the management committee;

b) The nine independence criteria previously set out in Article 526ter of the former Companies Code shall continue to apply unchanged to insurance and reinsurance companies, even if the CAC adopts a slightly different approach. The intention is to confirm this approach through an amendment to the Solvency II Law which would reintegrate the old criteria of Article 526ter but provide for a so-called "comply or explain" system. In this regard, the Circular specifies that if a company intends not to meet one of the aforementioned nine independence criteria, it should send a formal statement justifying the reasons behind this decision to the Bank together with the "Fit & Proper" file of the person concerned;

c) In Chapter 9, reference is made to the new rules on conflicts of interest involving members of the management committee as included in the Solvency II Law. In this regard, the impact of the CAC is limited as the management committee remains competent for conflicts of interest. However, members involved in conflicts of interest should inform the other members and incorporate the opposing interests in the minutes, a copy of which should be submitted to the board of directors during its next meeting. As regards the rules applicable to the board of directors, there is no specific provision in the Solvency II Law regulating situations of conflict of interest involving members of the board of directors. It should be deduced that the ordinary law rules of Article 7:96 of the CAC apply;

d) Chapter 12 on shareholders was modified to specify that insurance and reinsurance companies (except those incorporated as cooperative companies) may now have a single shareholder.

Furthermore, the Bank wishes to use this Communication to clarify its expectations regarding the social status of directors and members of the management committee for insurance and reinsurance companies.

The Bank stresses that a position of director or member of the management committee of a insurance or reinsurance company cannot be exercised under an employment contract. This rule, which was expressly set out in the CAC adopted on 23 March 2019, applies to both directors and members of the management committee of insurance and reinsurance companies. In case of non-compliance, the Bank expects companies to remedy this situation.

Additionally, the Bank considers that the combination of two statuses (the status of self-employed as director or member of the management committee and the status of employee in a relationship of subordination for another technical or administrative service function) within the same company is not reconcilable with the principles of sound governance applicable to insurance and reinsurance companies, neither for members of the management committee, nor for directors:

- for members of the management committee, a relationship of subordination – if proven - would compromise the proper functioning of the management committee since the relevant member of the management committee would be in a relationship of subordination to his/her colleagues, which is not acceptable from a governance perspective given that collegiality is an essential element for the proper functioning of any management committee;

- for members of the board of directors, a relationship of subordination – if proven - would jeopardise the effectiveness of the board of directors' supervision of the company's management, which is also unacceptable in terms of governance as management supervision is an essential task of any board of directors.

Thus, having regard to the above-mentioned governance requirements, the Bank considers that a combination of statuses is prohibited for members of the management committee and directors of insurance and reinsurance companies and requests that, if companies should discover the existence of such a combination of statuses by their managers, they terminate it.

2. Introduction of standard schemes for the distribution of tasks between members of the management committee for significant companies

In Chapter 1, the expectations relating to the distribution of tasks between members of the management committee were simplified with a view to enhancing flexibility.

For companies that are considered significant in accordance with the criteria included in the introduction of the overarching circular on governance, the Bank's expectations are shown in the form of standard schemes. These schemes are indicative schemes that translate the expectations of the Bank regarding the distribution of tasks without prohibiting insurance and reinsurance companies from adopting a more complete model if they comply with size recommendations.

Less significant companies are free to organise the distribution of tasks between the members of their management committee as they wish as long as obvious conflicts of interest are prevented, such as (i) the combination of Risk Management and Commercial or Risk Management and Investment and (ii) the combination of Internal Audit and Commercial.

3. Outsourcing: clarification of certain general requirements

The operational resilience of insurance and reinsurance companies is a point of attention for the Bank. Thus, a certain number of aspects of its expectations regarding outsourcing were clarified. The main changes to Chapter 7 of Circular NBB_2016_31 are:

a) Clarification of the prudential expectations of the Bank relating to the governance of the outsourcing process for a critical or important function or activity taking into account the different stages of the outsourcing cycle:
   - pre-contractual stage (monitoring conditions, due diligence of the service provider and performance of a risk assessment);
   - contractual stage (content of the outsourcing agreement);
   - post-contractual stage (outsourcing monitoring system and exit strategy).

b) Clarification of the Bank's expectations relating to intragroup outsourcing and outsourcing to a third country.

c) The specification of the outsourcing monitoring tasks assigned to the compliance and internal audit functions. In this regard, attention is drawn to the fact that this does not involve assigning new tasks to these control functions, but concretising tasks in relation to outsourcing that are already expected of these control functions. The Bank expects files for the notification of critical or important outsourcings to now include an opinion of the persons responsible for the compliance function certifying compliance with the governance requirements pertaining to outsourcing.

d) Clarification of the Bank's expectations for documentation and reporting. In this context, a new standard form for notifying the Bank of a critical or important outsourcing has been appended as **Annex 4** to the overarching circular on governance. Similarly, **Annex 5** comprises the standard opinion to be filled in by the person responsible for the compliance function to confirm that he/she has verified the governance aspects relating to a critical or important outsourcing as well as the completeness and accuracy of the reporting submitted to the Bank.

These changes to the general outsourcing framework also make it possible to ensure consistency with the new Circular on cloud outsourcing.

4. New requirements on remuneration

Following an Opinion published by EIOPA on 7 April 2020 to ensure a better convergence between supervisors with regard to the supervision of remuneration rules, the Bank decided to reinforce its expectations on remuneration for Identified Staff receiving a significant variable remuneration i.e. persons who receive a variable remuneration which exceeds € 50,000 and represents more than a third of their total annual remuneration.

In concrete terms, the new additional rules included in Chapter 8 can be summarised as follows:

a) Fixed/variable balance: if the ratio of fixed/variable remuneration exceeds the reference ratio of 1:1 or 1:0.5 for persons responsible for the independent control functions, the insurance company should justify to the Bank why it does not comply with this ratio.

b) Deferral of a substantial portion of the variable remuneration: the Bank considers that a three-year deferral of 40 % of the variable remuneration constitutes a "substantial portion" of the variable remuneration within the meaning of Article 275 of Delegated Regulation 2015/35.

c) Financial and non-financial criteria to be used when assessing individual performance: the individual performance of Identified Staff receiving significant variable remuneration should be based on (quantitative) financial and (qualitative) non-financial criteria. The financial criteria should cover a sufficiently long period to reflect the risks taken by the Identified Staff concerned and should be risk adjusted.

d) Downward adjustments: downward adjustments comprise all types of adjustments: malus, clawback and in-year adjustments. The Bank requires insurance companies to ensure that downward adjustments for Identified Staff receiving significant variable remuneration are well described in the remuneration policy.

e) Termination payments: insurance companies are expected to specify their policy for the potential granting of termination/severance payments in their remuneration policies and to ensure that the following information is included: (i) the maximum amount of the termination payment or the criteria used to determine the amount of the payment and (ii) the fact that a substantial portion of the termination payment should be deferred in time.

Furthermore, a slightly modified template for reporting figures is included in Annex 3 to the overarching circular on governance.

5. IT infrastructure

Chapter 10 of the overarching circular on governance was modified in two ways:

a) An explicit reference to cyber security was added in Section 10.1. "IT security", and

b) It was specified that the Bank extends the scope of Communication NBB_2015_32 on continuity to all significant companies.

Moreover, reference is also made to the new Circular NBB_2020_18 on cloud outsourcing which transposes EIOPA's guidelines on the subject published on 6 February 2020.

6. Recommendations on sustainable finance

In line with the ongoing work on Environmental Social Governance at the level of EIOPA, the following recommendations regarding sustainable development were introduced in the overarching circular on governance:

a) In Chapter 1 "Management structure", it is indicated in Section 1.1.5. "Training" that the Bank recommends that the training programmes cover all risks to which the insurance company is exposed, including sustainability risks;

b) In Chapter 5 "Independent control functions", it is indicated that the risk management function should identify sustainability risks and that the actuarial function should take sustainability risks into consideration in the context of the opinion to be given on the underwriting policy;

c) In Chapter 6 "Financial management", it is specified in Section 6.1. "Prudent person principle" that the company should take into account sustainability risks;

d) In Chapter 8 "Remuneration", it is specified that environmental criteria are a good example of non-financial criteria to be used for determining variable remuneration.

Entry into force of the changes to the overarching circular on governance

The changes to the overarching circular on governance are shown in track changes in the attached document (changes from the version of September 2018 of this Circular). Moreover, for the convenience of the insurance and reinsurance companies, the overarching circular on governance is published on the Bank's website in a web format, each chapter being provided as a separate web page, with links to any underlying thematic circulars.

The changes to the overarching circular on governance are effective immediately, with the exception of (i) the new recommendations on outsourcing which companies should comply with from 1 January 2021 (the date from which the standard form and the opinion of the person responsible for the compliance function should also be submitted) and (ii) the expectations regarding remuneration that shall apply to variable remunerations paid in 2021 for 2020 (in this regard, the modified template for remuneration figures should be used for the first time in the context of the reporting to be submitted in April 2021).

A copy of this Circular will be forwarded to the accredited statutory auditor of your company.

Yours faithfully,

Pierre WUNSCH
Governor

Annex: Updated Overarching Circular on System of Governance (version with track changes).