



Draft EIOPA Guidelines on facilitating an effective dialogue between insurance supervisors and auditors

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Preliminary observations

- Auditing a financial institution is quite a challenge
- The audit market for financial institutions is highly concentrated
- An audit failure in relation with a financial institution may put the survival of the audit firm at risk (see, the trial against PwC in relation with the bankruptcy of Colonial bank)
- There is a need to clearly define the respective roles of auditors and supervisors in relation with the audit of a financial institution

EU context

- BCCI Directive of 29 June 1995: requirement for auditors of financial institutions to communicate irregularities to competent authorities (auditor as “whistleblower”)
- Green Paper (2010): “Audit Policy: Lessons from the Crisis”: where were the auditors? + audit reform
- Regulation (EU) No 537/2014 of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities: recital 15: “Supervisory tasks would be facilitated if supervisors of insurance undertakings and their statutory auditors and audit firms were required to establish an effective dialogue with each other”

Art. 72 Solv.II Framework Directive (2009)

- Prompt reporting to supervisory authorities of any fact or decision which is liable to bring about any of the following:
 - Material breach of the legal provisions concerning the conditions of authorisation or pursuit of activities
 - Impairment of the continuous functioning of the insurer
 - Refusal to certify the accounts or expression of reservations
 - Non-compliance with the SCR or the MCR
 - Same requirement for closely linked undertakings that are audited by the same auditor

Art.12 EU Audit Regulation (2014)

- Repeats the requirement already existing for financial institutions to promptly report material breaches, threats or audit reservations to supervisory authorities
- Requires the establishment of an effective dialogue between the supervisory authority and the statutory auditor. The responsibility for complying with this requirement rests with both parties to the dialogue
- Requires EIOPA to issue guidelines to national competent authorities, in order to facilitate this dialogue, taking into account current supervisory practices

What are guidelines?

- “Instructions” issued by EIOPA on the basis of Art. 16 of the EIOPA Regulation (2010) reflecting appropriate supervisory practice in the EU or how EU law should be applied in practice
- Addressed to competent authorities which should apply the guidelines on a comply or explain basis with notification to EIOPA and public disclosure
- Draft guidelines are consulted upon and must be accompanied by an impact assessment
- The opinion of the IRSG must be published and be properly considered

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- Issued for consultation on 3 February 2016 with deadline for comments by 28 April 2016
- EIOPA has cooperated with EBA on the investigation of current supervisory practices relating to the communication between competent authorities and statutory auditors. Main conclusion: lack of formal rules or provisions regulating the contacts and exchanges of views
- No final text available yet after the consultation
- View of Insurance and Reinsurance Stakeholder Group available on EIOPA's website

Contents of the draft guidelines

- Consultation document of EIOPA is much shorter than the document that was issued on 26 July 2016 by EBA after its consultation: 6 guidelines v. 7 principles
- IRSG suggests that EIOPA should take account of the guidelines issued by EBA, particularly on the following points:
 - Clearer application of the proportionality principle
 - Inclusion of an Annex, listing examples of issues on which information could be shared

Guideline 1: objectives of the dialogue

- The dialogue should be open and constructive, as well as sufficiently flexible
- Respect of the confidentiality principle: how can the auditor be protected from disciplinary proceedings concerning information communicated to the supervisor relating to an undertaking that is established outside the EU?
- The supervised entity should remain the main source of information for supervisory or audit purposes
- Application of a risk based approach to the frequency and depth of communication to ensure a proportionate approach

Guideline 2: Nature of the information to be exchanged

- Information should be relevant and could be undertaking-specific, industry-specific, current and emerging
- Examples: external environment of the undertaking, corporate governance, internal controls, going concern assumption, audit approach, communication with the board and with the audit committee, valuation and own funds, investments, financial statements and other audit documentation, etc.
- If the undertaking is part of a multinational group, competent authorities, in particular group supervisors, should also consider covering relevant group-audit issues

Guideline 3: Form of the dialogue

- Consider and choose the most appropriate and most effective means and channels of dialogue in light of the individual circumstances of the dialogue
- Channels may include written or oral communication, including phone calls and regular physical meetings
- Physical meetings should be promoted in order to facilitate open communication, especially when initiating a dialogue with participants for the first time
- A record should be kept of the communication in order to ensure proper follow-up

Guideline 4: Representatives in the dialogue

- Invitation of individuals from both parties who are knowledgeable, informed and empowered by their organisation or firm to exchange information relevant to the dialogue
- Consider the appropriate number and role of participants taking into account the issues discussed
- Primary participants should be a representative of the supervisory authority acting as team leader and the key audit partner
- Possibility of trilateral meetings including representatives from the undertaking, in particular of the audit committee

Guideline 5: Frequency and timing of the dialogue

- Regular dialogues as frequently as necessary to ensure that the dialogue is effective and taking into account the planning cycle of supervisory inspections and of the statutory audit
- Possibility to have an ad hoc dialogue meeting
- At least an annual meeting particularly for insurance undertakings that are highly risky and that have an expected high impact in case of a given failure (risk based approach v. proportionate approach)

Guideline 6: Dialogue with auditors or audit firms collectively

- In order to promote a more efficient dialogue at sectoral and national level, regular dialogues should be held with statutory auditors collectively to allow an exchange of views on current and emerging developments, at least annually, where relevant
- No undertaking-specific information should be shared during such a meeting and the same confidentiality and professional secrecy requirements as in individual dialogues should apply.

Some questions?

- Should a regular dialogue between supervisor and auditor also contribute to improve audit quality?
- How can an insurance undertaking remain the main source of information when no representative of the undertaking is present during the dialogue?
- Should the supervisor also inform the auditor about significant matters that have occurred and that might have an impact on the financial statements or on going concern? Or on the statutory audit?
- Should public oversight bodies be allowed to participate in a bilateral meeting between supervisor and auditor?

Role of statutory auditor in supervision

- The Solvency II Framework Directive does not require the audit of supervisory information, such as the solvency balance sheet, the SCR, the MCR or periodical information to be submitted to the supervisor
- The Solvency II Framework Directive allows supervisors to require auditors to provide information needed for supervisory purposes
- Many competent authorities in the EU request an external audit of supervisory information or of regulatory public disclosures such as the Solvency and Financial Conditions Report (see, EIOPA “message” of 29 June 2015)

Important message

“Although communication between competent authorities and auditors aims to facilitate the exercise of the task of supervision, each party should bear the ultimate responsibility and accountability for its individual tasks. Neither party should use the work of the other as a substitute for its own work. The supervised (...) institution should remain the main source of information for the work of the competent authority and the auditors” (EBA Guidelines, p. 6)

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