

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

CONSULTATION DOCUMENT

CONSULTATION ON INSURANCE RULES IMPLEMENTING AUDIT COMMITTEE REQUIREMENTS

[MFSA REF: 05-2016]

31st May 2016

Closing Date: 14th June 2016

Note: The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly, these proposals are not binding and are subject to changes and revisions following representations received from Licence Holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

Note for Consultation

1. Purpose

With the view of enhancing the degree of public confidence in the annual and consolidated financial statements of “*public interest entities*¹”, Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, (“the Statutory Audit Directive”), has been amended by Directive 2014/56/EU of 16 April 2014. Moreover, the special provisions for the statutory audits of public-interest entities set out in the Statutory Audit Directive have been further developed in the new Regulation (EU) No 537/2014 of the European Parliament and of the Council of the European Union of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC, (“the Statutory Audit Regulation”).

During April 2016, it was brought to the attention of the MFSA that Directive 2014/56/EU, which amends the Statutory Audit Directive, will be partially transposed in a Draft Bill amending the Accountancy Profession Act (Cap. 281) and the Companies Act (Cap. 386), and that some Articles found in the Statutory Audit Directive, as amended, may apply to authorised insurance undertakings and authorised reinsurance undertakings, since these fall within the definition of “*public-interest entities*” found in Article 2 of the said Directive. Prior to the amendments introduced by Directive 2014/56/EU, non-listed “*public-interest entities*” could be exempt from the requirement to have an Audit Committee under Article 39 of the Statutory Audit Directive. However, Directive 2014/56/EU now removes the discretion, which was previously available, to exempt non-listed public interest entities from the Audit Committee requirement. Therefore, authorised insurance and reinsurance undertakings (including non-listed) will now be subject to the requirements to set up an Audit Committee under the new Article 39 of the Statutory Audit Directive. The transposition deadline for Directive 2014/56/EU is 17th June 2016.

This Consultation Document lays down the proposed Insurance Rules transposing the new Article 39 of the Statutory Audit Directive which requires authorised insurance undertakings and authorised reinsurance undertakings, considered to be “public-interest entities” in terms of the said Directive, to establish an Audit Committee. It is proposed to include the amendments relating to the Audit Committee in Chapter 6 on System of Governance, in Part B of the Insurance Rules. In addition, the proposed Insurance Rules also contain a cross-reference to the relevant provisions of the Statutory Audit Regulation, in particular Title III (Articles 16 to 19) of the said Regulation relating to the appointment of statutory auditors or audit firms.

¹ The term “public interest entities” is defined in Article 2 of Directive 2006/43/EC as amended by Directive 2014/56/EU, and includes both insurance and reinsurance undertakings.

Any comments and feedback are to be addressed to the Insurance and Pensions Supervision Unit by email on ipsu@mfsa.com.mt. Interested parties are kindly asked to submit any comments in writing by not later than **Tuesday 14th June 2016**.

2. Insurance Rules – Audit Committee

The new Article 39 of the Statutory Audit Directive sets out the requirements on the audit committee composition and the functions that audit committees should perform. The requirement to set up an audit committee will encourage good practices relating to systems of governance, thus ensuring that policyholders are appropriately protected.

The proposed Insurance Rules transpose the provisions of Article 39 of the Statutory Audit Directive. In its proposal, the MFSA also considers the options or derogations found in the said Article 39.

2.1 Structure, Membership and Functions of the Audit Committee

In paragraph 1.2, which transposes Article 39(1) of the Statutory Audit Directive, it is being proposed that the Audit Committee of an authorised insurance undertaking and an authorised reinsurance undertaking is to be established as a stand-alone committee which shall be composed entirely of non-executive directors of the Board of Directors and shall have at least three members. This composition aims to ensure that there is the necessary level of independence for the audit committee to carry out its role.

In order to reinforce the independence and technical competence of the audit committee, Article 39(1) provides that at least one member of the audit committee shall have competence in accounting and/or auditing and that committee members as a whole shall have competence relevant to the business of insurance carried on by the authorised insurance and reinsurance undertaking concerned. In addition, a majority of the members of the audit committee shall be independent of the undertaking, as required by the said Article.

The Chairman of the Audit Committee shall be independent of the authorised insurance and reinsurance undertaking. It is also being proposed that the Chairman of the Audit Committee is to be appointed by the members of the Audit Committee.

Moreover, paragraph 1.3, which transposes Article 39(6) of the Statutory Audit Directive, provides for a non-exhaustive list of the functions to be performed by the Audit Committee.

2.2 Member State Options or Derogations from the requirements of Article 39(1) of the Statutory Audit Directive

Article 39(2)

Pursuant to the first sub-paragraph of Article 39(2)² of the Statutory Audit Directive, a derogation from the requirements of Article 39(1) may apply in respect of an authorised insurance and reinsurance undertaking which is a “*small and medium-sized enterprise*”³ within the meaning of Article 2(1)(f) of Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC. In such a case, the MFSA is of the view that in order to facilitate a proportionate approach, an authorised insurance and reinsurance undertaking which is a “*small and medium-sized enterprise*” is to be permitted to assign the Audit Committee functions to the Board of Directors as a whole, as provided in paragraph 1.4 of the proposed Insurance Rules. Moreover, in paragraph 1.5 of the Insurance Rules, pursuant to the option available in the second sub-paragraph of the said Article 39(2), it is being proposed to adopt the option such that where the Audit Committee of an authorised insurance and reinsurance undertaking forms part of the Board of Directors of the undertaking, the Board shall be responsible to perform the functions of the Audit Committee for the purpose of the obligations set out in the Statutory Audit Directive and in the Statutory Audit Regulation.

Article 39(3)(a)

Article 39(3)(a) of the Statutory Audit Directive provides that by way of derogation from Article 39(1), Member States may decide that any public-interest entity which is a subsidiary undertaking within the meaning of Article 2(10) of Directive 2013/34/EU⁴ is not required to have an Audit Committee if that entity fulfils the requirements set out in Article 39(1)(2) and

² Article 39(2) first sub-paragraph: “By way of derogation from paragraph 1, Member States may decide that in the case of public-interest entities which meet the criteria set out in points (f) and (t) of Article 2(1) of Directive 2003/71/EC of the European Parliament and of the Council, the functions assigned to the audit committee may be performed by the administrative or supervisory body as a whole, provided that where the chairman of such a body is an executive member, he or she shall not act as chairman whilst such body is performing the functions of the audit committee.”

³ Article 2(1)(f) of Directive 2003/71/EC provides that: ““*small and medium-sized enterprises*” means companies, which, according to their last annual or consolidated accounts, meet at least two of the following three criteria: an average number of employees during the financial year of less than 250, a total balance sheet not exceeding EUR 43 000 000 and an annual net turnover not exceeding EUR 50 000 000.”

⁴ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

(5) of the Statutory Audit Directive and Articles 11(1) and (2) and 16(5) of the Statutory Audit Regulation, at group level.

In paragraph 1.6 of the Insurance Rules, it is being proposed to adopt the option such that an authorised insurance and reinsurance undertaking is to be exempt from the requirement to set up an audit committee if it is a subsidiary of a parent undertaking whose head office is in a Member State or EEA State and such parent undertaking complies with the requirements of Article 39 of the Statutory Audit Directive, at group level.

Listed insurance and reinsurance undertakings

In the case of an authorised insurance and reinsurance undertaking which is listed on a regulated market, the proposed Insurance Rules provide that such an undertaking is required to comply with requirements of the audit committee found in the Listing Rules issued under the Financial Markets Act (Cap. 345).

2.3 Regulation (EU) No 537/2014 (“Statutory Audit Regulation”)

As stated above, the Statutory Audit Directive is supplemented by the Statutory Audit Regulation. Although the Statutory Audit Regulation does not require transposition into national law, undertakings carrying on business of insurance are nonetheless required to comply with the Articles contained therein, as applicable. This Regulation contains specific requirements regarding the statutory audit of public-interest entities. It is important that, in so far as the requirements relating to the audit committee are concerned, authorised insurance and reinsurance undertakings refer to and comply with the provisions of this Regulation, in particular with Title III (Articles 16 to 19) of the said Regulation relating to the appointment of statutory or audit firm by public interest entities.

It is also to be noted that Article 41 of the Statutory Audit Regulation sets out transitional provisions which apply in relation to Articles 16(3) and 17 of the said Regulation, as applicable.

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