

Chapter on System of Governance

1. Introduction - General Governance Requirements

- 1.1 In terms of article 18I (1) of the Act, an authorised insurance undertaking, an authorised reinsurance undertaking, a captive insurance undertaking and a captive reinsurance undertaking (“an authorised undertaking”), is required to have in place appropriate systems and structures to ensure an effective system of governance which provides for the sound and prudent management of the business of the undertaking. The system of governance shall be proportionate to the nature, scale and complexity of the operations of the authorised undertaking.
- 1.2 The system of governance shall, at least, include:
- (a) an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities; and
 - (b) an effective system for ensuring the transmission of information.
- 1.3 The system of governance shall be subject to regular review by the authorised undertaking and shall include compliance with the system of governance requirements as laid down in Article 18I of the Act, this Chapter and the Chapter on Fit and Proper Requirements.
- 1.4 An authorised undertaking shall:
- (a) have written policies in relation to at least, risk management, internal control, internal audit and, where relevant, outsourcing;
 - (b) make those policies subject to the prior approval of the Board of Directors;
 - (c) ensure that those policies are implemented;
 - (d) review those policies at least annually; and

(e) adapt those policies in view of any significant change in the system or area concerned.

1.5 In particular, the written policy on risk management referred to in paragraph 1.4(a) shall comprise:

(a) of the policies relating to the areas specified in paragraphs 3.2(c) indents (i) to (vi); and

(b) where the volatility adjustment referred to in paragraphs 3.25 to 3.33 of the Chapter on Solvency II – Pillar 1 Requirements is applied, a policy on the criteria for the application of the volatility adjustment.

1.6 At least the four functions included in the system of governance, namely the risk management, the compliance, the actuarial and the internal audit function, are considered to be key functions and consequently also important or critical functions. Furthermore, persons are considered to be persons having key functions if they perform functions of specific importance for the undertaking in view of its business and organisation. These additional key functions, if any, are identified by the undertaking, but the determination of whether such functions should be considered key or not may be challenged by the competent authority.

1.7 An authorised undertaking shall take reasonable steps to ensure continuity and regularity in the performance of its activities, including the development of contingency plans. For this purpose, the authorised undertaking shall employ appropriate and proportionate systems, resources and procedures.

1.8 The verification of the system of governance of an authorised undertaking and the evaluation of emerging risks identified by that undertaking, which may affect its financial soundness, shall be carried out by the competent authority. If circumstances so warrant, the competent authority shall require that the system of governance of an authorised undertaking be improved and strengthened to ensure compliance with the requirements set out in Article 18I of the Act, this Chapter and the Chapter on Fit and Proper Requirements.

2. Fit and proper requirements of persons who effectively run the authorised undertaking

2.1 An authorised undertaking shall ensure that all persons who effectively run the undertaking or have other key functions comply, at all times, with the fitness and properness requirements found in paragraphs XX¹ of the Chapter on Fit and Proper Requirements.

3. Risk management

3.1 In terms of Article 18I (2) of the Act, an authorised undertaking shall have in place an effective risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report on a continuous basis the risks, at an individual and at an aggregated level, to which it is or could be exposed, and their interdependencies.

3.2 The risk-management system shall:

(a) be effective and well integrated into the organisational structure and in the decision-making processes of the authorised undertaking with proper consideration of the persons who effectively run the undertaking or have other key functions;

(b) cover the risks to be included in the calculation of the Solvency Capital Requirement as set out in paragraph 5.4(b) of the Chapter on Solvency II - Pillar 1 Requirements, as well as the risks which are not, or not fully, included in the calculation thereof; and

(c) cover **at least** the following areas:

(i) underwriting and reserving;

(ii) asset-liability management;

¹ To eventually cross refer to relevant rules in the Chapter on Fit and Proper Requirements, once Rulebook is complete

- (iii) investment, in particular derivatives and similar commitments;
- (iv) liquidity and concentration risk management;
- (v) operational risk management;
- (vi) reinsurance and other risk-mitigation techniques.

3.3 Where an authorised undertaking:

- (a) with the prior approval of the competent authority, applies the matching adjustment referred to in paragraphs 3.13 to 3.19 of the Chapter on Solvency II – Pillar 1 Requirements; or
- (b) applies the volatility adjustment referred to in paragraphs 3.25 to 3.33 of the Chapter on Solvency II Pillar Requirements,

such undertaking shall set up a liquidity plan projecting the incoming and outgoing cash flows in relation to the assets and liabilities subject to those adjustments.

3.4 An authorised undertaking shall, as regards asset-liability management:

- (a) regularly assess the sensitivity of their technical provisions and eligible own funds to the assumptions underlying the extrapolation of the relevant risk-free interest rate term structure referred to in paragraphs 3.11 and 3.12 of the Chapter on Solvency II - Pillar 1 Requirements;
- (b) where the matching adjustment referred to in paragraphs 3.13 to 3.19 of the Chapter on Solvency II Pillar Requirements is applied, regularly assess:
 - (i) the sensitivity of its technical provisions and eligible own funds to the assumptions underlying the calculation of the matching adjustment, including the calculation of the fundamental spread referred to in paragraph 3.21(b) of the Chapter on Solvency II - Pillar 1 Requirements, and the possible effect of a forced sale of assets on their eligible own funds;

- (ii) the sensitivity of its technical provisions and eligible own funds to changes in the composition of the assigned portfolio of assets;
 - (iii) the impact of a reduction of the matching adjustment to zero;
- (c) where the volatility adjustment referred to in paragraphs 3.25 to 3.33 of the Chapter on Solvency II Pillar Requirements is applied, regularly assess:
- (i) the sensitivity of their technical provisions and eligible own funds to the assumptions underlying the calculation of the volatility adjustment and the possible effect of a forced sale of assets on their eligible own funds;
 - (ii) the impact of a reduction of the volatility adjustment to zero.
- 3.5 An authorised undertaking shall submit the assessments referred to in paragraph 3.4 annually to the competent authority as part of the information reported under Article 32 of the Act and paragraphs 6.1 to 6.6 and 6.10 to 6.15 of the Chapter on Financial Statements and Supervisory Reporting Requirements. Where the reduction of the matching adjustment or the volatility adjustment to zero would result in non-compliance with the Solvency Capital Requirement, the authorised undertaking shall also submit an analysis of the measures it could apply in such a situation to re-establish the level of eligible own funds covering the Solvency Capital Requirement or to reduce its risk profile to restore compliance with the Solvency Capital Requirement.
- 3.6 An authorised undertaking shall, as regards investment risk, demonstrate that it complies with paragraphs 7.1 to 7.11 of the Chapter on Solvency II - Pillar 1 Requirements, the EU Commission Delegated Regulation, and any regulatory technical standards issued pursuant to Article 135 of the Solvency II Directive.
- 3.7 An authorised undertaking shall provide for a risk-management function which shall be structured in such a way as to facilitate the implementation of the risk-management system.
- 3.8 In order to avoid overreliance on external credit assessment institutions, when an authorised undertaking uses external credit rating assessment in the calculation of technical provisions and the Solvency Capital Requirement, that undertaking shall

assess the appropriateness of those external credit assessments as part of its risk management by using additional assessments wherever practicably possible in order to avoid any automatic dependence on external assessments.

3.9 An authorised undertaking using a partial or full internal model approved pursuant to Article 15 of the Act and in accordance with paragraphs 5.48 to 5.55 of the Chapter on Solvency II Pillar Requirements, shall ensure that its risk management function covers the following additional tasks:

(a) to design and implement the internal model;

(b) to test and validate the internal model;

(c) to document the internal model and any subsequent changes made to it;

(d) to analyse the performance of the internal model and to produce summary reports thereof; and

(e) to inform the Board of Directors about the performance of the internal model, suggesting areas needing improvement, and updating the Board on the status of efforts made to improve previously identified weaknesses.

4. Own risk and solvency assessment

4.1 As part of its risk-management system, an authorised undertaking shall conduct its own risk and solvency assessment (“ORSA”).

4.2 The ORSA shall include, at least, the following:

(a) the authorised undertaking’s overall solvency needs, taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the undertaking;

(b) the compliance, on a continuous basis, with:

(i) the Solvency Capital Requirement and the Minimum Capital Requirement, as laid down in paragraphs 5.1 to 5.87 and 6.1 to 6.10 of the Chapter on Solvency II – Pillar 1 requirements, the EU Commission Delegated Regulation, any regulatory or implementing technical implementing measures issued pursuant to Articles 111, 114, 127 and 130 of the Solvency II Directive, and regulation 5 of the Insurance Business (Solvency II Transitional Provisions) Regulations, 2015; and

(ii) the requirements regarding technical provisions, paragraphs 3.1 to 3.46 of the Chapter on Solvency II – Pillar 1 requirements, the EU Commission Delegated Regulation, any regulatory or implementing technical implementing measures issued pursuant to Article 86 of the Solvency II Directive;

(c) the significance with which the risk profile of the authorised undertaking deviates from the assumptions underlying the Solvency Capital Requirement as laid down in paragraphs 5.4 and 5.5 of the Chapter on Solvency II – Pillar 1 requirements, calculated with the standard formula in accordance with paragraphs 5.17 to 5.47 of the Chapter on Solvency II – Pillar 1 requirements, the EU Commission Delegated Regulation, any regulatory or implementing technical implementing measures issued pursuant to Article 111 of the Solvency II Directive, or with its partial or full internal model in accordance with paragraphs 5.48 to 5.87 of the Chapter on Solvency II – Pillar 1 requirements, the EU Commission Delegated Regulation, any regulatory or implementing technical implementing measures issued pursuant to Articles 114 and 127 of the Solvency II Directive.

4.3 For the avoidance of doubt, the ORSA shall not serve to calculate a capital requirement. The Solvency Capital Requirement shall be adjusted only in accordance with article 31C of the Act and regulations 23 to 25 and 29 of the Insurance Business (Supervision of Insurance and Reinsurance Undertakings in a Group) Regulations, 2015.

4.4 For the purposes of paragraph 4.2(a), the authorised undertaking shall:

(a) have in place processes which are proportionate to the nature, scale and complexity of the risks inherent in its business and which enable it to properly identify and assess the risks it faces in the short and long term and to which it is, or could be, exposed; and

(b) demonstrate the methods used in that assessment.

- 4.5 Where an authorised undertaking applies the matching adjustment referred to in paragraphs 3.13 to 3.19 of the Chapter on Solvency II - Pillar 1 Requirements, the volatility adjustment referred to in paragraphs 3.25 to 3.33 of the Chapter on Solvency II - Pillar 1 Requirements, or the transitional measures referred to in Regulations 15 and 16 of the Insurance Business (Solvency II Transitional Provisions) Regulations, 2015, that undertaking shall perform the assessment of compliance with the capital requirements referred to in paragraph 4.2(b)(i), with and without taking into account those adjustments and transitional measures.
- 4.6 In the case referred to in paragraph 4.2(c), when an internal model is used, the assessment shall be performed together with the recalibration that transforms the internal risk numbers into the Solvency Capital Requirement risk measure and calibration.
- 4.7 An authorised undertaking shall:
- (a) make the ORSA an integral part of its business strategy and shall take the ORSA into account on an ongoing basis in the undertaking's strategic decisions;
 - (b) perform the ORSA regularly and without delay following any significant change in its risk profile;
 - (c) inform the competent authority of the results of each ORSA as part of the information reported under article 32 of the Act and paragraphs 6.1 to 6.6 and 6.10 to 6.15 of the Chapter on Financial Statements and Supervisory Reporting Requirements.

5. Internal control, including the compliance function

- 5.1 An authorised undertaking shall have in place an effective internal control system which shall, at least, include administrative and accounting procedures, an internal

control framework, appropriate reporting arrangements at all levels of the undertaking and a compliance function.

5.2 The compliance function referred to in paragraph 5.1 shall include:

(a) advising the Board of Directors on compliance with the Act, any regulations and Insurance Rules issued thereunder, the Insurance Intermediaries Act, (Cap.487), any regulations and insurance intermediaries rules issued thereunder, and any other applicable laws, in so far as they apply; and

(b) an assessment of the possible impact of any changes in the legal environment on the operations of the undertaking concerned and the identification and assessment of compliance risk.

5.3 The person responsible for the the compliance function shall be the compliance officer appointed by the authorised undertaking and approved by the competent authority.

6. Internal Audit

6.1 An authorised undertaking shall provide for an effective internal audit function which shall:

(a) include an evaluation of the adequacy and effectiveness of the internal control system and other elements of the system of governance; and

(b) be objective and independent from the operational functions.

6.2 An authorised undertaking shall ensure that any findings and recommendations of the internal audit are reported to the Board of Directors which shall:

(a) determine what actions are to be taken with respect to each of the internal audit findings and recommendations; and

(b) ensure that those actions are carried out.

7. **Actuarial function**

7.1 An authorised undertaking shall provide for an effective actuarial function to:

- (a) coordinate the calculation of technical provisions;
- (b) ensure the appropriateness of the methodologies and underlying models used, as well as the assumptions made in the calculation of technical provisions;
- (c) assess the sufficiency and quality of the data used in the calculation of technical provisions;
- (d) compare best estimates against experience;
- (e) inform the Board of Directors of the reliability and adequacy of the calculation of technical provisions;
- (f) oversee the calculation of technical provisions in the cases set out in paragraphs 3.41 and 3.42 of the Chapter on Solvency II - Pillar 1 Requirements;
- (g) express an opinion on the overall underwriting policy;
- (h) express an opinion on the adequacy of reinsurance arrangements; and
- (i) contribute to the effective implementation of the risk-management system referred to in Section 3 of this Chapter, in particular with respect to the risk modelling underlying the calculation of the Solvency Capital Requirement and the Minimum Capital Requirement set out in paragraphs 5.1 to 5.87 and 6.1 to 6.10 of the Chapter on Solvency II – Pillar 1 Requirements, the EU Commission Delegated Regulation, any regulatory or implementing technical implementing measures issued pursuant to Articles 111, 114, 127 and 130 of the Solvency II Directive, and to the undertaking's ORSA referred to in Section 4 of this Chapter.

7.2 The actuarial function shall be carried out by persons who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the business of the authorised undertaking concerned, and who are able

to demonstrate their relevant experience with applicable professional and other standards.

8. Outsourcing

- 8.1 When an authorised undertaking outsources a function or any insurance or reinsurance activity, the undertaking shall remain fully responsible for discharging all of its obligations under the Act, any regulations and Insurance Rules issued thereunder.
- 8.2 An authorised undertaking shall not undertake the outsourcing of a critical or important operational function or activity in such a way as to lead to any of the following:
- (a) materially impairing the quality of the undertaking's system of governance;
 - (b) unduly increasing the operational risk;
 - (c) impairing the ability of the competent authority to monitor the undertaking's compliance with its obligations;
 - (d) undermining the continuous and satisfactory service to policyholders.
- 8.3 An authorised undertaking shall:
- (a) notify the competent authority in writing and in a timely manner, prior to the outsourcing of critical or important functions or activities as well as of any subsequent material developments with respect to those functions or activities;
 - (b) provide the competent authority with a copy of the draft outsourcing agreement which are to be entered into between the authorised undertaking and the service provider, and which is to clearly define the respective duties and responsibilities of the service provider;
 - (c) in its written notification to the competent authority of any outsourcing of critical or important functions or activities, include a description of the scope and the rationale for the outsourcing and the service provider's name. When outsourcing

concerns a key function, the information should also include the name of the person in charge of the outsourced function or activities at the service provider.

8.4 Without prejudice to paragraphs 8.1 to 8.3, an authorised undertaking which outsources a function or an insurance or reinsurance activity shall take the necessary steps to ensure that the following conditions are satisfied:

(a) the service provider must cooperate with the competent authority in connection with the outsourced function or activity;

(b) the authorised undertaking, its auditors and the competent authority shall have effective access to data related to the outsourced functions or activities; and

(c) the competent authority shall have effective access to the business premises of the service provider and is able to exercise those rights of access.

9. Application of System of Governance at group level

9.1 The system of governance requirements referred to in this Chapter and in Annex XX², which apply to individual undertakings, apply *mutatis mutandis* at the level of the group. This is established by Article 246 (1) of the Solvency II Directive.

9.2 For the purposes of Part I of Annex XX:

(a) the implementation of governance requirements at group level shall be understood as having in place a robust governance system applied to one coherent economic entity (holistic view) comprising all entities that are part of the group;

(b) all the insurance and reinsurance undertakings in a group should have in place a risk management system and an internal control system which is to be applied in a consistent manner. However, from a group risk management and governance

² To eventually cross refer to relevant number of the Annex in the Chapter relating to Sales Process once the Rulebook is complete

perspective, the group and the group supervisor have also to take into account the risks arising from other entities that are part of the group;

(c) when a reference is made to entities that are part of the group, in general, it is a reference to insurance and reinsurance undertakings, but also to all the other entities that are part of the group;

(d) the governance requirements at group level take into account the corporate governance responsibilities of both, the Board of Directors at group level, that is, the Board of Directors of the participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company, and the Board of Directors of legal entities that are part of the group.

10. Additional requirements and obligations

10.1 In complying with the provisions of article 18I of the Act and with this Chapter, an authorised undertaking shall also refer to and comply with the following:

(a) Chapter IX of the EU Commission Delegated Regulation (Articles 258 to 275);

(b) any regulatory or implementing technical standards to be issued by the European Commission under Article 50 of the Solvency II Directive; and

(c) the Annex to this Chapter which adopts the following Guidelines issued by EIOPA:

(i) Guidelines on system of governance, which are based on Articles 40 to 49, 93, 132 and 246 of the Solvency II Directive and on Articles 258 to 275 of the EU Commission Delegated Regulation; and

(ii) Guidelines on own risk and solvency assessment, which are based on Articles 41, 44, 45 and 246 of the Solvency II Directive and on Articles 262 and 306 of the EU Commission Delegated Regulation.