

## ACP Advice to EIOPA on proportionality areas in AWP 2021

In accordance with Art. 1(7) of Regulation (EU) No 1094/2010 concerning the applicable regulatory framework, EIOPA has established an Advisory Committee on Proportionality.

The ACP is developing a methodology that shall support ACP members to identify the areas where proportionality matters the most in a structured way and support members in prioritising the areas to be identified in ACP's advice to EIOPA in the future.

While the methodology is not developed yet it is important that the ACP already provides advice to EIOPA regarding the Annual Work Plan (AWP) 2021. It is acknowledged that the AWP 2021 is already approved, however is still deemed as relevant that the ACP provides advice to EIOPA regarding areas included in the approved AWP.

ACP identified the following areas to provide advice. This is the first Advice of the ACP and many areas were discussed. The areas proposed reflect the priorities identified but as well resources availability and the regulatory developments on-going. For each topic, first the already existing proportionality measures are mentioned, followed by possible areas of enhancement.

### 1. Solvency II regulatory work

Following-up to the Opinion on the 2020 review of Solvency II Directive, EIOPA shall pay particular attention to the implementation of the proportionality principle.

EIOPA is proposing a new proportionality framework under Solvency II. It is acknowledged that the work on proportionality needs to continue after the delivery to the COM of the amendments to the Solvency II Directive and Delegated Regulation to ensure a convergent implementation of the proportionality principle and therefore EIOPA has identified in its AWP for 2021 additional work to supplement the Opinion. The AWP 2021 envisages further work from a regulatory perspective to further promote convergence in the implementation of the future framework and also from a supervisory perspective (see point 2). The new framework is based on three main pillars:

- 1) Improve the process for the application of the proportionality principle by introducing well-defined and predictable pre-conditions which reduces the degree of uncertainty, in the current framework, while keeping room for supervisory judgement and risk-based supervision;
- 2) Introduce some new proportionality measures and/or link the (current/new) proportionality measure to the new framework being proposed;
- 3) Improve the awareness of stakeholders on the use of proportionality measures in the EU by introducing a new report to be published by EIOPA.

#### **Possible areas for enhancement/review (subject to the political developments):**

- Consider further developing the notification process of the "low risk undertakings", in particular addressing the transparency and accountability of the process;
- Further develop expected process and criteria to be taken into account by supervisory authorities when classifying as 'low risk undertakings' undertakings not complying with the criteria to be defined in Level 2;
- Further develop expected process and criteria to be taken into account by supervisory undertakings when allowing the use of specific proportionality measures by undertakings not classified as 'low risk undertakings';
- Consider developing a Rulebook on proportionality (consolidating the proportionality framework of Solvency II – to support small undertakings identifying the different proportionality aspects of the framework).
- Follow-up on the supervisory practices for the application of the proportionality principle in governance requirements regarding key functions.

ACP may provide further advice on this area after Q2 2021, in particular on account of any political developments not yet foreseeable.

## **2. Solvency II supervisory convergence work:**

EIOPA has been using specific supervisory tools to achieve a more convergent implementation of proportionality principle:

- EIOPA Supervisory Statement - Application Proportionality Solvency Capital Requirement;
- Peer review on the supervisory practices for the application of the proportionality principle in governance requirements regarding key functions;
- Peer Review on the Regular Supervisory Report Proportionality of the RSR;
- Report on the Limitation and Exemption of Reporting.

However, the reality reveals the need to develop further work and explore other tools to promote the implementation of proportionality and the new framework proposed should be seen as an opportunity to develop further other supervisory convergence tools to complement the future proportionality framework and the Guidelines to be developed.

### **Possible areas for enhancement/review:**

- Promote a common understanding of the principle of proportionality and a culture of implementation and transparency of implementation of proportionality by national supervisory authorities. This could be achieved through different initiatives, including for example by addressing proportionality in the training events and promoting workshops on the matter;
- Assess the need for further supervisory convergence tools to complement the regulatory work such as the development of a specific chapter of the Supervisory Handbook on the use of proportionality in the SRP, including for example different examples from different supervisory authorities, or a dedicated subsection for each chapter of the handbook;
- Monitor the implementation of and prepare the development of a regular Report on implementation of Proportionality in Solvency II, including how the conclusions of the future reports will be followed-up. The report should be a tool to promote the application of proportionality EU wide in a convergent way.

## **3. Digital operational resilience:**

### **a) ICT Guidelines**

EIOPA recently published the Guidelines on ICT security and governance (come into force 1 July 2021). As far as proportionality measures are concerned, the current application of proportionality has been addressed in legislation (through the proportionality principle) and generally in the Guidelines (GL1). The Guidelines contain, however, limited guidance on how to take a proportionate approach to the different elements of the supervisory assessment.

The application of 'proportionality' was left open for dialogue between the undertakings and the NCA to allow for flexibility in the implementation of the requirements. The application of proportionality in the area of digital operational resilience should take into account the ICT-risks. The risks might not be directly linked to the scale of the undertaking, in case of ICT-risk, the complexity and nature could play a vital role. For instance the nature of a 'health insurer' compared with a 'pension insurer' can make a huge difference (the impact of a data breach within a health insurer could be much bigger than of a pension insurer, although the 'technical provisions' of the first one can be significantly smaller).

### **b) Digital Operational Resilience Act**

The work in this area will be highly impacted by the publication of the Digital Operational Resilience Act (DORA) by the European Commission. Some areas covered by the DORA are of particular relevance for proportionality considerations: ICT-related incidents reporting and digital operational resilience testing.

The overall idea is to create a reporting system where the undertakings would report directly and with no delay to the local NCA the incident, triggering the creation of a report that summarizes the actions undertaken on the spot to recognise the impacts of the incident, an interim report that explains the measures undertaken to block the spread of the consequences of the incident and a final report where the undertaking explains the outcome of the remedial actions undertaken.

In here an area of concern would be 2-fold: (1) define proportionate reporting requirements for cyber incidents that do not overlap with existing reporting schemes (e.g. NIS Directive, currently being reviewed) in place; (2) Define the materiality of incidents affecting specific undertakings according to nature, scale and complexity of those undertakings (i.e. requiring reporting only for “major” incidents, calls for a dynamic definition of major incidents according to the size of the undertaking).

The capabilities and functions included in the ICT risk management framework need to be periodically tested for preparedness and identification of weaknesses, deficiencies or gaps, as well as the prompt implementation of corrective measures. The already foresees a proportionate application of digital operational resilience testing requirements depending on the size, business and risk profiles of financial entities: while all entities should perform a testing of ICT tools and systems, only those identified by competent authorities as significant and cyber mature should be required to conduct advanced testing based on Threat Led Penetration Testing.

Lastly, EIOPA planned for 2021 the revision of the System of Governance Guidelines, considering as well specific work on Outsourcing and Third Party Providers in the context of the DORA.

**Possible areas for enhancement/review:**

1. Develop supervisory convergence tools addressing the application of proportionality principle in the SRP regarding the implementation by the undertakings of the areas covered by the ICT governance and security Guidelines, considering as well the DORA proposals;
2. Consider the development of a clear set of Guidelines addressing proportionality when revising the ‘System of Governance Guidelines’;
3. Consider the development of clear proportionality provisions in the ‘Opinion on the supervision of the management of operational risks faced by IORPs’, in particular in the area of cyber risks;
4. Engage with the COM to discuss and better understand how proportionality envisaged in the Regulation proposal is intended to be applied, i.e. what this means in practical terms when it is not concretely defined;
5. When initiating the contributions to the future RTSs and ITSs related to DORA and moving forward on the discussions in general, but particularly on the ICT risk management framework, the cyber incident reporting and the digital operational resilience testing to take into account the specific risks of the undertakings and the nature, scale and complexity of the risks involved, for example when discussing the criteria to be used for the purpose of the application of Threat Led Penetration Testing.

**4. IORPs: Proportionate and relevant application of the IORP II Directive**

EIOPA has identified as a priority for 2021 the need to ensure a proportionate and relevant application of the IORP II Directive. Proportionality will also matter in the context of EIOPA’s advice on the scheduled review of the IORP II Directive once the Advice is received.

In the meantime, one of the pensions’ supervisory activity in the 2021 Supervisory Convergence Plan will be the multi-employer IORPs in particular IORPs set up by third parties (e.g. consultants, asset managers)

A two-phased approach may be considered for this work where EIOPA first needs to better identify and understand supervisory practices and issues, and depending on the outcome of the work, to draft a Chapter of the Supervisory Handbook. NCAs’ supervisory approach to proportionality should be an important part of these activities.

**Possible areas for enhancement/review**

The primary objective of this work is to assess whether the IORP II provides adequate requirements with respect to multi-employer IORP providers. This work could also consider to what extent proportionality aspects may apply to multi-employer IORPs (e.g. lower frequency of reporting) and under what conditions. In other words,

do multi-employer IORPs feature certain characteristics (e.g. 'automated' nature of on-boarding subsequent employers into the same scheme) which may give scope for proportionate supervision? What considerations do NCAs have in respect of the size, nature, scale and complexity of the risks inherent in the activities of multi-employer IORP providers, notably in comparison with (non-commercial) IORPs managing schemes for related sponsors (e.g. industry