

## ACP Advice to EIOPA on proportionality areas in AWP 2022

In accordance with Article 1(7) of Regulation (EU) No 1094/2010, EIOPA established, as its integral part, the Advisory Committee on Proportionality (the “ACP”). The ACP shall advise EIOPA as to how, in full compliance with applicable rules, EIOPA’s actions and measures should take account of specific differences prevailing in the sector, pertaining to the nature, scale and complexity of risks, to business models and practice as well as to the size of financial institutions and of markets to the extent that such factors are relevant under the rules considered.

The areas identified by the ACP reflect the priorities in terms of proportionality but as well resources availability and the regulatory developments on-going. For each topic, first the background and existing proportionality approaches and measures are mentioned when available, followed by possible areas of enhancement.<sup>1</sup>

### 1. System of Governance

EIOPA System of Governance Guidelines were published in 2016 and EIOPA Guidelines on Own Risk and Solvency Assessment (ORSA) in 2015. Since then the experience with the implementation of the proportionality principle in the system of governance has evolved. EIOPA’s work in this area, developed for the Solvency II 2020 review, has already identified a number of improvements to be reflected both in the Solvency II Directive and respective Delegated Regulation. Some of the proposed legal changes aim to make the application of the proportionality principle binding under certain circumstances as a number of the proposed proportionality measures can already be applied under the current regulation. In 2018, EIOPA performed a peer review on supervisory practices for the application of the proportionality principle with regard to key functions. This was followed up in 2020 with an assessment as to what extent NCAs have implemented actions recommended to them as a consequence of the review of their supervisory practices. EIOPA plans to review the Guidelines on System of Governance soon.

#### Possible areas for enhancement/review:

When reviewing the System of Governance Guidelines EIOPA should consider:

- whether it would be beneficial to use the findings from the peer review on key functions to clarify what should be expected from undertakings concerning the fitness of the key functions considering the specific undertakings’ risk profiles;
- incorporate the proposals from the EIOPA Solvency II 2020 Opinion in the Guidelines when possible, i.e. in the cases where the proposals, if incorporated within the Guidelines would be in line with the current legislation to promote its earlier implementation;
- identify areas where the Guidelines may be amended, simplified or new guidelines are needed to better reflect principle of proportionality:
  - one area that may deserve more attention is the fitness and propriety requirements required for the undertakings’ staff when the key functions are outsourced<sup>2</sup> (Guideline 14 of the EIOPA System of Governance Guidelines), in particular when the nature, scale and complexity of the undertakings is the main reason to outsource certain functions.
  - other area of interest is to assess areas leading to a higher compliance cost such as the development and review of the different policies to be developed in the System of Governance

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<sup>1</sup> The Methodology document outlines in more detail preliminary remarks on the idea of proportionality in light of Article 1(7) of EIOPA Regulation following which the methodology is set out in several steps.

<sup>2</sup> Outsourcing in particular with regards to Actuarial Function and risk management function is of concern.

(supervision of governance requirements where Guidelines 18, 20, 21, 22, 24, 25, 26, 36, 42 and 52 EIOPA System of Governance Guidelines provide guidance).

- Regarding the ORSA, EIOPA should elaborate on the development of guidance to undertakings on how to assess material and immaterial changes in the risk profile. Further, there should be a clear statement that in cases where the outcome is no material change, the undertaking does not need to fully recalculate the Solvency Capital Requirement and can use the last calculation of the SCR. This is particularly relevant when the ORSA reference date is not the end of the financial year and the undertaking is providing the information foreseen in Article 306(c) of Delegated Regulation 2015/35.

## **2. Directive on the activities and supervision of institutions for occupational retirement provision (IORP II Directive) 2016/2341**

IORP II Directive is a minimum harmonising directive and leaves some freedom to Member States to decide how to transpose it into national legislation. Additionally, the implementation of the IORP II Directive was delayed in many countries and transposed into national legislations only recently. In most Member States IORPs are still adapting and NCAs have only limited experience with the impacts of the Directive. Real costs and impacts of the implementation, including proportionality, are therefore not fully known yet and can be substantially different among Member States as well as among IORPs. A common supervisory approach is an important part to ensure harmonisation and convergence of supervisory practices, while the supervision of the internal processes and policies are elements where proportionality can play an important role.

IORP Directive recognises and applies the principle of proportionality in several areas: Governance system, Remuneration policy, Key functions (actuarial, risk management and internal audit), Own Risk Assessment (ORA), Environment, Social and Governance (ESG) factors and Supervision. The proportionality aspect is referred to in terms of “proportionate to the size, nature, scale and complexity of their activities”, “proportionate to the size and internal organisation of IORPs, as well as to the size, nature, scale and complexity of their activities” or “proportionate to the size, nature, scale and complexity of the risks inherent in its activities”.

In addition, IORP II Directive includes three ladders of proportionality:

- IORPs with less than 100 members may be excluded from the scope but:
  - all IORPs shall apply the rules on Assets safety (articles 32-35), regardless of any MS option;
  - IORPs with more than 15 and less than 100 members shall apply the Prudent Person Rule (article 19(1) and System of Governance general article (article 21(1) and (2));
- IORPs with more than 100 members shall apply the Directive but proportionality principle applies.

Provided IORP II Directive is of a minimum harmonisation nature, the further implementation of measures on proportionality is in the remit of the EU Member States national legislation.

Considering the tasks EIOPA foresees for 2022 on the IORP area and the foreseen technical advice on the scheduled review of the IORP II Directive, this Advice provides ideas for EIOPA to consider when developing work on this area.

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

With the objective to identify concrete proportionate implementation measures to be applied to specific groups of IORPs, we advise EIOPA to conduct the following initial steps:

### **a. Mapping of the implementation of proportionality at national level**

Considering the recent implementation of IORPs II Directive, it is important to understand first how proportionality already allowed has been implemented. The ACP has prepared an example of a survey that could be carried out in order to understand how the principle of proportionality has been implemented in different member states, understand the impacts, collect good practices and help to determine areas where the principle could be more widely used (Annex 1 to this Advice). The elements of the survey can be used by EIOPA in its regular work, for instance as part of a follow-up survey based on a future Call for Advice from the Commission regarding IORP II revision. The results and potential identification of good practices can support EIOPA to suggest where proportionality should be more precise in the legal text of the directive.

### **b. Reassess the measure of proportionality**

When referring to proportionality, the IORP II Directive refers to the size, nature, scale and complexity of the IORP activities. EIOPA should take the opportunity to engage in a more fundamental discussion on the set of criteria that could be used to measure proportionality as done for Solvency II, where criteria should be determined (from scratch) according to specifics of IORPs. Even if not directly applicable<sup>3</sup>, the European Commission work on the small and mid-size enterprises definition can be a source of inspiration for potential work on the definition of “Small and Medium-size IORPs”.

### **c. New regulations affecting IORPs and IORP Rulebook**

Numerous (new) regulations (e.g. Digital Operational Resilience Act (DORA), Sustainable Finance Disclosure Regulation (SFDR) Shareholder Rights Directive) will affect the functioning of IORPs and will bring an additional strain especially for smaller IORPs. Those regulations will have new requirements concerning management system and overall processes of functioning together with new disclosure requirements. Even if not directly linked to the IORPs II review it is recognised that these new requirements could be burdensome for many small IORPs and could lead to overlooking or not complying with some of the requirements.

EIOPA could consider, within its scope for action as defined under Article (1) of EIOPA Regulations, extending the scope of the IORP Rulebook to be published on its website to cover European regulations impacting IORPs to support IORPs to overcome these challenges and reduce some of the administrative burden. An overview would bring more clarity, would reduce time, resources and costs and would benefit all IORPs but especially smaller ones. Where possible, EIOPA should clearly present where proportionality is explicitly allowed.

## **3. DORA**

The development of technology and knowledge is very fast thereby making legislation necessary but challenging. It is consequently important to enhance the use of the principle of proportionality in order to achieve the objectives of cyber resilience without unnecessary increase in the amount of demands and regulatory burdens and costs.

The DORA is in the stage of adopting procedure. While the final wording of legislative text is not known yet, EIOPA continues to monitor the development of the discussions of the COM Proposal of DORA and preparing for its implementation. Some areas covered by the DORA are of particular relevance for proportionality

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<sup>3</sup> IORPs are typically different from enterprises. They have very few employees (if any) and many millions or even billions of assets. Their nature is being a social protection scheme, not an enterprise. Their main purpose is provision of retirement income, not making profits.

considerations: Information and communication technology (ICT) risk-management, ICT-related incidents reporting and digital operational resilience testing.

The DORA proposal from September 2020 ([link](#)) excludes only micro-enterprises from the application of certain requirements. Also, only a broad and unevenly widespread application of DORA is currently at the basis of the framework, with no reference to already-existing sectoral legislation in the list of financial entities in scope. However, the proportionality principle, including exclusions from scope, approaches towards different types of financial entities and link to proportionality approaches under the sectoral legislations are still under discussion.

Financial entities shall have in place internal governance and control frameworks that ensure an effective and prudent management of all ICT risks. When assessing the ICT risks it is important to not only consider the size of the entity or the number of employees but as well the maturity and level of technology development. In a technology intense entity sometimes a more flexible and proportionate approach could be needed. The need for application of proportionality could be related to the type of measures that are relevant for a supervised entity. For example, when it comes to measures of protection but also control and follow ups there would typically be much wider possibilities to adjust supervision to the entity's risk profile than in situations where action is needed due to e.g. an imminent threat. The special features of insurance such as diversity in business models and long-term characteristic could also call for further proportionality.

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. DORA 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.

**Possible areas for enhancement/review:**

- A more comprehensive and flexible inclusion of the principle of proportionality within the DORA framework would be preferable, also taking into account and making use of the application of thresholds set in sectoral legislations. EIOPA should continue to monitor and engage with legislators to explain the need for proportionality, in particular for intermediaries and IORPs and the interaction with the future Solvency II proportionality approach including the new framework for the application of the proportionality principle, e.g. there could be a link between the Low-Risk Profile Undertakings status and lighter requirements/simplifications that are set out in the DORA regulation.
- DORA contains comprehensive regulatory rules. In the context of proportionality stakeholders often discuss the new high burden that the implementation of such complex set of rules imply. In this respect, it is important to highlight that, given the number of RTS foreseen in the COM draft to be submitted shortly after the entry into force of DORA, a sequential and incremental approach for their application could be key to ensure that the impacted entities in the financial market have the right time to sequentially adapt to changes and ensure an appropriate level of compliance to the new framework. Entities should have the opportunity to have a full and complete picture of the new requirements as soon as possible, in order to plan their implementation comprehensively. Therefore, the implementation period should be appropriate.
- Within their internal governance and control frameworks, financial entities shall assign the responsibility for managing and overseeing ICT-related operations and shall establish a control function in relation to ICT risks, independent and segregated from ICT operations processes. When EIOPA, together with the Joint Committee, develops the draft Regulatory Technical Standards, in particular the ones addressing the further harmonisation of ICT risk management tools, methods,

processes and policies it should particularly take into account the size, nature, scale and complexity and overall risk profile of the entities as well as its application to different financial entities such as to IORPs and intermediaries. The same should apply to the technical standards to define the content of the policies, procedures and plans foreseen in the Regulation (e.g. ICT security policies and procedures, ICT Business Continuity Policy, ICT business continuity plans, ICT Disaster Recovery Plan).

- The ICT Guidelines are considered a good preparation step for DORA compliance, Eiopa should identify concrete proportionate implementation aspects i.e. with a view of informing the work on the DORA RTSs. Approaches to their proportionate application could be identified by building on NCAs experience in the supervision of such Guidelines from the beginning. An area of interest could be e.g. the different approaches/methods/tools applied by the undertakings to test the ICT risk management framework and the supervisory assessment of its adequacy.

#### **4. Sustainable finance (Environment, Social and Governance)**

Insurance undertakings and IORPs, as managers of large parts of society's risks and important long-term investors have a particular interest in mitigating the impact of climate change and facilitating the transition to a more sustainable and resilient economy.

Due to its high importance, sustainable finance has been addressed in European legislation since 2019 and is core within the discussion of the financial sector:

- Requirements related to insurance undertaking's risk management: Undertakings should manage sustainability risks on their assets and liabilities and take into account the potential long-term impact of their investment strategy and decisions on sustainability factors. See Commission Delegated Regulation amending Solvency II Delegated Regulation (EU) 2015/35 (April 2021, pending adoption by the European Parliament and the Council, which amends Articles 260, 269, 272 and 275 of the Solvency II Delegated Regulation and adds a new article on the integration of sustainability risks in the prudent person principle, based on Eiopa's technical advice of April 2019 on the integration of sustainability risks and factors in Solvency II and IDD);
- Requirements related to the governance of IORPs: The system of governance shall include consideration of environmental, social and governance factors related to investment assets in investment decisions, and shall be subject to regular internal review (Article 21(1) of the IORP II Directive)
- Requirements related to IORPs' risk management: the requirements are laid down in the IORP II Directive ) (Article 25(2)(g) on risk-management and article 28(2)(h) on own-risk assessment (ORA));

In April 2021, Eiopa issued an Opinion setting out Eiopa's expectations to national competent authorities on the supervision of the integration of climate change risk scenarios by undertakings in their ORSA.

Regarding the disclosure requirements the RTSs are at a final stage of approval and it may be expected that the ESAs will need to review them soon (potentially end 2022). Therefore, the ACP did not focus its analysis on pillar III disclosures.

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

With the aim to foster supervisory convergence a proportionate approach is needed since the materiality of climate change risks differs across entities and may change over time. For example, performing forward looking analysis on climate change risks in the ORSA may need guiding undertakings through supervisory expectations.

- Considering lessons learned from the past Eiopa should consider working on supervisory convergent tools to set out supervisory expectations from an early stage. Such supervisory convergence tools could – with the primary purpose to apply proportionality address how to supervise the integration of climate change-related risk in the business model and strategy, governance, risk appetite, risk management of both the assets and liabilities and investment strategy taking into consideration the principle of proportionality including the materiality of the exposure to climate related risks e. g. to develop risk management guidance on how to identify and assess climate change-related risks

considering proportionality principle, in particular for low risk profile undertakings and IORPs or to analyse the new requirements of Articles 260, 269, 272 and 275 of the Solvency II Delegated Regulation and express expectation how to implement them in an appropriate way.

- Following the publication of EIOPA Opinion on the supervision of the use of climate change risk scenarios in the ORSA, EIOPA could also consider to monitor the implementation of such Opinion and develop supervisory convergence tools e.g. on which areas proportionality is expected and/or how low risk profile undertakings can apply proportionality in the identified cases (as benchmark for a minimum implementation). This exercise could also feed work on supervisory convergence to IORPs ORA as well.

**ANNEX: Example of a survey on the application of proportionality by Member States**

1. Please fill in the table below

IORP Article/ Recital	Area of proportionality	Has the principle of proportionality been transposed into your national legislation (YES/NO)?	If yes, was the principle transposed generally or did your MS use more precise provisions for using this proportionality principle? Please provide any examples of implementation into your national legislation.	Did your NCA adopt any guidelines or recommendations for using proportionality?
A 5	Small IORPs			
A 21	Governance System			
A 23	Remuneration policy			
A 24	Key functions (KF)			
A 25	KF Risk Management			
A 26	KF Internal Audit			
R 40	KF Actuarial			
A 28	Own Risk Assessment			
R 58	ESG factors			
A 47	Supervision			

2. In which cases has the principle of proportionality been applied when supervising IORPs (on-site, off-site)?
  
3. What were the implications for IORPs using proportionality? If possible, please provide any examples of how the principle has been applied by IORPs?
  
4. What supervisory tools are being used to monitor the application of principles of proportionality?
  
5. Have the proportionality criteria “size of activities”, “size”, and “internal organisation of IORPs”, that are in comparison to Solvency II framework additional criteria, been specified by your NCA? If so, how?