

## Insurance Europe response to EIOPA's consultation on draft opinion on supervision of remuneration principles.

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Referring to:	EIOPA's <a href="#">Consultation Paper on draft Opinion on the supervision of remuneration principles in the insurance and reinsurance sector</a>		
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### Summary

Insurance Europe key messages on the draft opinion:

#### Legal basis

- Insurance Europe acknowledges that it is EIOPA's task to ensure an effective and consistent level of supervision.
- However, Insurance Europe is not aware of any detrimental effects of divergent market practices across the European Union or evidence thereof, and the convergence of market practices is not part of EIOPA's mandate.
- While for the banking sector, EBA was clearly mandated by sectoral regulation to issue guidelines on sound remuneration policies, there is no such legal basis for EIOPA to develop a detailed opinion on remuneration principles in the Solvency II Directive or Delegated Regulation.
- The Solvency II regulation follows a principle-based approach, and, unlike other financial sectors, its design was not intended to prescribe specific detailed requirements on the level of remuneration.
- With this opinion, EIOPA seeks to create additional obligations rather than interpreting requirements within the limits set by the legislator, and therefore exceeds its mandate.

#### Context and objectives

- The regulatory framework should not intend to prescribe particular designs or levels of individual compensation.
- A one size fits all approach could in fact be detrimental to sound risk management.
- Despite the non-binding nature of this opinion, it is likely to result in an application of arbitrary figures across the Union.

#### EIOPA's expectations on supervision of remuneration policies

##### General comments on EIOPA's expectations

- EIOPA's opinion is aligned to the text of CRD IV and CRD V, which raises a question whether it has been copied across from what is deemed appropriate in the banking sector.
- Implementing banking rules without taking the specific nature of insurers' business model into account, as well as considering the specific activity undertaken by individuals within a company, is inappropriate.

##### Scope of application

- EIOPA set thresholds for the application of this opinion, which are significantly lower than currently applied in some jurisdictions. Any reference at all to a preset ratio between fixed and variable remuneration should be avoided.
- A more appropriate implementation of proportionality is needed.

Comments on specific requirements proposed by EIOPA

- Diverging practices can exist between markets regarding the average share of the variable component of the remuneration due to cultural and historical reasons.
- EIOPA's proposed ratios go beyond the scope of interpretation of level 1 and 2 regulation, and it is not in EIOPA's mandate to implement additional requirements via opinions.
- High level, qualitative guidelines should instead inform each NSA's approach to supervising remuneration policy, without setting specific limits on variable remuneration.
- Specifically:
  - Establishing a specific ratio 1:1 between variable and fixed compensation is overly prescriptive and prevent companies from applying a flexible remuneration policy that aligns with risk appetite and sound risk management.
  - SII regulation does not offer the scope of interpretation to consider that performance assessment should be informed by 20% or more of non-financial indicators.
  - Considering a deferral rate of the variable remuneration higher than 40% in case of a "particularly high variable remuneration" not only introduces a new threshold, but also a tiered approach to applying enhanced requirements.
  - EIOPA goes beyond interpretation of the current regulation and creates unnecessary burden by requiring an exhaustive description of downwards adjustments of the deferred part of the variable remuneration.
  - Insurance Europe strongly opposes termination payments being considered a form of variable remuneration and, consequently, subject to deferral.

**Response**

**Question 1**

Please provide any comments on section 1 of the Opinion: Legal basis here:

**Insurance Europe acknowledges that it is EIOPA's task to ensure an effective and consistent level of supervision** and that convergent supervisory practices should be built upon a common understanding of Union laws and regulations. However, the issuance of more detailed opinions on the interpretation of laws and regulations must always be proportionate to the detrimental effects of differences in application. **Insurance Europe is not aware of any detrimental effects of divergent market practices across the European Union or evidence thereof, and the convergence of market practices is not part of EIOPA's mandate.**

While the EBA was clearly mandated by the CRD IV Directive<sup>1</sup> to issue guidelines on sound remuneration policies, the Solvency II Directive never mentions this topic. For the insurance sector, the European co-legislators provided instead a general requirement for a system of governance<sup>2</sup>. The requirement to develop remuneration policies was set out in Article 275 of the Delegated Regulation<sup>3</sup>, in which the European Commission chose to not establish fixed thresholds or quantitative ratios, in respect with Solvency II Directive's principle-based approach. This fundamental judgement should not be undermined by EIOPA. **With this opinion, EIOPA would create additional obligations rather than interpreting requirements within the limits set by the legislator, and therefore exceed its mandate.**

<sup>1</sup> Articles 74 (3) and 75 (2) of the CRD IV Directive, available here: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013L0036>

<sup>2</sup> Article 41 of the Solvency II Directive 2009/138/EC, available here: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02009L0138-20140523>

<sup>3</sup> Delegated Regulation available here: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0035&from=EN>

## Question 2

Please provide any comments on section 2 of the Opinion: Context and objectives here:

Insurance Europe supports that the supervision should "focus on a reduced scope of staff identified as potential higher profile risk-takers to promote a proportionate approach".

Although Insurance Europe does not deny that sound compensation practices are part of a sound and prudent risk management framework, **the regulatory framework should not intend to prescribe particular designs or levels of individual compensation.** Insurance Europe supports EIOPA's intention to ensure convergent supervision of remuneration policies within the EU.

However, while for the banking sector, EBA developed guidelines on remuneration as expressly mandated by the CRD IV Directive, there is no such legal basis for EIOPA to develop a detailed opinion on remuneration principles, as stated above.

In addition, Insurance Europe highlights that it is of the responsibility of national supervisory authorities (NSAs) to assess whether remuneration policies exist and are effectively applied and, on a risk-based approach, consider a closer monitoring of companies whose practices differ widely compared to local market practices.

**A one size fits all approach could in fact be detrimental to sound risk management** in certain jurisdictions, considering the widely diverging cultures among the insurance sector across member states (see response to question 3).

Insurance Europe acknowledges EIOPA's statements regarding the importance of a risk-based approach and supervisory judgement. However, it may be easier and less resource consuming for NSAs to apply indicative figures regardless of the local specificities of their market. Therefore, **despite the non-binding nature of this opinion, it is likely to result in an application of arbitrary figures across the Union.**

Additionally, paragraph 2.9 suggests that for the staff out of the scope of this opinion, NSAs " may also adopt a proportionate and more flexible approach". However, EIOPA considers that a proportionate approach should only result in the widening of the scope, which is clearly unbalanced. Likewise, paragraph 2.11 explicitly states that NSAs may impose stricter requirements. Although paragraph 2.9 acknowledges that thresholds need to be adapted to local practices, EIOPA's opinion is too prescriptive to do so. This further enhances concerns regarding the legitimacy of EIOPA's opinion to ensure convergence, since NSAs are encouraged to impose stricter requirements, and to follow a risk-based approach, since a lower risk cannot result in lower requirements.

## Question 3

Please provide any comments on section 3 of the opinion: EIOPA's expectations on supervision of remuneration policies here:

**EIOPA's opinion is aligned to the text of the Capital Requirements Directive** (CRD IV<sup>4</sup> in force, and CRD V<sup>5</sup> applying from 29 December 2020), **which raises a question whether it has been copied across from what is deemed appropriate in the banking sector.** It is therefore questionable whether the differences in the governance requirements between the two industries have been adequately considered. Banks necessarily have more prescriptive remuneration requirements due to the nature of the products sold or activity undertaken,

<sup>4</sup> Article 94 of CRD IV Directive, available here:

<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02013L0036-20180709>

<sup>5</sup> Amendments set out in Article 2 (27) of CRD V Directive, available here:

<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0878&from=EN>

especially relating to trading activity that could pose a risk to the financial system as a whole. **Implementing banking rules without taking the specific nature of insurers' business model into account, as well as considering the specific activity undertaken by individuals within a company, is inappropriate.**

**EIOPA should act according to its mandate, and seek the convergence of supervisory practices, and not of figures across member states.**

*"Scope of application"*

EIOPA's opinion suggests proportionality should only apply for employees where variable remuneration is no more than €50 000 and is no more than 1/4 of total remuneration.

The objective to apply this opinion only when the variable remuneration is material is welcome, to avoid disproportionate burden and costs for the industry.

However, materiality is a relative concept and its appreciation should be left at the discretion of NSAs, following a risk-based approach suited to the respective markets. **Such an arbitrary absolute threshold is not appropriate and does not capture economic differences across the EU.** Since the implementation of Solvency II, the interpretation of Article 275 of the directive by NSAs has to date allowed a much **more appropriate implementation of proportionality than EIOPA's opinion.**

*"Fixed and variable components of remuneration have to be balanced"*

Insurance Europe notes that **diverging practices can exist between markets regarding the average share of the variable component of the remuneration due to cultural and historical reasons.** In fact, the co-legislators refrained from imposing certain ratios in Article 275 (2) (a) of the Delegated Regulation, consistently with the risk-based approach of the Solvency II framework.

There have not been in the past significant cases of excessive and detrimental use of variable remunerations in the insurance industry which would justify depriving undertakings of this crucial flexibility and competitiveness on the labour market.

Paragraph 3.3 implies that a reference ratio of 1:1 in the form of a fixed/variable remuneration ratio is considered balanced. As stated above, no ratio has been set in the Solvency II regulation for insurance companies. Moreover, even under CRD requirements, the 100% "bonus cap", similar to a 1:1 ratio proposed by EIOPA, can be increased to 200% with shareholder approval. Therefore, **setting this new requirement goes significantly beyond current regulation, and beyond practice in the financial sector.**

Furthermore, by identifying the threshold of a 1:1 ratio as potential trigger for supervisory measures, **EIOPA exceeds the limits set by Level 1 and 2 requirements.** Moreover, there is no comprehensive evidence that the violation of this ratio would encourage excessive risk taking. **Simply adopting requirements from the banking sector is not appropriate.**

Insurance Europe is of the view that establishing the specific ratio 1:1 between variable and fixed compensation is **overly prescriptive and prevents companies from applying a flexible remuneration policy that aligns with risk appetite and sound risk management.** Although EIOPA suggests this opinion is not intended to introduce new requirements, in practice NSAs are likely to introduce hard limits on companies' remuneration policies in order to comply with this opinion. **High level, qualitative guidelines should instead inform each NSA's approach to supervising remuneration policy, without setting specific limits on variable remuneration. For these reasons, any reference at all to a preset ratio between fixed and variable remuneration should be avoided.**

*"A substantial proportion of the remuneration has to be deferred"*

EIOPA states that the deferral should apply to all the variable component, **both linked to short term and long term performance horizons.** This sentence should be deleted, as it implies that the deferral may be divided into separate parts subject to different deferral periods. This interpretation can't be derived from Article 274 (2) (c), which does not include a reference to the duration of performance goals. It is not consistent with the

remuneration practice, which is regularly based on the assumption that the period for the performance assessment is aligned with the deferral period. In addition, the purpose of deferral can be well achieved without imposing deferral mechanism on each single incentive system (which on the contrary would entail significantly higher costs for the industry, including the need to redesign and renegotiate existing packages)."

Moreover, exceeding any preset indicator should not trigger automatic action from NSAs, such as "engaging" with the undertaking and "investigating" its policies. Any action should only be taken where the NSA deems it appropriate.

Paragraph 3.7 indicates that the **deferral rate should be considered to be higher than 40% in case of a particularly high variable remuneration**, eg in case of a ratio variable component/fixed component higher than 1:1. This specific enhanced deferral requirement in the case of "particularly high variable remuneration" **not only introduces a threshold which is new to the sector, but also a tiered approach to applying enhanced requirements.**

The quantitative criteria proposed seem rather low and arbitrary for specific and complex management of remuneration policies. In order to preserve proportionality, indicators could be replaced by supervision focusing on how companies' approach to remuneration align with their risk management. Regulation should remain principles-based and encourage proactive supervision. Such a close monitoring of ratios should remain a tool at the discretion of NSAs, where risk management in a company has been proved unsound.

"Financial and non-financial criteria have to be taken into account when assessing an individual's performance"

The proposal in paragraph 3.9 to specify the consequences of performance on variable remuneration, combined with the requirements in paragraph 3.11 to document an extensive list of performance criteria may lead to formulaic and overly bureaucratic approaches to performance management, which do not necessarily lead to an improvement in the relationship between remuneration and risk. It should also be clarified that the list of criteria for non-quantitative performance indicators set out in Paragraph 3.11b is just illustrative and does not require mandatory consideration.

Insurance Europe would also point out that **Article 275 (2) (d) of the Delegated Regulation does not offer the scope of interpretation to consider the performance assessment for granting variable remuneration potentially inadequate if it is informed by 20% or less of non-financial indicators.** Furthermore, Article 275 of the Delegated Regulation does not require undertakings to set a multi-year framework for performance assessments. The long-term perspective of performance assessments is already ensured by the mandatory deferral and possible downwards adjustment of the variable remuneration.

"The measurement of performance has to include a downwards adjustment for exposure to current and future risks"

Downward adjustment should not be linked on an absolute basis to the performance of an individual's business unit. Since an individual's performance may differ from the unit as a whole, it is important that individual good behaviour and performance are not discouraged

Paragraph 3.16 requires undertakings to maintain an exhaustive description of downwards adjustments, indicating that undertakings must take account of any adjustment option available. This is not in line with Article 275 (2) (e) of the Delegated Regulation, requiring undertakings to settle on one method without stipulating extensive documentation and analysis. **It is not in EIOPA's mandate to implement additional legal requirements via opinions.**

"Termination payments have to be related to performance achieved over the whole period of activity and be designed in a way that does not reward failure"

Insurance Europe notes that Article 275 (2) (f) of the Delegated Regulation requires undertakings to make sure that termination payments do not reward failure. However, it does not legitimise treating these payments as variable remuneration, as suggested in Paragraph 3.19. **Contrary to EIOPA's view, termination payments do not relate to the individual performance achieved over the entire period of activity.**

The excessive level of detail devoted to termination payments in the draft opinion is also oblivious to the fact that the underlying agreements are regularly not exposed to the regulatory risk of rewarding failure. Subject to national regulation, these are either dominated by requirements and considerations imposed by labour law, branch agreements or used for executive positions that are not subject to labour law and are normally paid only if the company terminates the employment without specific reason. **By contrast, variable compensation is as a rule based on performance criteria that are defined in advance.**

In any case, national differences regarding labour law must be taken into consideration. For example, in some jurisdictions, "payments that are mandatory under national labour law" may include collective bargaining agreements, and "settlements made for the loss of office where they are subject to a non-competition clause in the contract" are different from and do not include "gardening leave".

In addition, undertakings need a great deal of flexibility to negotiate such agreements in order to prevent detrimental effects on the reputation and to ensure the capacity to act. Moreover, combined to the proposed reference ratio (1:1), this proposal is not aligned with the provisions set in other industries and is significantly lower when including the severance entitlements due upon termination according to most European labour systems.

**Insurance Europe strongly opposes the assertion that termination payments are considered as a form of variable remuneration and, consequently, should be subject to deferral or taken into account when assessing whether the variable/fixed components of the remuneration are balanced.**

#### Question 4

Please provide any comments on section 4 of the opinion: Composition of variable remuneration here:

**Insurance Europe strongly disagrees with the requirement to award 50% of variable remuneration in shares, equivalent ownership or share-linked instruments.** Unlike the banking sector regulation, the Solvency II Delegated Regulation does not provide the legal foundation to impose such a requirement. There is no regulatory rationale to adopt this banking rule in the insurance sector. It must be left to the discretion of undertakings to decide whether stock-based remuneration is deemed proportionate and feasible, in order to preserve flexibility.

Moreover, unlike the banking sector, the insurance sector comprises numerous mutuals and cooperatives. The requirement to award 50% of the variable remuneration in shares "if proportionate and feasible" seems also simply copied from the rules of the banking sector, and **may create an unlevel playing field between shareholder companies and mutuals/cooperatives where it cannot apply.**

The proposal in paragraph 4.1 which requires firms to provide 50% of variable remuneration in the form of shares or similar instruments, would prove impractical and limit the benefit of reward packages. This requirement is highly prescriptive and will limit firms' ability to design appropriate and competitive remuneration policy.

In addition, the combination of the requirements proposed in paragraph 4.1 with those in paragraph 4.2, which require a retention policy to be included in share linked instruments, could quite easily lead to confusion regarding the amount and ratio of variable remuneration deferred, as share price fluctuates. Unless clarified this could lead to an unfair and disproportionately high deferral rate for certain individuals. It is unclear whether this was EIOPA's intention.

Furthermore, **paragraph 4.4 should be deleted as it remains unclear how, and under which rationale, undertakings should be "encouraged" to develop equivalent non-cash instruments.**

**Question 5**

Please provide any comments on section 5 of the opinion: Reporting requirements here:

**Question 6**

Please provide any other comment here:

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Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of more than €1 200bn, directly employ over 950 000 people and invest over €10 200bn in the economy.