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EIOPA's Opinion on Supervision of Remuneration Principles in Insurance and Reinsurance Sector

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DATE: 09.04.2020

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Introduction

On 7 April 2020, the European Insurance and Occupational Pensions Authority ("**EIOPA's**") released its finalised Opinion on the Supervision of Remuneration Principles in the Insurance and Reinsurance Sector [1] ("Opinion"). The release of the Opinion followed a consultation period in respect of a draft Opinion which initiated on 25 July 2019 and closed on 30 September 2019. The decision to issue the Opinion was largely driven by EIOPA's identification of supervisory divergence in the application of the remuneration restrictions imposed on insurance undertakings under the Solvency II Framework [2].

Background to Supervision of Remuneration Requirements

The Solvency II Delegated Regulation (2015/35/EU) ("**Delegated Regulation**") sets out detailed requirements which insurance undertakings in the European Union must meet with respect to remuneration. The requirements can be categorised as follows:

1. **institution-level requirements to** be met within an institution's remuneration policy; and
2. **employee-level requirements** to be met in respect of an individual employee's compensation package.

EIOPA's Opinion focuses on the employee-level requirements. In the Opinion, EIOPA states that, since the remuneration principles defined in the Delegated Regulation *"are high-level and leave* *le discretion to undertakings and supervisory authorities, divergent practices have cross the European Union.” The Opinion aims to address this by providing guidance to authorities on “how to challenge the application of certain principles” and thus promote “the convergence of national supervisory practices and contribute to the improvement of the functioning of the internal market”.*

Which employees are within scope?

The Opinion applies to staff whose annual variable remuneration exceeds EUR 50,000 and represents more than 1/3 (amended from the proposed figure of ¼ in the draft Opinion) of that staff member's total annual remuneration and who fall into one of the following categories:

a) members of an undertaking’s administrative, management and supervisory body;

b) other executive directors who effectively run the undertaking;

c) key function holders as defined in EIOPA's Guidelines on System of Governance'; and

d) categories of staff whose professional activities have a material impact on the undertaking’s risk profile.

The Guidance

There are a number of key areas where the Opinion provides important guidance to the industry:

1. Balance between fixed and variable remuneration

Employees should not become overly dependent on the variable components of remuneration. The Opinion sets out a ratio in excess of 1:1 (i.e., if variable remuneration exceeds fixed remuneration) as an appropriate trigger for supervisory review of the remuneration arrangements. EIOPA has also stated that supervisory authorities “may consider lower thresholds if deemed appropriate based on a risk-based approach”.

2. Substantial portion of variable remuneration to be deferred for not less than three years

The Opinion notes that deferral of 40% of the variable component of remuneration is considered by EIOPA to be a substantial portion. It also sets out that where the balance between fixed and variable remuneration exceeds a 1:1 ratio, 40% is too low and should be revised upwards. Supervisory authorities are advised by EIOPA to examine firms whose deferral rate is lower than 40% to better understand their specific situations.

3. Financial and non-financial performance criteria

Firms should, in advance, set out financial (quantitative) and non-financial (qualitative) criteria and describe the consequences on the pay-out of variable remuneration when these criteria are not met by the individual. The criteria used should be linked to the decisions made by the staff member and should ensure that the remuneration award process has an appropriate impact on his/her behaviour. EIOPA states that an appropriate balance between financial and non-financial criteria should be required and identifies a ratio of 80% financial to 20% non-financial as a potentially imbalanced approach (but does not specify what it would require as a “balanced” approach).

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n sets out that undertakings should have clearly defined "malus" provisions and that downward adjustments should also apply in cases where the business unit, firm or group do not meet their objectives (rather than just the individual) and in circumstances where it becomes likely that a firm will breach its solvency capital requirement prescribed under the Directive.

5. Termination payments should not reward failure

EIOPA confirms that certain termination payments should also be subject to variable remuneration limits and deferral arrangements and identifies what termination payments are and are not "generally" taken into account as variable remuneration. The overarching requirement is that such payments should not reward failure.

6. Non-Cash Instruments

While not required by the Delegated Regulation, the draft Opinion had detailed that undertakings should award 50% of an individual's variable remuneration in shares, equivalent ownership or share-linked instruments, if proportionate and feasible. This however, does not feature in the final Opinion, a development which will be welcomed by the insurance industry. Stakeholders, when responding to this section of the guidance, argued that the proposal to have 50% of variable remuneration be awarded in shares had no legal basis in the Delegated Regulation. While EIOPA has acknowledged this and removed it from the Opinion, it has indicated that it is considering whether *"such a principle should be proposed to the European Commission as part of the Solvency II 2020 Review (to be in line with the CRD V (EU Directive 2019/878)*". So this issue may yet reappear.

What next?

EIOPA states that "*supervisory authorities should collect qualitative and quantitative data enabling them to perform supervisory review of the remuneration principles in accordance with this Opinion*." Consequently, undertakings can expect that the Central Bank of Ireland ("Central Bank") may look to achieve this either through (1) the regular supervisory reporting it receives or (2) through specific reporting requests.

As regards immediate obligations on undertakings as a result of the Opinion, EIOPA in its Feedback Statement indicates that

- *"it is assumed that the remuneration policies in place in insurance undertakings have taken due consideration of the principles set down in the Delegated Regulation and would not need to be amended as a result of the Opinion.[3]"; and*
- *there is no need for undertakings to reach out to supervisors however it is "expected that NSAs take the Opinion into consideration when establishing the scope, frequency and intensity of supervision of remuneration policies".*

EIOPA itself will start monitoring the application of the Opinion by supervisory authorities from April 2022. It seems quite likely then that the Central Bank will review the Irish industry's application of the remuneration principles in detail prior to that date, whether by means of a thematic review or by inclusion in its regular supervisory reviews.

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on provides clarification on how supervisory authorities should assess an undertaking's approach to remuneration of a key cohort of staff. While EIOPA indicates that no immediate action is required by undertakings, undertakings would be advised to consider the contents of the Opinion and review relevant policies and practices before any supervisory dialogue is initiated by the Central Bank. Should you require any assistance with this or related matters, please do not hesitate to contact your usual Matheson contact.

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[1] Dated 31 January 2020

[2] In the Feedback Statement on the Opinion, EIOPA states that it is its "duty to contribute to high quality common regulatory and supervisory standards and practices in particular by providing opinions." This duty arises from Article 29(1)(a) of EU Regulation 194/2010.

[3] EIOPA qualifies this by explaining that "undertakings with riskier remuneration policies are challenged in a convergent way by supervisors and, if adequate and not already done, are required to adequately justify their policies in light of the principles."