OPINION ON THE SUPERVISION OF REMUNERATION PRINCIPLES IN THE INSURANCE AND REINSURANCE SECTOR

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1. Legal basis

1.1. The European Insurance and Occupational Pensions Authority (EIOPA) provides this Opinion on the basis of Article 29(1)(a) of Regulation (EU) No 1094/2010.¹ This article mandates EIOPA to play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union by providing opinions to competent authorities.


1.3. This Opinion is addressed to the competent authorities, as defined in point (i) of Article 4(2) of Regulation (EU) No 1094/2010.

1.4. The Board of Supervisors has adopted this Opinion in accordance with Article 2(7) of its Rules of Procedure.⁵

2. Context and objective

2.1. The Solvency II framework acknowledges that remuneration policies and practices which provide incentives to take risks that exceed the approved risk tolerance limits of insurance and reinsurance undertakings (collectively “undertakings”) can undermine the effective risk management of such undertakings. Therefore, it provides for provisions on remuneration for the purposes of the sound and prudent management

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of the business and in order to prevent remuneration arrangements which encourage excessive risk.

2.2. In this context, Article 258(1)(l) of the Delegated Regulation requires all undertakings to adopt remuneration policies. Article 275 of the Delegated Regulation defines the remuneration principles undertakings have to comply with when establishing and applying their remuneration policies. Articles 294 and 308 of the Delegated Regulation set out the information on remuneration practices that should be reported to the supervisory authorities and published in the Solvency and Financial Condition Report.

2.3. Considering that the remuneration principles defined in the Delegated Regulation are high-level and leave considerable discretion to undertakings and supervisory authorities, divergent practices have emerged across the European Union.

2.4. This Opinion aims to enhance supervisory convergence by focussing on a set of remuneration principles identified in the Delegated Regulation. This Opinion gives guidance to the supervisory authorities on how to challenge the application of certain principles and focuses on a reduced scope of staff identified as potential higher profile risk-takers to promote a proportionate approach. It is not EIOPA’s intention to add requirements or to create administrative burden. A risk-based approach and supervisory judgement should be the basis of the supervision of such principles.

2.5. EIOPA’s task is to ensure an effective and consistent level of supervision in order to guarantee a similar level of protection for policyholders and beneficiaries at EU level. This Opinion aims at promoting the convergence of national supervisory practices and contributing to the improvement of the functioning of the internal market.

2.6. Convergent supervisory practices should be built upon a common understanding of Union laws and regulations, without prejudice to the application of supervisory judgment and the proportionality principle.

2.7. Risk-based supervision of the remuneration policy means that supervisory authorities should have a two-dimensional approach when assessing the risk: the first dimension being the undertakings’ overall risk profile and the second dimension being the design of the concrete remuneration policy which might be identified as being more risky than others.

2.8. For the undertakings’ staff not covered by this Opinion supervisory authorities may also adopt a proportionate and more flexible approach. As a result, supervisory authorities may choose to apply EIOPA’s guidance
to the undertakings’ staff below the thresholds defined in paragraph 3.1, taking into account aspects such as remuneration practices in the relevant national market, the responsibilities and job profile of those staff members or the size and risk profile of the undertaking.

2.9. For members of the administrative, management and supervisory body (AMSB) and the most highly paid employees of global systemically important undertakings (G-SIIs) besides the guidance provided in this Opinion supervisory authorities should take into account the FSB Principles and Standards for Sound Compensation Practices if these principles and standards apply in the respective jurisdiction6.

2.10. The benchmarks/thresholds included in this Opinion should be considered for the purposes of supervisory dialogue and not as hard targets for the practical implementation of the remuneration principles. These indicative benchmarks/thresholds do not in any way restrict the supervisory authorities from having stricter practices, i.e. lower benchmarks/thresholds, to trigger a supervisory dialogue with undertakings if it is deemed appropriate based on a risk-based approach. In this context, supervisory authorities may also adopt a proportionate and more flexible approach in the supervision of the remuneration principles when undertakings are categorised as ‘low risk’, including the design of the remuneration policy.

3. Supervision of the remuneration policies

Scope of application

3.1. This Opinion, in line with the proportionate and risk-based supervisory approach mentioned above, applies for the remuneration of the undertaking’s staff from the categories listed below, whose annual variable remuneration exceeds EUR 50,000 and represents more than 1/3 of that staff member’s total annual remuneration:
   a) AMSB members;
   b) other executive directors who effectively run the undertaking;
   c) key function holders as defined in EIOPA’s Guidelines on System of Governance7;
   d) categories of staff whose professional activities have a material impact on the undertakings' risk profile (material risk takers or MRTs).

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7 Paragraph 1.4 of EIOPA’s Guidelines on System of Governance (BoS-14/253): “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 supervisory authority.”
Fixed and variable components of remuneration have to be balanced (Article 275(2) (a) of the Delegated Regulation)

3.2. Where remuneration schemes have fixed and variable components, these components should be in such a proportion that the employees do not become overly dependent on the variable components. When employees are overly dependent on variable remuneration this could encourage behaviours that are not in line with the undertakings’ business and risk management strategy, endanger sound and prudent management, and encourage risk taking in order to maximise remuneration.

3.3. If an undertaking exceeds the threshold of a 1:1 ratio regarding any AMSB members, other executive directors who effectively run the undertaking, key function holders or MRTs, the supervisory authority should engage with the undertaking and investigate whether the remuneration policy is balanced with regard to the proportion of variable remuneration. To trigger the supervisory dialogue on the balance of fixed and variable components the supervisory authority may consider lower thresholds if deemed appropriate based on a risk-based approach considering for example the given position (for example, key function holders or AMSB members, the tasks assigned to a certain function, etc).

3.4. In addition to the fixed/variable remuneration ratio, supervisory authorities are recommended to pay specific attention to very low fixed remunerations, considering the context of national remuneration practices.

A substantial portion of the variable remuneration has to be deferred (Article 275(2)(c) of the Delegated Regulation)

3.5. When assessing the adequacy of the deferral period with regard to the nature of the undertakings’ business, its risks and the activities of the employees in question supervisory authorities should bear in mind that undertakings have different deferral periods depending upon the risks they enter into and that deferral period may or may not vary depending on the categories of staff.

3.6. The deferral of 40% of the variable remuneration is considered a substantial portion. Supervisory authorities should use their supervisory judgement to consider the need for a deferral rate higher than 40% and/or a longer deferral period as part of their risk-based approach. When the deferral is lower than 40% supervisory authorities are recommended to engage with the undertakings to better understand the specific situation. The deferral should apply to all variable components, both linked to short term and long term performance horizons.
3.7 The deferral rate is recommended to be higher than 40% in case of a particularly high variable remuneration, for example, in case of a ratio higher than 1:1.

**Financial and non-financial criteria have to be taken into account when assessing an individual’s performance (Article 275(2)(d) of the Delegated Regulation)**

3.8 Where variable remuneration is performance related, the total amount of variable remuneration has to be based on a combination of the assessment of the individual’s performance, the performance of the business unit concerned and the overall result of the undertaking or group to which the undertaking belongs.

3.9 Supervisory authorities should ensure that undertakings, when assessing an individual’s performance ex ante, 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.

3.10 The criteria used should be linked to the decisions made by the respective staff member and should ensure that the remuneration award process has an appropriate impact on the individual’s behaviour. The criteria should include achievable objectives and measures on which the staff member has some direct influence.

3.11 The assessment of performance should be set in a multi-year framework. The indicators on which the criteria are based and the entire decision-making process should be clear and predetermined, appropriately explained and documented. In the assessment the followings should be taken into account:

a) financial (quantitative) criteria that should cover a period which is long enough to capture the risk taken by staff members and should be risk adjusted;

b) non-financial (qualitative) criteria that should contribute to the creation of value for the undertaking, such as for example compliance with external and internal regulations, the efficiency of customer service management, the achievement of strategic goals (for example, Environmental, Social and Governance criteria, ethical aspects), behaviour including towards customers, turnover of staff, adhering to the values of the company, impact on the undertakings’ reputation, consumer satisfaction, adherence to the undertakings’ risk management policy, leadership, teamwork, creativity, motivation and cooperation with other business units, internal control and corporate functions among others.

3.12 Furthermore, financial and non-financial criteria should be appropriately balanced. For instance, where the criteria is 80% financial and 20% non-
financial supervisory authorities may come to the conclusion that the assessment framework is not appropriately balanced. In any case, non-financial criteria should not be negligible and should have a substantial value as indicators of the above mentioned aspects. Supervisory authorities should challenge the balance of the criteria if they are not consistent with a sound and effective risk adjusted remuneration policy or do not sufficiently reflect the undertaking’s strategic objectives.

3.13 The evaluation of non-financial criteria is of utmost importance for the assessment of key function holders based on Article 275(2)(h) of the Delegated Regulation.

The measurement of performance has to include a downwards adjustment for exposure to current and future risks (Article 275(2)(e) of the Delegated Regulation)

3.14 For the supervisory dialogue with undertakings supervisory authorities should consider as part of the term downward adjustment all kind of adjustments, for example malus clawback and in year adjustments (for example, by lowering the overall bonus pool, which will ultimately translate into lowering - or not awarding at all- the variable remuneration of an individual).

3.15 Variable remuneration should not only be adjusted downward when staff members do not meet their personal objectives, but also when their business units and/or the undertaking as a whole fail to do so. If an undertaking is likely to breach or has breached the Solvency Capital Requirement, its remuneration policy should prescribe that downwards adjustment will be applied.

3.16 Supervisory authorities should require a clear description of the downwards adjustment(s) from undertakings. This should at least:
   a) show how the short to long-term risks, the cost of capital, (internal) capital requirements, as well as the dividends policy have been taken into account;
   b) include examples of how the downwards adjustment works;
   c) include the rationale for the chosen downwards adjustment and the triggers used;
   d) in any case, downwards adjustments should be designed in a way that - in the event of an individual’s negative contribution to the undertakings’ results in any year of the deferral period - any unvested portion of the variable remuneration may be subject to malus.

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8 In line with EIOPA’s Opinion to institutions of the European Union on the harmonisation of recovery and resolution frameworks for (re)insurers across the Member States, EIOPA believes that supervisory authorities should have as an early intervention power, the power to require undertakings to limit variable remuneration and bonuses. If this power is already available at national level, supervisory authorities should consider using this power in case of a potential breach of the Solvency Capital Requirement.
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 (Article 275(2)(f) of the Delegated Regulation)

3.17 The supervisory assessment of the undertakings’ remuneration policies should cover the policy for the possible use of termination payments, which should contain guidance of the maximum payment or the criteria for determining the amount of the payment. Supervisory authorities should take into consideration that termination payments are often broadly regulated by national (labour) law and differ per undertaking and country due to these legal requirements.

3.18 The following amounts of termination payments are generally not taken into account as variable remuneration:

a) payments that are mandatory under national labour law, mandatory payments following a court decision or payments which are calculated through a predefined generic formula set within the remuneration policy in the cases referred to under paragraph 3.19;

b) settlements made for the loss of office where they are subject to a non-competition clause in the contract (‘gardening leave’) and awarded in future periods up to the amount of the fixed remuneration which would have been paid for the non-competition period, if staff were still employed;

c) payments that belong to the category listed in paragraph 3.19, and that do not fulfil the condition in paragraph (a) above, where the undertaking has demonstrated to the supervisory authority the reasons and the appropriateness of the amount of the termination payment.

3.19 The amounts of termination payments paid under the following conditions are generally taken into account as variable remuneration:

a) when the undertaking terminates contracts because of a failure of the undertaking;

b) when the undertaking terminates a contract following a material reduction of the undertakings’ activities in which the staff member was active or where business areas are acquired by other undertakings without the option for staff to stay employed in the acquiring undertaking;

c) when the undertaking and staff member agree on a settlement in case of a potential or actual labour dispute, to avoid a decision on a settlement by the courts.
3.20 When assessing the remuneration policy of the undertaking the following points should be taken into account in the supervisory dialogue on the amounts of termination payments:
   a) when determining the fixed/variable remuneration ratio how the undertaking considers:
      i. the sum of any higher amounts than the fixed remuneration for the future periods which would have been paid for the non-competition period, if staff were still employed under paragraph 3.18(b); and
      ii. any other termination payment not listed under paragraph 3.18.
   b) how is the amount awarded and the criteria used to determine the amount, including if it is linked to the performance achieved over time;
   c) if and under which conditions the termination payment is deferred in time;
   d) the relationship between the severity of failures and the amount of the termination payment and how it is ensured that termination payments do not reward failures;
   e) the identification by the undertaking of the situations where termination payments should not be made.

4. Reporting requirements

Supervisory authorities should collect qualitative and quantitative data enabling them to perform supervisory review of the remuneration principles in accordance with this Opinion. Instruments for data collection might be either the regular supervisory reporting or a specific request.

5. Monitoring by EIOPA

5.1 EIOPA will start monitoring the application of this Opinion by the supervisory authorities two years after its publication.

5.2 This Opinion will be published on EIOPA’s website.

Done at Frankfurt am Main, [*]

[signed]

For the Board of Supervisors
Gabriel BERNARDINO
Chairperson