AMICE CONGRESS JUNE 2012 GDANSK

Presentation by Chris van Toor: Sharing the internal audit function

Slide 1 'Sharing the internal audit function' is a subject that will be dealt with at the end of my presentation. I would first like to share various experiences with you regarding Solvency II. And before I do so, I would like to tell you something about the organization I represent, the FOV: the Federation of mutual insurance companies in the Netherlands.

Slide 2 As the name implies, the FOV is a federation. But more specifically, the FOV is a sector organization that represents the interests of its affiliated members, comparable to Amice. The FOV is an enthusiastic member of Amice because approximately 70% of national legislation originates in Europe and this is where Amice operates. The FOV has 100 members, varying from the largest insurance company in the Netherlands, with a turnover running into billions, to the smallest insurer with a turnover of some ten thousand euros. This gives a broad and varied membership.

Slide 3 Since 2003, our members have taken note of the forthcoming legislation about amended capital requirements, Solvency II. Working groups have been set up since 2005 and the main insurance companies in the Netherlands have begun preparing for the new solvency framework. This has proved a difficult task as the legislation was – and still is – being developed. A medium-sized insurance company recently described preparing for Solvency II as:

Slide 4 'Shooting at a moving target in dense fog'. I am sure you can all picture this.

Slide 5 In 2010 my organization felt that the requirement framework had been developed to such a stage that the implementation of Solvency II could be undertaken by all the members – with the exception of Solvency II basic insurers incidentally, but more on that later. To get things going, the FOV organized a meeting about Solvency II in April 2010. Items on the agenda were the Solvency II directive, risk management as one of its elements, the GAP analysis to be made (i.e. a picture of the current state of affairs and a picture of the future requirements, which would clearly show the gap to be closed and thus the 'homework') and a number of other items which are shown on the slide. The meeting was attended by 50 of the 100 members. Most of them were medium-sized to small insurers. The larger members had already been working on this for some time by themselves.

Slide 6 It was clear that Solvency II was a subject where cooperation would be appropriate, so the proverbial wheel would not need to be reinvented everywhere. To gauge the interest in cooperation, the FOV organized a follow-up meeting in the autumn of 2010. The focus of this meeting was one of the elements of Solvency II, risk management, and the manner in which members could work together was discussed; by investigating together, sharing experiences and sharing costs when experts needed to be called in. The meeting was attended by 15 of the 100 members, clearly showing that there was not nearly as much interest as in the first meeting, when we were able to welcome 50 of the 100 members.

Slide 7 The meeting in September concluded with an announcement to the members, that the FOV could only take up its coordinating role if requested by the members. The response in the end was nil. To some extent, this was understandable, as the requirement framework for the members who would not come under the scope of Solvency II but under the national regime Solvency II basic – basically the companies with a premium income below EUR 5 million – still had to be designed.

Slide 8 In and from 2010, it was clear that the large companies were tackling the Solvency II matter themselves. A number of smaller companies, operating under the same label, tackled the matter as a group. A small group stayed out of the picture - some awaited developments and planned to come on board when the market had found its direction - and the Solvency II basic insurers were still awaiting further information about the regime applicable to them.

Slide 9 The clock did not stop and the deadline approached. A survey of the FOV members in 2011 showed that there was a need for practical support where Solvency II and Solvency II basic were concerned. This need was particularly evident in the companies shown in red on the slide, a number of smaller partiers therefore. The FOV naturally wished to respond to this request for support and took a number of initiatives.

Slide 10 A number of market providers were contacted who would be able to support our members on a cost-sharing basis. The underlying idea was that groups would be formed who would deal with individual topics of Solvency II / Solvency II basic with the assistance of an external expert. These groups were formed, and it was basically assumed that the difference between Solvency II and Solvency II basic would not be significant. Meetings were held about the internal audit and about ORSA. These were well attended. As a result of the meetings about the internal audit, a working group was set up which is currently working on a handbook and operating instructions. This approach of individual topics has been completed with a total offer: companies can, if they so wish, make use of an agency that guarantees that, given 260 hours, it can make a company Solvency II basic-compliant in time. To date, this offer has not been taken up, probably because of the price of EUR 35,000 ex VAT per company. It is clear that a partial approach is required and the associated costs need to be kept as low as possible. On more than one occasion this has made me feel that companies are insufficiently prepared to make investments for Solvency II or Solvency II basic. This is possibly again due to the fact that the forthcoming legislation is generally considered to be too complicated. In other words, there is resistance. This is understandable but does not alter the fact that the new requirements must ultimately be complied with.

Slide 11 Focusing on the internal audit function, the main topic of my introduction, as mentioned, a working group was set up within the FOV for this purpose. The group consists of representatives of a number of members and is supported by an external consultancy that has specialized in the subject of internal audits. It became evident from the first few meetings that it is not quite clear to everyone what an internal auditor should do. This is the result of principle-based regulation, regarding which a number of smaller insurers have stated that it would probably have been better for this group if rule-based regulation had been opted for. This was not opted for, however. The question at hand was what the tasks of an internal auditor should be. Does he/she mainly look at the accounts receivable and accounts payable management or does he/she audit the procedures within a company, examining matters such as:

- Have all the risks been identified?
- Have they been reported to the board?
- Has this report been discussed at a meeting and resolutions adopted?
- Have those resolutions subsequently been followed up?
- Has an evaluation been arranged?
- Has the supervisory board determined the risk appetite?
- Etc.

I am curious as to your views. This is why I would like to ask you the following question, which you can answer.

Slide 12 My question concerns the task of the internal auditor. What do you think it consists of? You can choose from one of the following 4 answers:

1 The auditor must focus on the accounts receivable and accounts payable management (which includes the settlement of claims)
2 The auditor must focus on the procedures within a company
3 The auditor must deal with both 1 and 2
4 I don't know.

Slide 13 The FOV working group was of the opinion that the task of the internal auditor was to focus on the auditing of and reporting on the procedures within a company. He/she should above all not be redoing the work of the accountant (which includes the accounts receivable and accounts payable management). Given your answers, there is therefore (not) a match. We (do not) agree on what the task of an internal auditor should be.

Slide 14 We now arrive at the essence of the presentation: Who can act as internal auditor? Can this be a member of the company's own board? How can the independence be assessed in that case? And in particular where elected directors are concerned: are they 'fit and proper'? Can you satisfy that criterion simply by handing over a manual and operating instructions? Should it not be, rather, that an auditor must be capable of asking the questions behind what is evidently clear? This requires knowledge of operating matters. Or are we all making matters far too complicated? Can the audit be left to the accountant? Or should we engage an external agency for this? Or should we share an auditor by appointing one together or carrying out audits of each other? If the latter, should the auditor be someone who has operating knowledge at management level? Again, I am curious as to what you think and put the second question to you:

Slide 15 Who would you prefer to act as auditor?
1 A member of the company's own board
2 The company's own accountant
3 An external specialist
4 A shared official.

Our working group has not arrived at an answer yet. There is a tendency to go for 2, 3 and 4 but 1 has not yet been ruled out. The regulator ought to be consulted to ensure that whatever we arrange, it is future proof. Incidentally, the working group would prefer the most cost-efficient options 1 or 4.

Slide 16 It is time for some concluding remarks. There has been a long period of 'wait and see' where Solvency II is concerned. The market can no longer afford to do so. Although the requirements are still not clear, everyone will have to get to work. So let us – in so far as necessary – put any resistance aside. Undesired and inappropriate elements must of course be exposed but that should not be our basic attitude.

Slide 17 Come into action, not because we have to but because we want to! I wish you every success and thank you for your attention.