ΣΧΟΛΗ ΟΙΚΟΝΟΜΙΚΩΝ ΚΑΙ ΠΟΛΙΤΙΚΩΝ ΕΠΙΣΤΗΜΩΝ
ΤΜΗΜΑ ΟΙΚΟΝΟΜΙΚΩΝ ΕΠΙΣΤΗΜΩΝ

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Εσωτερικός Έλεγχος ως βασική λειτουργία Ασφαλιστικής Επιχείρησης : Εποπτική Προσέγγιση

ΝΙΚΟΛΑΟΣ ΠΑΛΑΙΟΘΟΔΩΡΟΣ

ΚΑΘ. ΠΑΝΑΓΙΩΤΗΣ ΑΛΕΞΑΚΗΣ

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1. Abstract

This study aims to provide a comprehensive analysis of the expectations of Insurance firms, stakeholders and Supervisory authorities with regards to the Internal Audit function, as a key function for Insurance firms. This analysis was performed by utilizing the available regulatory framework, the supervisor guidelines, research already performed on the topic of internal audit maturity and professional experience gained on the industry. Through this study it was achieved to group together regulatory framework, supervisor expectations and actual challenges of internal audit function in the insurance industry.

A short overview of the Internal Audit profession has been provided and extends to the current requirements as set by the regulators, businesses and stakeholders, providing empirical knowledge from a supervisory perspective.

Governance structure, independence, objectivity, fit and proper have been analysed and provided the necessary insight of the current expectation status.

Internal Audit tasks and supervisory requirements have been defined, in a summarized format, however it provides the necessary understanding of what internal auditors are expected to do and the methodology of providing the necessary documentation to the Board and to Supervisory Authorities.

2. Introduction

As the main component of this study is to focus on the Internal Audit of an Insurance firm, as a key function in view of its business and organisation, this chapter will provide the necessary introduction of what internal audit is, what are the historical developments, what are the differences between internal audit and external audit, to which committee it is expected to report to and finally how internal audit effectiveness is achieved.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The activity is performed by professionals with an in-depth understanding of the business culture, systems, and processes and provides assurance a) that internal controls are in place and are adequate to mitigate risks, b) governance processes are effective and efficient, and c) organizational goals and objectives are met.

According to the Definition of Internal Auditing in The IIA's International Professional Practices Framework (IPPF), internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The core mission of internal audit is to enhance and protect organizational value by providing risk-based and objective assurance, advice and insight.

Conformance with the internal audit principles is required and essential for the professional practice of internal auditing and mandatory guidance has been developed through core Principles, auditing standards and the code of ethics.

The International Professional Practices Framework (IPPF), its forerunner first adopted in the 1970s. The International Standards for the Professional Practice of Internal Auditing are mandatory requirements for the professional practice of internal auditing and for evaluating the effectiveness of its performance. To be effective, practitioners and the internal audit activities they serve must be able to demonstrate achievement of all ten principles.

Demonstrates integrity, quality and continuous improvement, due professional care, communicates effectively, is objective and free from undue influence (independent), provides risk-based assurance, aligns with the strategies, objectives and risks of the organization, is insightful, proactive and future-focused, is appropriately positioned and adequately resourced, promotes organizational improvement.

Additionally, the IIA’s Code of Ethics promotes an ethical culture in the profession of internal auditing and has two components: 1) Principles that are relevant to the profession and practice of internal auditing and 2) Rules of Conduct that describe behavior norms expected of internal auditors.

The IIA’s Code of Ethics expects internal auditors to apply and uphold the following principles:

1. Integrity: The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

2. Objectivity: Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

3. Confidentiality: Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

4. Competency: Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

3. Analysis of the theoretical foundations of the study

3.1 Historical Developments

If we follow the evolution of internal control, we can see that before 1940's when the Institute of Internal Auditors was established, it was only an office function while the recordkeeping was done by hand and the auditors were needed only to check and find errors in the accounting data after the completion. The idea of the internal auditor is associated with the sense of security while its primary objective is to detect fraud (Pickett, 2003).

The audit function first appeared as part of a stewardship process and it was an auxiliary and supportive function. Later, in 1941, emphasis was given to the introduction of Institute of Internal Auditors- IIA and to the professional standards. Alongside with these developments, the Board of Directors and the Audit Committee as well as the external auditors contributed to enhance the role of the Internal Auditor. Finally, some changes were made in the perspective of internal auditors. On the one hand, they gained a complete form and spiked with additional activities and tasks, but, on the other hand, they resulted in reshaping their relations with auditees.

In Greece, the College of auditors appeared in 1931 under the law 5076/1931 and finally the "Chartered Accountants" was founded in 1955 under the law 3329 / 1955. The introduction of Certified Auditors with the assistance of the standards issued by the IAASB (International Assurance and Auditing Standards Board) and the Code Professional Ethics of IFAC (International Federation of Accountants) aims to ensure the professional independence of the Certified auditors and the impartiality and transparency.

Traditionally, internal audit has focused primarily on identifying policy violations and encouraging compliance with regulations. However, internal audit departments have recently turned their efforts towards an integrated approach to risk management. This evolution of internal audit came about as a result of both the changing nature of the market and industry regulations. The new outlook also involves a transition from a document-centric approach to a data-centric approach, allowing internal audit to take advantage of technology that can enhance enterprise risk management (ERM).

The Institute of Internal Auditors (IIA) defines internal audit as a value-added activity that helps an organization achieve its objectives, “by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” In the past, these responsibilities were carried out through a bottom-up, checklist methodology.

Following the Sarbanes-Oxley Act and the issuance the PCAOB’s Auditing Standard No. 5, the approach has developed into an increasingly top-down, consultative methodology. In addition to bringing best practices into an organization, the evolved approach also assists in reducing redundancies and inefficiencies by breaking down the silos in an organization.

A barrier to top-down ERM techniques in the past was the complexity of data gathering and management.

Today, centralized technology frameworks can assist internal audit in identifying, assessing, and monitoring risks and controls. This also allows a transition from a document-centric approach to a data-centric approach, increasing the ease of efficiency and accuracy in reporting across the business. It also enables data collection to be standardized with greater security and data integrity, leading to more consistency throughout the organization. The data can then be utilized in evaluating historical trends and providing management and the board with better access to information underlying enterprise risks in the organization.

Recently, internal audit departments have employed “continuous auditing” in an effort to review, analyze, and report on issues in a near real-time environment.

Traditionally, there has been a considerable lapse between the completion of fieldwork and the issuance of audit reports, making the reported information less valuable to users. By using a centralized technology framework, the continuous audit capability provides meaningful information within a shorter time frame. In addition, the process can assist in understanding changes in risk, supporting a proactive management approach, and engaging business units in active risk management efforts.

3.2 Internal Audit versus External Audit

Internal audit considers whether business practices are helping the business manage its risks and meet its strategic objectives - it can cover operational as well as financial matters.

With the term Internal auditors, we mean those individuals who work as a part of an organization or a company, and they transfer the significant audit information to the company's audit committee and consequently to the Board of directors. Also, Internal auditors hold a consulting role since, they reassure that the company's internal control system is adequate and appropriate for implementing corporate strategy.

On the other hand, with the term External auditors, we mean the professionals who are auditing a company and announce relevant reports to the company's shareholders and the public through the publication of the audit report. External Auditors report on an annual basis and in some industries even quarterly. The external audit report shows if the accounts are in true and fair value.

There are many differences between internal and external audit. However, the main differences include:

1. External audit mainly considers whether the annual accounts give a 'true and fair view' and are prepared in accordance with legal and accounting requirements. Internal auditors can be employed by the business or outsourced. While an accounting background is common, they can also come from other backgrounds.
2. The internal audit agenda is set internally in the light of the business's risks and objectives. The external audit firm will set its own program of work based on its assessment of the risks of the accounts being materially misstated.

3. Internal auditors report internally. Relevant managers will usually receive copies of reports as there will be recommendations that would have been discussed that they will need to act on. Ultimately internal auditors report to the audit committee or the Board so there is high level oversight. External auditors report primarily to the shareholders or the trustees for an unincorporated charity.

4. Internal auditors provide a tailored report about how the risks and objectives (of the business area being audited) are being managed. There is a focus on helping the business move forward - so expect there to be recommendations for improvement. External auditors' main report is in a format required by Auditing Standards and focuses on whether the accounts give a true and fair view and comply with legal requirements. If other things come to light which the auditors think should be brought to the client's attention they will be reported separately to the directors in a 'management letter point' document.

5. Internal auditors' reports are not published whereas external auditors' report will be publicly available.

3.3 Internal Audit Effectiveness

Due to the diversification of business sizes and managing types the implementation of an effective internal control system needs to ensure that each business needs has been addressed.

The Institute of Internal Auditors (IIA) has defined internal audit effectiveness as the degree to which establish objectives are achieved. Internal auditing could assist organizations in better accomplish their objectives by fetching a systematic and disciplined approach to improve and evaluate the control, risk management, and the governance processes effectiveness (IIA, 2009). The internal auditors have to be characterized with the highest professional objectivity levels of communicating skills including gathering and evaluating information related to the examined activities or processes (IIA, 2009). While management's increased attention to internal audit recommendations encouraged internal auditors to provide their best efforts, the lack of management attention gives the auditee a bad idea regarding the importance of internal auditing which in turn adversely affect the auditee attributions (Mihret and Yismaw, 2007).

The effectiveness of an internal control system is driven by a set of features and includes independence which is flagged as an indispensable element for the effectiveness of an internal control system, as it allows auditors to act unaffected and free of any interference.

The evaluation of the business internal control by the internal audit is also utilized by external auditors who rely on internal auditors' results illustrating their effective role in evaluating and improving that organization internal control system.

With high quality findings of internal audit, the internal audit function will be highly effective (Munro & Stewart, 2011).

Therefore, expert auditors have to be sure that their judgments in any issue must always be accurate enough to keep on going along with the standards. Bierstaker and Thibodeau (2006) indicated that auditors with high level of experience could acquire and consider the relevant information better than those with less experience because the former has the ability to utilize more concepts in a way that leads them to acquire more relevant information. Audit experience has been considered by Musig and Ussahawanitchakit (2011) as the skills that the auditors gained when auditing the tasks by applying relevant audit standards, accounting guidance and then their error specific experiences. Therefore, auditing experience plays a major role in auditing effectiveness.

3.4 Audit Committee

The Audit Committee is an independent advisory board with increased responsibilities and it is composed by independent and non-independent non-executive only members and operates with the decision of the Board.

An audit committee is a selected number of members of a company's board of directors whose responsibilities include helping auditors remain independent of management.

Most audit committees are made up of three to five or sometimes as many as seven directors who are not a part of company management.

The Audit Committee meets at least four times annually.

An audit committee is one of the major operating committees of a company's board of directors, which among others, is also in charge of overseeing financial reporting and disclosure. The audit committee's role includes the oversight of financial reporting, the monitoring of accounting policies, the oversight of any external auditors, regulatory compliance and the discussion of risk management policies with management. The committee also has the authority to initiate special investigations in cases where it is determined that accounting practices are problematic or suspect, or when serious issues arise with employees. An internal auditor would assist the committee in such efforts.

The Audit committee with the management and with the external auditors, assesses the results of the external auditor report, reviews the effectiveness of internal controls, monitor and periodically assess the adequacy of organizational structure of the company and the internal control system, asseses the procedures followed in preparing the financial statements and the information presented in company shareholders, supports the work of the external auditors to facilitate them to access the information they need to complete their work, appoints auditors, supervises the Internal Audit Unit and facilitate its work, approves the annual audit plan and is ultimately the responsible committee for the results of internal controls.

By effectively carrying out its functions and responsibilities, the audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management’s practices and internal controls, and that the outside auditors, through their own review, objectively assess the company’s financial reporting practices.

4. Insurance Sector Internal Audit & Supervisory Approach, Empirical Analysis

4.1. Internal Audit Insurance firms – Historical Developments

Under the new legal framework for Insurance firms, Solvency II, the importance of the role of the Internal Audit in the system of governance has been acknowledged by the European Union for the insurance industry.

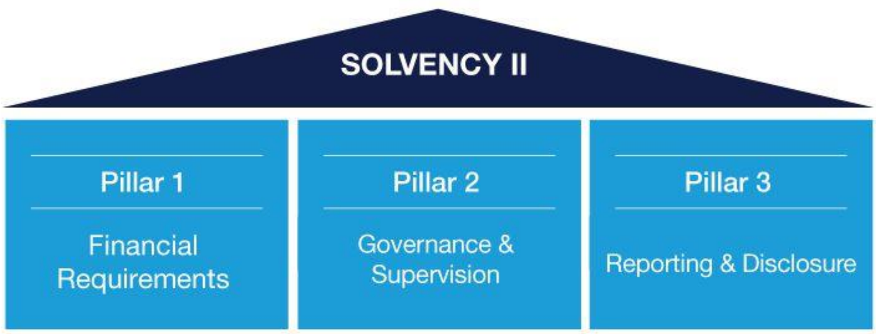
Specifically, the high level of independence of Internal Audit, clearly distinguishing it from the other governance functions, has been emphasized by the new framework.

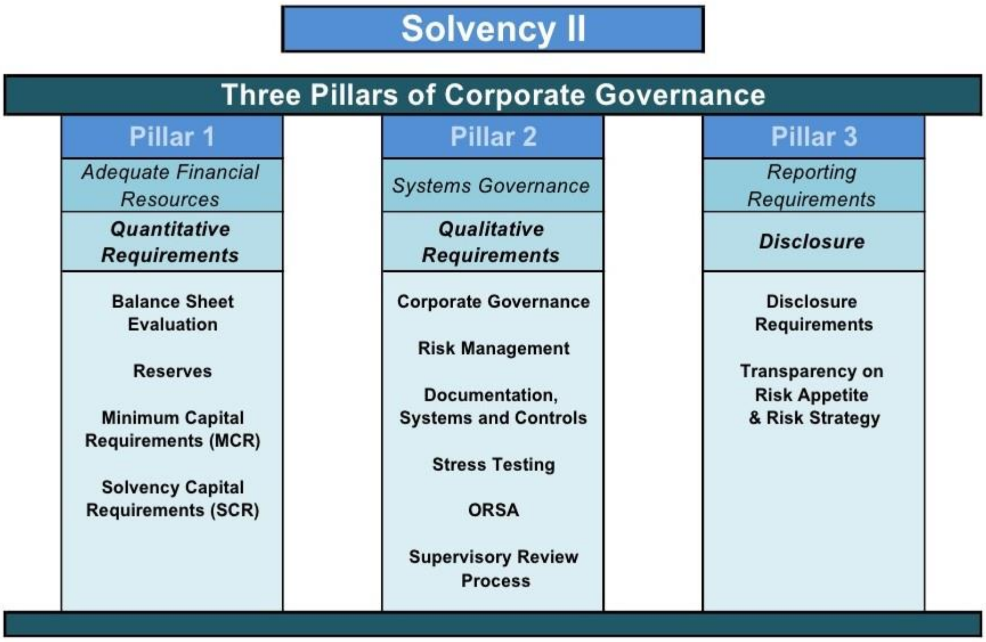
A high level of independence is a key factor if Internal Audit is to perform its primary role as the assurance function for the Board of an insurance undertaking. The definition of the position, role and tasks of Internal Audit in the Solvency II directive is fully in line with the applicable internal auditing standards and the generally accepted good practice of the procession.

Thus Solvency II does not in principle lead to any real change in the role of Internal Audit.

4.2. Solvency II requirements for Internal Audit

The requirements regarding the key functions in Solvency II are established in Articles 41-50 of the Directive 2009/138/EC (Solvency II Directive), Articles 268-274 of the Commission Delegated Regulation 2015/35/EU (Delegated Regulation) and in EIOPA Guidelines on the System of Governance and ORSA1 (SoG Guidelines and ORSA Guidelines).





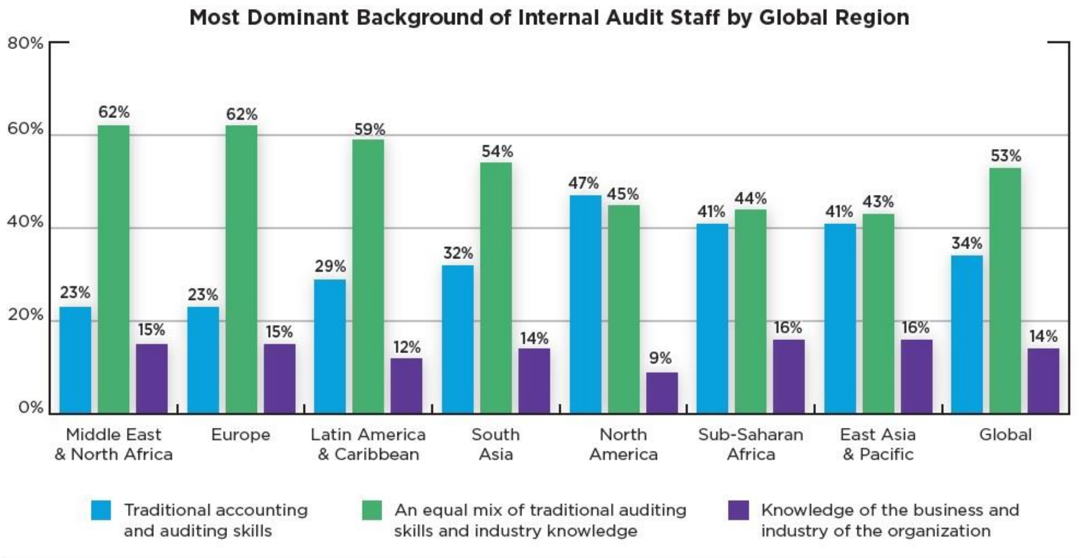
One of the most important challenges that Solvency II initiated regarding Internal Audit is Internal Audit's position within the Company's organizational chart. In order to be able to act independently Internal Audit must have direct und unrestricted access to the Board, whose members should receive, as a minimum, a summary of and access to all audit reports. The Head of Internal Audit should report functionally to the Board and administratively to the Chief Executive Officer. Furthermore, Internal Audit should have the right to audit any activity of an insurance firm at its discretion without any limitation and free of any influence in the performance of its audit.

Solvency II has required a new governance system and the creation of an adequate risk management system. Ultimately, Internal Audit needs to extend its activities and comply to this framework. These new activities will to some extent require Internal Audit to have different competences than those traditionally required. In particular, Solvency II will require insurance internal auditors to further enhance their technical abilities on governance, risk assessment and on actuarial skills, in order to be able to ensure confidence in the new legislation and to ensure the right capabilities are in place to assess the controls which should be implemented in the new processes.

This may require greater investment in the training and human capital of Internal Audit departments and/or more structured insourcing of skills.

"The relevant background of the internal audit department staff is an indicator of the department's maturity. A global average of 53% of Chief Audit Executives report that their staff has an equal mix of traditional auditing skills and industry knowledge. In

34% of the cases, the staff has a more traditional accounting and auditing profile. Several Chief Audit Executives confirmed that staff members with varied backgrounds are important maturity indicators. Firsthand business knowledge and an understanding of the drivers of operations are key advantages to an entrant to the internal audit department. This background mix is most common in the Middle Ease & North Africa (62%) and Europe (62%) and least common in Sub-Saharan Africa (44%) and East Asia & Pacific (43%).



It is therefore evident that the actions which are required from the firms is to a) build an internal audit staff with varied backgrounds via appropriate recruiting and on-the-job training, b) ensuring that there is a structured and documented training program in place for staff. c) ensuring the training program is sufficiently diversified to offer the right training to the right people., d) make sure the staff is able to follow training outside the normal internal audit field to further develop skills in critical thinking and leadership." Sarens G. 2016, Benchmarking Internal Audit Maturity.

4.3. Internal Audit as a Key Function of Insurance firms

With the new governance system defined by Solvency II, the functions which are flagged as mandatory is the Internal Audit, Risk Management, Compliance and Actuarial function.

A good coordination between the governance functions is therefore vital for a sound governance system. The Lines of Defence has been increasingly applied to corporate governance and is a useful tool to explain and demonstrate the different roles in governance and risk management.

The persons carrying out the internal audit function shall not assume any responsibility for any other function. However according to the framework and respecting the principle of proportionality laid down in paragraphs 3 and 4 of Article 29 of Directive 2009/138/EC, the persons carrying out the internal audit function may also carry out other key functions, where all of the following conditions are met:

(a) this is appropriate with respect to the nature, scale and complexity of the risks inherent in the undertaking's business,

(b) no conflict of interest arises for the persons carrying out the internal audit function,

(c) the costs of maintaining persons for the internal audit function that do not carry out other key functions would impose costs on the undertaking that would be disproportionate with respect to the total administrative expenses.

The internal audit function is also expected to include the following tasks:

(a) establish, implement and maintain an audit plan setting out the audit work to be undertaken in the upcoming years, taking into account all activities and the complete system of governance of the insurance or reinsurance undertaking

(b) take a risk-based approach in deciding its priorities

(c) report the audit plan to the administrative, management or supervisory body

(d) issue recommendations based on the result of work carried out and submit a written report on its findings and recommendations to the administrative, management or supervisory body on at least an annual basis

One additional element that Supervisors are monitoring is resources and staff. They verify that each key function is sufficiently resourced and staffed. During their audits the following assessment will be might be relevant:

a) Is there a specific department/team responsible for each key function, b) How many people work within the key function, c) Is the number of dedicated staff for each key function considered proportionate to the undertaking's nature, scale and complexity, d) Is the number of dedicated staff for each key function considered sufficient to ensure an effective and efficient performance of the key function, e) Is the job position, remuneration and skill level of each key function staff in line with other management functions and other key functions, f) Have any resources constraints been identified by the key function holder, g) Was it communicated to the Audit Committee or Board

In case the conclusion from supervisors is that a certain key function is under-staffed this should be raised to the undertaking. Under-staffing of key functions affects the effectiveness of the system of governance and should be addressed by the business.

Supervisors request detailed information from the insurance firms on the remedial measures to be adopted. Several solutions are expected therefore from the businesses which a) recruitment of additional employees, b) employee transfers within the organisation, c) outsourcing, d) business restructuring etc.

Solvency II Directive does not explicitly establish a number of persons who should be responsible for each key function. In a typical situation only one person would be responsible for a given key function. Based on the proportionality principle, one person could be responsible for more than one key function. However, when it is allowed by national law and taking into account the fact that the structure of the system of governance is to be decided by each business, the undertaking may decide, taking into account the nature, scale and complexity of its business, to allocate the responsibility of certain key function to more than one person.

For example, for the actuarial function the responsibility could be split between life and non-life, or split between technical provisions for accounting and solvency purpose. In the cases where this happens and the responsibility is allocated to more than one person, supervisory authorities assess if the situation is adequate or if it could lead to concerns. During their assessment they consider if the business can demonstrate compliance with the following principles:

a) segregation and clear allocation of duties are respected. Criteria to assess include: no dilution of responsibilities, all the areas should be clearly covered, overlap of responsibilities are properly identified and managed.

b) effective communication between the persons responsible for the given key functions, between those persons and the Board and between those persons and the supervisory authority is ensured

c) the requirements in relation to the key functions defined by the Solvency II Directive are being met, such us maintain independence from the operational functions.

If the responsibility for a given key function is divided, the fitness and propriety requirements should naturally apply to both (each and every one of the) persons responsible for the key function, as well as any other requirement established in the Solvency II Directive, the Delegated Regulation and the Supervisor guidelines (Bank of Greece in Greece).

Supervisors are also verifying the proper allocation of responsibilities within each key function. During their audit the also assess:

a) Which are the criteria for the internal distribution of tasks within the persons performing each key function,

b) Are all the areas subject to control of that key function explicitly covered by such distribution of tasks,

c) Are interdependencies duly identified and managed through close cooperation of the relevant staff and proper oversight of the holder of the key function,

d) Is the internal allocation of tasks clearly stated in the undertaking's written policies,

e) Is the allocation of responsibilities revised in case of significant changes of the undertaking,

One of the most important elements of their assessment is to assess if the person(s) who are in charge of the basic functions have:

a) sufficient standing necessary to assume his or her responsibilities, namely if the persons responsible for the key functions have an appropriate level/seniority within the undertaking that coincides with the responsibilities assumed,

b) independence to perform their duty. What is expected to be evidenced is that the function is free from influences that may compromise the function's ability to undertake its duties in an objective, fair and independent manner,

c) full access to confidential information in the undertaking that is relevant to perform their duty,

d) direct access to the Board or the relevant committees, In order to perform the above assessment supervisors will request the minutes of the Board or Committee meetings in which the appointment of the person responsible for each key function was decided in order to understand the terms and conditions of such appointments. Evidence which is usually requested included relevant internal documents in the field of human resources management, written policies affecting those employees responsible for the key functions, in order to better understand the circumstances affecting the individual performance of those persons. A particular focus will be given to the definition of responsibilities, the hierarchy issues, the system of remuneration and any labour condition that could jeopardize their independence or the proper development of their tasks.

The strategic objectives of the business and the objectives assigned to those persons responsible for the key functions together with the mechanisms used for the appraisal of their performance will be assessed through their audits on annual goals of function holders and their individual performance, with particular focus on those indicators which are linked to the remuneration system.

4.4. Fit and Proper

Given the fact that the activities of the Internal Audit are of a significantly wide scope, it has to be ensured that the Internal Audit function is composed by professionals with sufficient knowledge (e.g. insurance related actuarial, economical and legal knowledge as well as fraud risk and IT issues) to be able to challenge the functioning of the audited areas.

The insurance firm is expected have in place a fit and proper policy which will include all necessary criteria for the key function positions.

The assessment of whether a person is proper shall include an assessment of that person's honesty and financial soundness based on evidence regarding their character, personal behavior and business conduct including any criminal, financial and supervisory aspects relevant for the purposes of the assessment.

On the same time the assessment should include checks for misbehavior or infringement of codes of professional conduct or standards of practice applicable provided by relevant associations/institutions (for examples, institutes or societies of actuaries), sanctions received during the exercise of their profession.

Insurance firms are expected to monitor on an ongoing basis the fitness and propriety of key function holders and assess whether further professional training is necessary, so that the staff of the key function is able to meet changing or increasing requirements.

The firm should always be aware of signals that individuals are not acting according to the fit and proper criteria applicable to the key functions. These signals may come from media reports, supervisors, professional associations/institutions, external auditors or from regulatory supervisory interviews and reviews. These signals may refer to the individual performance of that person or more generally to deficiencies directly related to his/her area of responsibility. Following these signals, insurance firms may consider carrying out further investigations with respect the performance of the concerned individual.

Supervisors pay particular attention to the following:

a) if the description of the procedures for assessing fit and proper requirements included in the policy is a general one or if it is detailed,

b) if the criteria used to verify the skills, knowledge, expertise and personal integrity for each specific key function are identified,

c) if the minimum frequency of the assessment is defined,

d) if the policy addresses the proportionality principle and if yes, if it reflects the reality of the undertaking,

e) if the policy provides training objectives/obligations for the key functions (e.g. an annual minimum number of hours of training might be required for high impact undertakings).

Consequently, it is expected that they will assess the implementation of the policy, how it is checked in practice and how it is documented. Good practices mainly identified during their audits, among others, includes:

a) the firm has a list of all the persons assessed,

b) there is a checklist for the fulfilment of the criteria per each person,

c) ongoing assessments in addition to the initial one are also documented,

d) the revision of the policy referred to above is performed regularly.

Moreover, supervisors will consider supplementary ways to verify compliance with fit and proper requirements such as:

a) conducting interviews

b) reviewing the information and process as conducted by the undertaking

c) checking if the individual has been or is a key function holder of other supervised entity, and if yes reviewing information collected during on-site inspections and off-site activities.

Additional approaches may include reviewing the appointment process an undertaking followed, reviewing assessment results, or verifying references. This includes checks such as the reasons and circumstances related to any dismissal or resignation from previous positions reported in the documentation.

Concluding, insurance firms shall establish, implement and maintain documented policies and adequate procedures to ensure that all persons who are responsible for key functions are at all times fit and proper within the meaning of Article 42 of Directive 2009/138/EC.

4.5. Internal Audit within the Insurance firm governance structure

According to the Solvency II legislation and the related guidelines issued by the relevant European Authority "EIOPA", the insurance firm should ensure that the internal audit function does not perform any operational functions and is free from undue influence by any other functions including key functions. Additionally, it has to secure that the internal audit function is not subject to influence from the administrative, management and supervisory board that can impair its operational independence and impartiality during the execution of an audit and when evaluating and reporting the audit results.

All key functions explicitly mentioned in the Solvency II Directive have to be operationally independent. This means key functions have to retain the responsibility for taking the decisions necessary for the proper performance of their duties without undue interference from others. To assess if the key functions are operationally independent Supervisory authorities will consider if the key functions are integrated into the organisational structure in a way that ensures that there is no undue influence, control or constraint exercised on the functions with respect to the performance of their duties and responsibilities by other functions, senior management. Consequently, supervisors will form a view on whether the and influence exists to suppress or tone down key function recommendations. Another aspect on operational independence is that the tasks of the key function are not performed by persons involved in the performance of the tasks the key function has to assess.

The supervisory review includes the identification of the positioning of the key functions within the governance structure of the insurance firms by assessing at least the following elements:

a) How each key function interacts with the business staff

b) The position of the holder of the key function enable him/her to get a comprehensive view of the business

c) The owner of the key function and the persons performing the key function have the authority to directly communicate with operational functions within business

d) Committees are established by the Administrative, Management and Supervisory Body "AMSB" to which the key function is obliged to report periodically

Supervisors assess if the position of the key function holders and the persons performing the key functions within such structure allows them the effective performance of their tasks, facilitating coordination between key functions, proper oversight of the operational functions and fluent communication with the AMSB. A detailed analysis of the relation between key functions and the AMSB and the capacities of the key function holder will be performed by the Supervisors in order to understand the position of the key functions within the governance structure of the business.

Therefore direct access and report to the board without restrictions is one of the key elements that secures the independence of the function and supervisors will assess a) the frequency of the report of each key function to the AMSB, b) how the communication is done, c) Identify if the key function holders have regular meetings with the AMSB, d) Identify if the communication is done only to one member of the AMSB or to all members of the AMSB, e) consider the minutes of the AMSB meetings or take into account the insights made during meetings between supervisors and key function holders.

In order the above to be properly documented and be in force the Insurance firm must have an internal audit policy which covers at least the following areas:

a) the terms and conditions according to which the internal audit function can be called upon to give its opinion or assistance or to carry out other special tasks,

b) internal rules setting out the procedures the person responsible for the internal audit function needs to follow before informing the supervisory authority,

c) the criteria for the rotation of staff assignments

Supervisors will check if the audit policy of the Insurance firm provides for the absence of any impairment of the objectivity of the internal audit function and will analyse the concrete processes, procedures and measures in place in order to preserve objectivity. For such purpose, the expected assessment will include the following thematic areas : a) Is the holder of the internal audit function requested to formally declare on any conflict of interests, b) Are there any rotations foreseen between the team members of the internal audit function in order to avoid conflicts of interest, c) Are there any private relationships between team members of the internal audit function and the members of other units being addressed as potential conflicts of interest, d) Does the audit policy require the internal audit team members to announce a conflict of interest on their own initiative, e) Are the new team members of the internal audit function who have changed positions internally and carried out the audit of their own work.

The audit policy must provide sufficient safeguards for operational independence. During their inspections, supervisors usually (as an example) identify the following “good” and “bad” indicators:

<u>Good indicators</u>

- It is clearly written down and communicated to all units of the undertaking that they are obliged to give full information and access to all documents required by the internal audit function
- All units of the undertaking are obliged to inform the internal audit function when they are suspicious of irregularities.
- If the undertaking defines a procedure that foresees that the unit subject to the internal audit has the opportunity to comment on a draft of the audit report, it is clearly stated that such a comment is only limited on the understanding of the facts, not the assessments are under discussion.

Poor indicators

- There is no rule in the undertaking how one has to proceed when he/she is questioned by the internal audit function.
- There are no specific rules on communication between the audited unit and the internal audit.

Following the analysis of the internal audit policy, supervisors will verify its application in practice. This check may include the assessment of internal documentation concerning an audit assignment, including all previous drafts of the internal audit report, the minutes of interviews and meetings with the audited unit of the undertaking, and in case of concerns any information exchange (e.g. e-mail exchange) between the internal auditors and the staff of the unit under scrutiny.

“Therefore, Internal Auditors should be make sure that the audit procedures are documented and continuously monitored so that they can be adapted to the changing context if needed.

Documentation and its continuous monitoring are indicators of internal audit maturity. From a survey conducted by Sarrens Gerrit (2016)-Benchmarking Internal Audit Maturity- it was evidenced that the older the internal audit department the more likely that audit procedures are documented and monitored. A similar situation was found with organization size when using total assets, where internal audit departments in very large organisations have less documented and monitored audit procedures than medium-sized organisations.” Sarens G. 2016, Benchmarking Internal Audit Maturity.

Supervisors will try to identify whether access to documents or information was restricted for the internal audit function or if the internal auditors had to discuss with units/persons about the insight in and takeover of documents. If that was the case, internal auditors are expected to prove to the supervisors if the above facts have been documented and will also check if the internal audit function had to agree the outcome of its assessment with the units/persons which were subject to the internal audit.

Practical experience has shown that often findings of the internal audit function led to immediate reactions of the unit which is under audit, i.e. they immediately correct mistakes of which they are made aware of by the audit. From a supervisory perspective, that is basically correct, because the earlier the mistake is corrected, the better it is. However, supervisors will check if the mistake, even if solved immediately, is mentioned in the internal audit report to the Audit Committee or the Board.

4.6. Internal Audit Tasks

Internal audit function core task is to perform a proper evaluation of the adequacy and effectiveness of the firms internal control system and other elements of the system of governance. According to Solvency II framework the internal audit function is expected to fulfil each of the following tasks: a) establishing, implementing and maintaining an audit plan, b) taking a risk-based approach in deciding its priorities, c) reporting the audit plan to the Board or Audit Committee, d) issuing recommendations and report to the Board of Audit Committee, e) verifying compliance with the decisions of the Board or Audit Committee based on internal audit recommendations

The Internal Audit function should ensure that the internal audit plan:

a) is based on a methodical risk analysis, taking into account all the activities and the complete system of governance, as well as expected developments of activities and innovations;

b) covers all significant activities that are to be reviewed within a reasonable period of time

The supervisors are expected to analyse the content of the audit plan and the process of establishing, maintaining and implementing it, with special attention to the communication with the Audit Committee or the Board. During their inspections they identify good or poor quality audit plans which mainly include:

Good indicators:

a) the audit plan follows the “audit circle principle”, i.e. all areas of the undertaking are covered over an appropriate time-frame, b) it seems realistic to stick to the plan, also in terms of resources (resources are taken into account in the planning with realistic assumptions), c) there is certain capacity for additional ad hoc audits not covered by the plan, in case there occur any reasons for such audits, d) the audit plan covers topics which are risk-relevant in line with the concrete risks the undertaking is facing or topics which previously have arisen, e) Information exchanged between the Board and internal audit function/interview key function holder is available. f) the board/audit committee accepted the proposed audit plan or came up with good reasons to modify it, which are properly documented, g) the internal audit follows the plan. In case of changes, there are proper reasons duly documented.

Poor indicators:

a)certain areas of the firm are never made subject to an internal audit according to the plan, b) the plan is unrealistic being either too narrow or too ambitious, c) the audit plan mainly covers topics which are not central to the proper functioning of the undertaking, d) information exchanged between board and internal audit function/interview key function holder is not available, e) the Board influences the audit plan, the reason is unclear and not documented, just reference to oral meeting etc, f) actual deviations from the plan without reasoning or without due documentation.

Audit plan and any subsequent amendment to it has to be properly reported to the Audit Committee of the firm.

Supervisors will check the following:

a) Dates in which the audit plan was reported to the Committee

b) Versions of the audit plan and relevant supplementary documentation provided to the Committee

c) Acknowledgement and feedback received from the Committee

d) Communications means between the internal audit function and the Committee with respect to the audit plan: written reports, oral updates, meetings, etc.

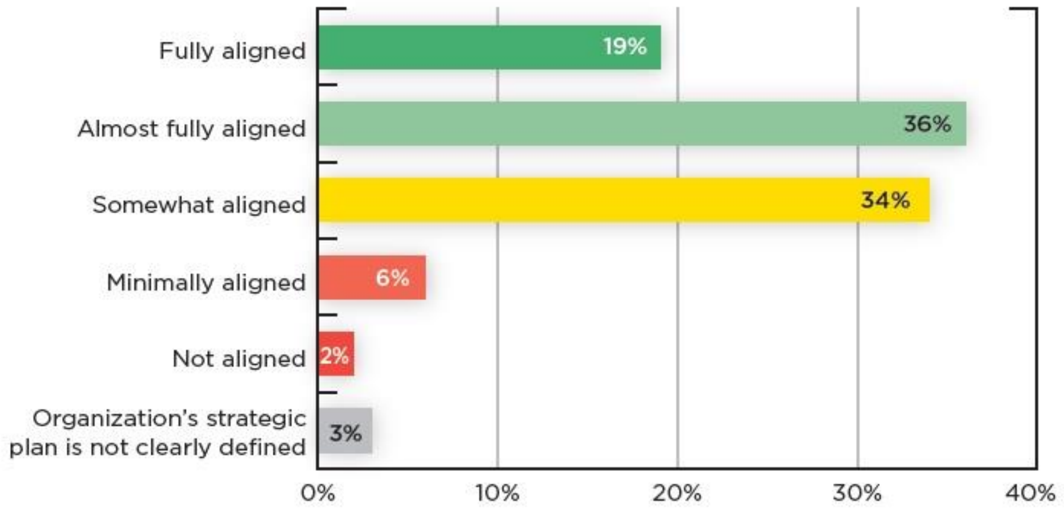
4.7. A Risk based approach

Internal Audit function is expected to follow a risk based approach when planning and carrying out the internal audit activities and should document properly and adequately which areas within the firm are regarded as high risk and why.

It is expected that the high risk areas are prioritised when defining the scope of the audit plan and when deciding the schedule of the monitoring activities to be carried out. Specific areas of the Insurance firms, such as calculation of technical provisions, investments management or reinsurance arrangements, require specific knowledge. Internal Audit planning and priorities should be ready to adapt to important changes in the strategic objectives of the organization. Agility and flexibility is an important asset for becoming a mature internal audit department.

A study performed by Sarrens Gerrit (2016), indicated differences between vatious regions of the world, with the highest proportion of internal audit departments being fully or almost fully aligned with the strategic plan of the organization in Latin America & Caribbean (70%) and Sub-Saharan Africa (65%). The lowest proportion is found in South Asia (42%) and East Asia & Pacific (44%). These results are interesting, perhaps indicating that the countries that more recently adopted the Western practice of internal auditing have chosen alignment with the strategic plan.

Alignment of the Internal Audit Department with the Strategic Plan of the Organization



At any case it is expected that the internal audit plan takes into account the strategic plan of the firm and that the risky areas are not avoided due to their complexity.

Internal audit reports produced will be reviewed by the supervisory authorities in order to form an opinion on the appropriateness and quality of the content.

It is assumed that the members of internal audit function have collectively the sufficient knowledge to be able to challenge the functioning of the audited areas. However, in case of need they can also require competent advice and assistance if they audit a topic for which they lack of specific knowledge or even outsource the specific audit task.

Regarding completeness, the following might be considered: a) contains recommendations as to how to cope with deficiencies, b) names the persons responsible for the measures to be taken, c) indicates the relative importance of the conclusions and d) contains a timeframe in which the measures to be taken should be taken.

During their inspections they identify good or poor indicators regarding the quality of the internal audit reports such as:

Good indicators: 1) The report clearly states its scope (activities/processes/areas subject to review, 2) the link between the scope of the report and the undertaking's internal audit plan is explicit, 3) If the report refers to an issue not previously included in the internal audit plan, a proper reasoning is given, 4) the report contains all relevant information on audits performed (such as methodologies used, findings, recommendations and follow-up status), 5) The report reflects the inputs used for the audits and the individuals with whom the internal audit function has particularly interact (staff/ externals) during the auditing, 6) Any supplementary analysis or documentation referred but not included in the report is properly recorded and at the disposal of the AMSB (and the supervisory authority), 7) The conclusions of the report are clear. The report specifies who is responsible for the following up on defects and shortcomings identified and taking appropriate measures and within what time limits, 8) time limits for actions recommended are justified, especially in case of long deadlines, 9) The report includes follow up of those significant issues identified in previous reports to the AMSB and gives an overview of the state of affairs regarding the implementation of the audit plan, 10) The report is signed by the holder of the internal audit function and there is record of any other staff performing the audit activities referred, 11) There is evidence of the date in which the report is forwarded to the AMSB and properly acknowledged, 12) In case the AMSB has established an Audit Committee, there is evidence that the AMSB as a whole had access to the internal audit report and have discussed the internal audit recommendations

Poor indicators : 1) the scope of the report is ambiguous, 2) The link with the internal audit plan not explicit, 3) The report contains only vague descriptions of the audits performed, 4) Lack of detail on specific inputs used and individuals/teams contacted, 5) The report refers to supplementary analysis or documentation with no supporting evidence, 6) The conclusions of the report are ambiguous or too generic, 7) Long deadlines for remedy actions without proper justification, 8) The track of the significant issues in previous reports is missing, 9) There is no proven record of the persons performing the audits and approving the results, 10) Uncertainty of the date in which the report was forwarded to the Board and properly acknowledged, 11) There is no evidence of the report being made available to all members; or no evidence of discussions on the internal audit report at the level of the Audit Committee, 12) The report is discussed by the Audit Committee but not at the Board level.

The recommendations made by the internal audit function which are extracted from the internal audit reports and the subsequent decisions adopted by the Board (extracted from the minutes of the Board meetings) are also included within the supervisor tasks.

Where relevant, for these Board decisions, supervisors commonly request from the internal audit function the monitoring activities planned and carried out and results of such monitoring activities.

Follow up with respect to recommendations in previous reports is a critical point and supervisors ask for the documented results of the compliance checks and documentation related to the tracking of open issues.

4.8. Internal Audit Tasks in Insurance Sector

In respect of Solvency II compliance items in each audit assignment, Internal Audit will perform specific steps to evaluate the application of risk related policies, set limits, the review of use tests as well as the reliability of data that will feed risk reporting and the Own Risk and Solvency Assessment 'ORSA' process. An assessment of the components of the system of governance" with particular attention to:

- the content, approval, application and reporting in respect of the remuneration policy (Advice on System of Governance);
- the process in place for ensuring compliance with regulatory provisions regarding outsourcing (art. 47-49).

Assessment of the "Risk Management function" and of the "Risk Management System" should consider the Solvency II requirements will have to be carried out by the Internal Audit through periodic evaluations and tests of the overall risk management process, as well as the appropriateness of internal controls. In general, Internal Audit evaluates the independence and the global effectiveness of the insurance company's risk management function.

Assessment of the Compliance function should consider the European supervisory authorities' requirements relating to the Solvency II Directive

Assessment of the process for designing and implementing risk models with specific focus on control activities implemented for ensuring:

- the adequacy of the model documentation and of the internal validation procedure
- compliance with the procedure to apply in the event of model change
- compliance with the reporting requirements
- the degree of inclusion of the different risks in the model
- the embedding of the model in the risk management
- the integrity of the management processing and information systems
- the quality of the data sources (consistency, reliability, continuity, timeliness, synchronism)
- the quality and the accuracy of the model and of the "ex post" control
- the quality of the stress testing
- the accuracy of MCR & SCR calculation
- the use test

Assessment of the actuarial function should consider the European supervisory authorities' requirements.

Assessment of the reinsurance management process should include evaluating the achievement of this process's objectives in terms of the company's solvency and profitability as well as the safeguarding of assets through optimisation of the reinsurance coverage in line with the company's risk appetite profile.

In addition, the evaluation should cover the processes for monitoring reinsurers' solvency, ceded reinsurance premiums and claims interventions.

Internal Audit, in its assurance role, will review the Own Risk and Solvency Assessment (ORSA) document process and outcome as it will be one of the key strategic decision-making processes of the undertaking as well as an important element in the risk management of the company. This review should facilitate the

Board of Directors and Executive Committee in discharging their responsibility to approve the ORSA policy and to ensure that the ORSA process is appropriately designed and implemented.

4.9. Consulting roles in the Solvency II context

As far as internal audit principles are concerned, the achievement of Internal Audit's plan must be prioritized over the performance of any consulting activity. In addition, consulting services should not result in operational or management responsibility being taken by Internal Audit. Such responsibilities are not compatible with the assurance role of Internal Audit.

Special attention should be paid to the role of Internal Audit in the Solvency II project implementation. All European insurance and reinsurance undertaking will have launched major projects aimed at aligning their operations to the new requirements, including the definition, if in scope, of the internal model.

Internal Audit should not be excluded from these projects as they are so central to the structure and performance of the risk management and internal control systems, but this participation should be carefully structured in order not to compromise the requisite independence and objectivity criteria.

The Internal Audit function should be prepared to provide support to the company in Solvency II alignment, and in particular in the following areas: a) Governance of the project, b) Written Policies and Procedures, c) Data quality, d) Internal model.

As already, implementation of Solvency II (policies, models, reports, limits, validation etc) is not considered a mission of Internal Audit. The Internal Audit is not expected to participate in the design or validation process of the model, nor will Internal Audit participate in the ORSA process (preparing, approving, evidencing and documenting ORSA outcome), nor re-perform the calculation of solvency margins or make quantitative assessments of risk undertaking. Design, implementation, testing and validation of internal models, as stated in article 44 of the Solvency II Directive, are tasks of the risk management function.

The Internal Audit therefore is not expected and must not participate on preparing, approving, validating or documenting the ORSA outcome, in order to ensure that it does not compromise its independent assurance role over the adequacy of processes from an internal control point of view.

4.10. Interactions with other key functions - Segregation of tasks

Segregation of tasks is required in order to prevent, wherever possible, a conflict of interests between functions. In cases where segregation of tasks is not possible, conflict of interests should be identified and managed appropriately.

Insurance firms are expected to verify that the segregation of tasks between functions in the undertaking is consistent with the tasks for each key function as defined in the Solvency II framework and to identify any inappropriate overlaps of activities and/or potential conflict of interests. Proper communication and cooperation between key functions is also expected to be verified.

Supervisors will form a view on the intra-structural relationship between key functions holders and between the key functions holders and holders of other functions inside the undertaking.

The understanding of the structure will extend in order to be assessed if the persons performing the key functions (other than the key function holders) are responsible for the performance of more than one function.

The assessment of clear segregation and appropriate allocation of responsibilities is performed by evaluating a) how each person responsible for a key function is aware of its role in the structure and in the global processes, and b) the frequency of the review of segregation of duties and responsibilities (and when it was last updated).

4.11. Conflicts of interest between functions

Insufficiency of resources within a firm usually leads towards aggregation solutions (e.g. multiple tasks allocated to few skilled persons) or dependencies on external competences (including other internal functions). However, skills, knowledge and expertise of persons performing key functions necessary to carry out the tasks or responsibilities allocated to them are very specific and allocating additional tasks includes the risk of performing a function without the required specialization.

Insurance firms are expected to have processes and procedures in place to prevent conflicts of interest, with specific focus on:

a) correlations between activities, related to different key functions, carried out by the same persons or units

b) correlations between activities of key functions and related activities carried out by other functions in the firm,

c) powers of delegation,

d) resources involved in the function’s activities, in particular, resources with multiple tasks,

e) responsibilities, including the person responsible for key functions in case of outsourcing,

f) previous work and tasks performed by the persons performing key functions,

Generally, potential conflicts of interest should be avoided. However, in the case where that is not possible, they always have to be identified and managed by the firm.

Examples of mitigating factors put in place to identify and manage conflict of interests, are usually the following:

a) Higher frequency of reporting to Board or Audit Committee

b) Higher involvement of the Board/Audit Committee, guaranteeing the application of the four eyes principle, including being more specific in the areas to be included in the regular reporting to Board

c) Specific tasks to be developed by the internal audit function;

d) Outsourcing of validations/controls of some aspects of the audit engagement

e) Higher standards regarding documentation, e.g. proper documentation of main decisions where conflict of interests may arise.

4.12. Outsourcing of Key functions

Any insurance firm which outsources or proposes to outsource key functions to a service provider shall establish a written outsourcing policy which takes into account the impact of outsourcing on its business and the reporting and monitoring arrangements to be implemented in cases of outsourcing.

The firm shall ensure that the terms and conditions of the outsourcing agreement are consistent with the firm's obligations as provided for in Article 49 of Directive 2009/138/EC. When outsourcing critical or important operational functions or activities the firm shall prove that has taken into account the extent to which it controls the service provider or has the ability to influence its actions.

As a general rule, the insurance firm is expected to apply the fit and proper procedures in assessing persons employed by the service provider or sub service provider to perform an outsourced key function. Additionally, it is expected that the firm will designate a person within the undertaking with overall responsibility for the outsourced key function who is fit and proper and possesses sufficient knowledge and experience regarding the outsourced key function to be able to challenge the performance and results of the service provider. This designated person should be considered as the person responsible for the key function according to Article 42 (2) of Solvency II that needs to be notified to the supervisory authority.

When choosing the service provider for any critical or important operational functions or activities, the Board or Audit Committee shall ensure that: (a) a detailed examination is performed to ensure that the potential service provider has the ability, the capacity and any authorisation required by law to deliver the required functions or activities satisfactorily, taking into account the undertaking's objectives and needs, (b) the service provider has adopted all means to ensure that no explicit or potential conflict of interests jeopardize the fulfilment of the needs of the outsourcing undertaking, (c) a written agreement is entered into between the firm and the service provider which clearly defines the respective rights and obligations of the undertaking and the service provider, (d)the general terms and conditions of the outsourcing agreement are clearly explained to the Board or Audit Committee, (e) the outsourcing does not entail the breaching of any law in particular with regard to rules on data protection, (f) the service provider is subject to the same provisions on the safety and confidentiality of information relating to the firm or to its policyholders or beneficiaries that are applicable to the firm.

The written agreement for the outsourced activity shall in particular clearly state all of the following requirements: (a) the duties and responsibilities of both parties involved, (b) the service provider's commitment to comply with all applicable laws, regulatory requirements and guidelines as well as policies approved by the firm and to cooperate with the supervisory authority with regard to the outsourced function or activity, (c) the service provider's obligation to disclose any development which may have a material impact on its ability to carry out the outsourced functions and activities effectively and in compliance with applicable laws and regulatory requirement, (d) a notice period for the termination of the contract by the service provider which is long enough to enable the firm to find an alternative solution, (e) that the firm is able to terminate the arrangement for outsourcing where necessary without detriment to the continuity and quality of its provision of services to policyholders; (f) that the firm reserves the right to be informed about the outsourced functions and activities and their performance by the services provider as well as a right to issue general guidelines and individual instructions at the address of the service provider, as to what has to be taken into account when performing the outsourced functions or activities, g) that the service provider shall protect any confidential information relating to the firm and its policyholders, beneficiaries, employees, contracting parties and all other persons, (h) that the firm, its external auditor and the supervisory authority have effective access to all information relating to the outsourced functions and activities including carrying out on-site inspections of the business premises of the service provider; (i) that, where appropriate and necessary for the purposes of supervision, the supervisory authority may address questions directly to the service provider to which the service provider shall reply, (j) that the firm may obtain information about the outsourced activities and may issue instructions concerning the outsourced activities and functions, (k) the terms and conditions, where applicable, under which the service provider may sub-outsource any of the outsourced functions and activities, (l) that the service provider's duties and responsibilities deriving from its agreement with the firm shall remain unaffected by any sub-outsourcing taking place according to point (k).

The firm that is outsourcing critical or important operational functions or activities shall fulfil all of the following requirements: (a) ensure that relevant aspects of the service provider's risk management and internal control systems are adequate to ensure compliance with Article 49(2)(a) and (b) of Directive 2009/138/EC, (b) adequately take account of the outsourced activities in its risk management and internal control systems to ensure compliance with Article 49(2)(a) and (b) of Directive 2009/138/EC, (c) verify that the service provider has the necessary financial resources to perform the additional tasks in a proper and reliable way, and that all staff of the service provider who will be involved in providing the outsourced functions or activities are sufficiently qualified and reliable, (d) ensure that the service provider has adequate contingency plans in place to deal with emergency situations or business disruptions and periodically tests backup facilities where necessary, taking into account the outsourced functions and activities.

- Supervisory Approach

When insurance firms outsource a key function, supervisory authorities receive a prior notification by the firm, including the indication of the person within the undertaking itself with the overall responsibility of the outsourced key functions.

Supervisors analyse the documentation from the firm (e.g. outsourcing policy, outsourcing agreement, the fitness of person with overall responsibility) to assess if a due process has been followed and whether the restrictions from the Solvency II Directive were properly considered (i.e. compliance check in accordance with Article 49 of the Solvency II Directive and Article 274 of the Delegated Regulation).

Supervisors expect that the outsourcing policy of the insurance undertaking as well as the terms and conditions of the outsourcing agreement reflect the way how the firm will be able to fulfil its obligations under the Solvency II Directive. They may request access to all relevant data held by the outsourcing service provider in order to perform checks on the outsourced activities and conclude if these are at a satisfactory level.

Supervisors main target is to gain the appropriate understanding of the outsourcing strategy of the firm, including the reasons for the decision to outsource but also the way the service provider influences the decisions of the undertaking (e.g. in cases of intra-group outsourcing).

For the critical functions, if outsourced, supervisor's assessment includes checks of whether: a) the firm is aware that the Board/Audit Committee retains ultimate responsibility for discharging its obligations, and the key function holders within the undertaking will remain responsible for answering on certain topics

b) the remuneration system of the service provider does not conflict with the proper operation of the function,

c) the firm ensures that all persons working in that function at the service provider are fit and proper,

d) in case sub-outsourcing is permitted by the contract if the firm ensured that it is informed by the service provider of any sub-outsourcing;

e) the firm also considered in its own contingency planning how, if needed, the outsourced can be taken over by a new service provider, or bring it back in-house, as appropriate,

f) the firm has considered if service provider regulations do not restrict access to information about the outsourced activity or function

5. CONCLUSIONS

Summarising our main conclusions, conformance with the internal audit principles is required and essential for the professional practice of internal auditing and mandatory guidance has been developed through core principles, auditing standards and the code of ethics.

Internal Audit is expected to demonstrate integrity, quality and continuous improvement, due professional care, effective communication, objectivity and independence.

A high level of independence is a key factor if Internal Audit is to perform its primary role as the assurance function for the Board.

One of the most important challenges that Solvency II initiated regarding Internal Audit is Internal Audit's position within the Company's organizational chart in order to be able to act independently through direct and unrestricted access to the Board.

Supervisory authority expectations include the integration of the key functions into the organisational structure in a way that ensures that there is no undue influence, control or constraint exercised on the functions with respect to the performance of their duties and responsibilities by other functions, senior management.

Operational independence is also achieved through the audit policy which is expected to be verified by the Supervisor in practice.

One additional element that Supervisors assess is whether the Internal Audit function is composed by professionals with sufficient knowledge. It is expected that the insurance firm will have in place a fit and proper policy which will include all necessary criteria for the key function positions, including Internal Audit. Supervisors also expect that the insurance firms have established, implemented and maintained policies and adequate procedures to ensure that all persons who are responsible for key functions are at all times fit and proper.

In particular, the new framework "Solvency II" includes the requirement of knowledge enhancement on the areas of governance, risk assessment and actuarial for the insurance internal auditors, in order to be able to ensure confidence in the new legislation and to ensure the right capabilities are in place to assess the controls which should be implemented in the new processes.

Furthermore, from this study it was identified that Supervisors also monitor resources and staff. In case the conclusion from supervisors is that Internal Audit (or other key function) is under-staffed this will be raised to the insurance firm, who will have to take actions of remediation. Under-staffing of key functions is considered as a major issue that may affect the effectiveness of the system of governance and will have to be addressed by the firm.

With respect to the Internal Audit activity, Supervisor expects that the Internal Audit plan is based on a methodical risk analysis, taking into account all the activities and the complete system of governance, as well as expected developments of activities and innovations and covers all significant activities that are to be reviewed within a reasonable period of time. The content will be analysed by the supervisors in order to understand the establishment process, maintenance process and implementation. Special attention will be given to the communication with the Audit Committee.

Good indicators include: a) the audit plan follows the "audit circle principle", b) resources are taken into account in the planning with realistic assumptions, c) there is certain capacity for additional ad hoc audits not covered by the plan, d) the audit plan covers topics which are risk-relevant in line with the concrete risks the undertaking is facing or topics which previously have arisen, e) the internal audit follows the plan, etc. Poor indicators: a) certain areas of the firm are never made subject to an internal audit according to the plan, b) the plan is unrealistic being either too narrow or too ambitious, c) actual deviations from the plan without reasoning or without due documentation etc.

Main tasks in insurance sector include the a) evaluation of the application of risk related policies, b) set limits and c) the reliability of data that will feed risk reporting and the Own Risk and Solvency Assessment 'ORSA' process.

In general, Internal Audit evaluates the independence and the global effectiveness of the insurance company's risk management function.

Internal Audit, in its assurance role, will review the Own Risk and Solvency Assessment (ORSA) document process and outcome as it will be one of the key strategic decision-making processes of the undertaking as well as an important element in the risk management of the company. This review should facilitate the

Board of Directors and Executive Committee in discharging their responsibility to approve the ORSA policy and to ensure that the ORSA process is appropriately designed and implemented.

In conclusion, having thoroughly analysed the main components of Internal Audit requirements under the new legislation and the Supervision approach, we are of the opinion that the requirements set out in Solvency II as to the work, structure and organisation of an Internal Audit department are not new as they follow the guidelines already defined by the Institute of Internal Auditors for the profession.

However, Solvency II presents a challenge for the profession as there may still be a long way to go for many insurance firms to fully comply with the new regulation and the existing IIA Standards.

This applies in particular in the area of the independence of Internal Audit. This is crucial, if Internal Audit wants to act as the objective assurance function for the Board.

Another challenge is the extension of the audit universe by Solvency II, which requires an internal audit function to possess additional skills.

Internal Audit will need to ensure an adequate professional knowledge through investment in human capital as well as insourcing expertise as appropriate.

Last but not least the creation of a new governance system by Solvency II means a challenge not only for Internal Audit but for the insurance industry as a whole, if the governance system is to work effectively.

I hereby declare that, in accordance with article 8 of Law 1599/1986 and article 2.4.6 par. 3 of Law 1256/1982, this thesis/dissertation is solely a product of personal work and does not infringe any intellectual property rights of third parties and is not the product of a partial or total plagiarism, and the sources used are strictly limited to the bibliographic references.

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