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Editors

The Governance of Insurance Undertakings

Corporate Law and Insurance Regulation

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Contents

Part I The System of Governance of Insurance Undertakings

Corporate Governance and the So-Called 'Four-Eyes Principle' 3
Niccolò Abriani and Armando Catania

The Risk Management System, the Risk Culture and the Duties of the Insurers' Directors 25
Pierpaolo Marano and Simon Grima

The Role of the Compliance Function in the Process of Managing the Risk of Non-Compliance in an Insurance Undertaking 47
Wojciech Paś

Insurance Outsourcing: A Legal Analysis 71
Monika Szaraniec

Remuneration Policies of Insurance Undertakings in Europe: Principles for a Deeply Heterogeneous Reality 95
Covadonga Díaz Llavona

Corporate Governance Standards for Insurers in Singapore 117
Christopher Chen

Part II Insurance Business and Corporate Law

Recovery and Resolution of Insurance Companies and Director's Duties 141
Michele Siri and Arthur Van den Hurk

Restructuring, Winding-Up & Portfolio Transfer of Insurance Companies in Distress 171
Kyriaki Noussia, Peter Underwood, and Stergios Frastanlis

Insurance in M&A Transactions 199
Angelo Borselli

The Algorithmic Future of Insurance Supervision in the EU: A Reality Check 217
Andromachi Georgosouli and Jeremmy Okonjo

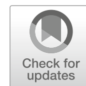
Financial Reporting in Insurance and International Financial Reporting Standards 245
Katica Tomic

Recent Directions in the Regulation of Insurance Claims Handling in the United Kingdom and Australia: A Model for Other Jurisdictions to Consider? 263
Robin Bowley

Business Registration Data as the Best Vehicle to Achieve KYC and AML for Business 297
Erick Rincón Cárdenas and Valeria Martinez Molano

The Influence of Public and Corporate Insurance Law on the Application of Private International Law: Selected Issues 317
Mariusz Fras

Remuneration Policies of Insurance Undertakings in Europe: Principles for a Deeply Heterogeneous Reality



Covadonga Díaz Llavona

Abstract The provisions on remuneration policies and practices under the Solvency II framework have been recently supplemented by an Opinion published by the European Insurance and Occupational Pensions Authority. The lack of any high-level standard in this respect in the Directive and the open character of most of the principles and orientations entailed in these instruments have led to a landscape of different national implementation rules, which also need to be connected to the different corporate governance provisions of each Member State.

This chapter aims to analyse the European provisions about remuneration in the insurance industry and connect them first to those provided for the banking sector, and then to the Member States regimes that arise from both the implementation of the EU policies and the international rules, with the purpose of pointing out the weaker aspects of the existing regulation and proposing some possible ways for improvement.

1 Introduction

On 1 January 2016, the Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II Directive) entered into force.[1]

In relation to the present chapter, the provisions of Solvency II Directive were supplemented by the Commission Delegated Regulation (EU) 2015/35, and more recently, by an Opinion of the European Insurance and Occupational Pensions

[1] Although the Solvency II framework is working well, the Directive itself foresaw a review of its provisions at the latest by 1 January 2021 to improve the existing regulation based on the experience during the past years of application and to consider the changes in the economic context. References to this review will be made later.

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Authority (EIOPA) on the supervision of remuneration principles in the insurance and reinsurance sector (EIOPA -BoS-20-040, 31 January 2020).

While the guidelines are few and apparently clear, the way in which the European Institutions have incorporated the new remuneration provisions via delegated act, without including an express mention in the Directive itself, entails many problems that are addressed in the chapter. As will be shown, the poor structure of the insurance sector provisions is in contrast to the much better constructed regime of the remuneration provisions included in the CRD III and CRD IV package for the banking sector. A comparison of both schemes can reveal some means for improvement in the insurance sector. As it gets analysed in the latter part of the chapter, the insurance market shows a complex situation regarding remuneration policies, arising mainly from two factors: on the one hand, the European insurance industry presents a wide range of organisational structures and business models, especially regarding size and risk profile. These differences demand a flexible application of the rules and, in some cases, the taking into account of the proportionality principle. On the other hand, the application of these special rules to insurance undertakings does not prevent these undertakings from also being subject to the company law of their country of origin. It is a known fact that the structure of the governing bodies of the companies and the legal regime applicable to them vary greatly between Member States, which makes it more difficult to determine the scope and application of provisions contained in the above-mentioned insurance industry's specific rules on remuneration policies.

The chapter aims to analyse the European provisions about remuneration in the insurance industry and connect them first to those provided for the banking sector, and then to the Member States regimes that arise from both the implementation of the EU policies and the international rules, with the aim of pointing out the weaker aspects of the existing regulation and proposing some possible ways for improvement.

2 European Regulatory and Supervisory Framework for Remuneration Policies in Insurance Undertakings

The introduction of Solvency II regime involved a complete transformation of the prudential framework for insurance firms in the European Union. The new risk-based approach was achieved by the Directive and the delegated acts that followed through a three-pillar structure: quantitative requirements (Pillar I), governance of the undertaking and supervisory activity (Pillar II) and supervisory reporting and public disclosure (Pillar III). The issues addressed in this study fall under the second pillar, which sets out requirements for risk management, governance and process of supervision.

The Directive itself does not include specific remuneration provisions, but it does dedicate the whole Section 2 of Chapter IV to the system of governance of insurance

and reinsurance undertakings. Articles 41 to 50 set out some high-level principles that apply to all aspects of the system of governance of the firms and, therefore, also to their remuneration system. At this respect, among those principles, as provisions connected in certain way to the remuneration system of undertakings, one can refer to the need of a transparent organisational structure with clear allocation and appropriate segregation of responsibilities (Art. 41), the fit and proper requirements for persons who effectively run the undertaking or have other key functions (qualification and experience, and persons of good repute) (Arts. 42–43), or with a clearer link to remuneration, the need to implement an effective risk-management system to identify, measure, monitor, manage and report on a continuous basis the risks to which the undertaking could be exposed (Arts. 44–45), or the need for an internal control system with four control functions: risk-management, compliance, internal audit, actuarial and risk-management (Arts. 46–49, 246).[2] The connection with remuneration is, in any case, indirect, as there is no specific provision on compensation of staff in the Directive.

Following the Lamfalussy process, the principles entailed in the Directive were further developed by the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014. On the governance system, Chapter IX of the Regulation includes detailed provisions in five aspects: Elements of the system of governance, Functions, Fit and proper requirements, Outsourcing, and Remuneration policy. As said, remuneration is the only element not expressly mentioned in the higher standard, but it is considered as a key issue for risk management in the Delegated Regulation. As expressed in Recital 102 of the Regulation, 'remuneration policies and practices which provide incentives to take risks that exceed the approved risk tolerance limits of insurance and reinsurance undertakings can undermine the effective risk management of such undertakings. It is therefore necessary to provide for requirements on remuneration for the purposes of the sound and prudent management of the business and in order to prevent remuneration arrangements which encourage excessive risk-taking'.

As a general requirement for the system of governance, Article 258.1.l) calls for a written remuneration policy, even when the Directive does not include it among the other areas in which a written policy is required.[3] The approval process of this written policy should follow the same requirements as the other policies expressly mentioned in the Directive and, therefore, on the one hand, it should be approved by the administrative, management or supervisory body of the insurance or reinsurance undertaking (41.3 Directive)[4] and, on the other hand, the remuneration policy shall

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[2] As will be shown, the EC Regulation, which does include for the first time specific requirements on remuneration of staff in insurance undertakings, sets the link with the Directive via the need of a sound and prudent management of the business.

[3] The inclusion of remuneration in Article 41.3 of the Directive is one of the proposals included by EIOPA in its Opinion on the 2020 review of Solvency II—EIOPA-BoS-20/749, 17 December 2020, paragraph 8.47.

[4] As will be shown, this acts as a minimum requirement often exceeded by stricter measures at national level.

be reviewed at least annually and in the case of any significant change in the system or area concerned.

2.1 European Principles Relating Remuneration Policy and Practices in the Insurance Sector

As is the case with the Directive, the Regulation sets out nothing but principles to be observed by companies in shaping their remuneration policies. Article 275 includes seven main principles and another eight that specify the way in which the part of remuneration connected with tasks and performance of some members of the staff should be designed by the undertaking.

These following can be highlighted as the main principles:

- Alignment between remuneration policy and practices and the risk management strategy of the undertaking and the long-term business and its performance as a whole
- Respect of the risk tolerance limits of the undertaking
- Consideration of the tasks and performance of the administrative, management or supervisory body (AMSB), persons who run the undertaking or have other key functions, or other categories of staff whose professional activities have a material impact on the undertaking's risk profile
- Responsibility of the AMSB for the oversight of the remuneration policy's implementation
- Need of an effective governance on remuneration
- Need of an independent remuneration committee to support the AMSB in the oversight, implementation and operation of the remuneration policies and practices, if appropriate, in relation to the significance of the undertaking (size and internal organisation)
- Disclosure of the remuneration policy to all members of the staff

Risks arise mainly from the variable part of remunerations, and this part is usually connected with the performance of the remunerated person. As said, in turn, the third principle referred to the consideration of the tasks and performance of those persons who run the company or have key functions in it is developed in other eight ones:

- Need for balance between the fixed and variable components of the remuneration schemes and for the fixed component to represent a sufficiently high proportion of the total remuneration. The objective is to avoid that an excessive dependence of a performance-related remuneration could artificially alter individuals' behaviour and, conversely, that a decision of not paying the variable remuneration considering the situation of the undertaking could be made without excessively affecting the remuneration received.

- In case of performance-related variable remuneration, the principle of connection between the total amount and the performance, not only of the individual, but also of his/her business unit and the overall result of the undertaking or of the group.
- Need for a substantial deferred component of the variable remuneration to connect it with the mid and long-term results of the undertaking. The deferral period shall not be less than three years.
- Consideration of both financial and non-financial criteria when assessing an individual's performance.
- Inclusion of a downwards adjustment for exposure to current and future risks in the measurement of performance.
- Relation between termination payments and performance achieved over the whole period of activity without rewarding failure.
- Commitment of persons subject to the remuneration policy to not use hedging strategies or insurances that could undermine the risk alignment effects of their remuneration arrangement.
- Independence of the variable part of remuneration of staff engaged in the four key functions (risk management, compliance, internal audit and actuarial) from the performance of the units and areas submitted to their control.

As this is the first level of regulation for the remuneration principles,[5] there are many concepts that remain quite open and need further accuracy. That is the case with the sufficiently high proportion of the fixed component of the remuneration, or with the substantial deferred component of the variable remuneration. This lack of definition led in the first years of implementation of the Directive and the Regulation to divergent practices across the European Union, and that is why the European Insurance and Occupational Pensions Authority (EIOPA) released the *Opinion on the supervision of remuneration principles in the insurance and reinsurance sector*, in April 2020 (EIOPA-BoS-20-040, 31 January 2020).

2.2 EIOPA's Perspective on Remuneration in the Insurance Industry

The Opinion looks for a more consistent approach and convergence of national supervisory practices on the implementation of remuneration principles in the insurance sector. As it is known, opinions are non-binding instruments and therefore this one does not prevent the Supervisory Authorities to consider stricter criteria when appropriate or, reversely, to adopt a more flexible approach in supervision of low-risk undertakings. Despite this non-binding character, the Opinion acts as a very valuable tool of convergence through a better definition of the open concepts

[5] As will be shown in Sect. 3 of this chapter, it would be preferable that the Directive itself included at least some high-level principles on remuneration policies and practices of staff in insurance undertakings, in line with the structure followed by the European institutions in the banking sector.

mentioned in the Regulation. Nevertheless, the selection of an instrument like the opinion, non-compulsory and less detailed than other tools available for EIOPA, could restrict its future scope. As it will be pointed out, there are many questions that remain unsolved. Even when probably the need for an in-depth regulation is higher in the banking sector, a framework like the one existing for banks—including the Guidelines of the European Banking Authority (EBA) on sound remuneration policies[6]—could have led to a more finished result.[7] This idea will be approached again later in the text.

2.2.1 Scope

As pointed out, risk arising from the compensation policy of the undertaking appears mostly in connection with the variable part of the remuneration and on remunerations of the highest paid employees. Hence, the instrument narrows its scope of application according to two cumulative criteria:

- Category of staff member: only AMSB members, other executive directors who effectively run the undertaking, key function holders (in the sense of the key functions already seen), or other categories of staff whose activities have material impact on the undertakings' risk profile.
- Minimum amount of the variable component of the annual remuneration: over EUR 50,000 provided it represents more than 1/3 of the staff member's total annual remuneration.

2.2.2 Developed Aspects

The Opinion addresses the four more indeterminate and open principles of the Regulation by establishing several benchmarks for the evaluation of the remuneration policies and practices at national level.

- On the need for balance between fixed and variable components of remuneration and for the fixed part to represent a sufficiently high proportion of the total amount, the text establishes a threshold of 1:1 ratio, i.e. the amount of the variable component should not exceed that of the fixed one.
- On the portion of variable remuneration that must be deferred, EIOPA sets the benchmark in the 40% of the total variable amount. Even when it is only an

[6]Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013, EBA/GL/2015/22, 21 December 2015.

[7]About the need for more detailed provisions in the insurance sector, as is the case with the banking activity, vid. Butera and Montemaggiori (2018), p. 41 et seq.

indicative threshold, it helps in defining the open expression 'substantial portion' used in the Regulation.

If the 1:1 ratio of variable remuneration is not observed (a deviation could be considered justified by the supervisory authority in view of the risk profile of the undertaking), then the proportion of the deferred component should also be higher.

- The text also refines the principle of consideration of both financial and non-financial criteria when assessing an individual's performance. These criteria refer to the quantitative and qualitative requirements set out in the remuneration policy for the pay-out of the variable remuneration. Criteria must include achievable objectives and measures as well as consequences of the non-compliance, and the assessment should consider a multi-year framework.
- Quantitative and qualitative requirements should be balanced too, but at this point, the Opinion does not set out any specific ratio. It does cite a distribution of 80% financial and 20% non-financial as a potentially not balanced division, which could lead to the conclusion that in this respect, there is no need of a 1:1 ratio, as is the case with variable and fixed components of the remuneration. A higher proportion of quantitative requirements seems to be acceptable, provided that it does not reach such a high percentage.[8]
- The principle of inclusion of a downwards adjustment for exposure to current and future risks in the measurement of performance also gets the attention of EIOPA. This mechanism should adjust remuneration not only when individuals do not meet their personal objectives, but also when their business units or the undertaking as a whole fail to do so. The downward adjustment inserted in the remuneration policy must include examples of how it would work and the rationale behind its dynamic. The Opinion's approach at this point is rather superficial and although it refers to all kind of adjustments—even with an express reference to clawback clauses—it does not go into any further analysis.
- Last point addressed refers to the principle of connection between termination payments and performance achieved over the whole period of activity. At this respect, the text distinguishes between those termination payments which are generally considered as variable remuneration and those which generally do not have this qualification. According to this general consideration of the payments, outside the concept of variable remuneration fall all mandatory payments (labour law, settled in a court decision), those that respond to a predefined generic formula, and those connected to a non-competition clause, but only, in this latter case, up to the amount of the fixed remuneration which would have been paid if staff where still employed.

  As generally considered variable remuneration, the text refers to any payment that arose from a termination because of a failure of the undertaking or because of a material reduction of the undertakings' activities in which the staff was active,

[8] In this respect, vid. Esquerra Resa (2020), p. 11 et seq.

or finally, to payments that arose from a settlement between the undertaking and the staff member in case of a labour dispute.

One finds here again a completely open formula[9] that leaves room for very different interpretations, starting with what is considered variable remuneration as it is expressed in terms of what is generally understood as such.

As shown, although the Opinion represents a significant step forward for the interpretation of the principles included in the Regulation, some provisions yet remain very undetermined and leave a very broad margin of assessment to undertakings and to the supervisory dialogue with them. This may be aligned with the different risk profiles of undertakings but can also lead to deep differences in treatment between Member States, and even to an undesirable situation of legal uncertainty in the insurance sector.

3 Regulatory Framework of Remuneration Policies and Practices in the Banking Sector: Means for Improvement in the Insurance and Reinsurance Sector

The legal treatment of remuneration policies and practices in the banking sector received the attention of the European legislator years earlier than in the insurance sector.

Following the financial crisis of 2008, several reports outlined that, while failures in the governance system have not been the main cause of the crisis, they did have played certain role.[10] A better bank governance would without any doubt contribute to reduce the likelihood of new bank crisis situations.

Among the identified failures in the governance system, the danger of certain incentives for directors and senior staff was frequently pointed out.[11] While some of these remuneration policies turned out to be inadequate for any firm, they showed particularly harmful effects in the banking sector. The variable and equity-based compensations stimulated dangerous behaviours consisting of generating short-term earnings while taking on high long-term risks.

[9] Much more open than the provisions included in point 9.3 of the EBA's Guidelines.

[10] See in this respect the so-known *Larosière Report* of 25 February 2009, of the High-level Group of Financial Supervision in the EU. Among other causes of the financial crisis, it mentions, as a corporate governance failure, in paragraph 24 'the remuneration and incentive schemes within financial institutions (that) contributed to excessive risk-taking by rewarding short-term expansion of the volume of (risky) trades rather than the long-term profitability of investments'.

[11] Basel Committee on Banking Supervision, Compensation Principles and Standards Assessment Methodology, January 2010, mainly principle 4.

These policies affected not only directors' remuneration, but also senior managers', the latter going completely unnoticed by supervisors and legislators for a long time.[12]

As the banking sector showed slightly less resistance to the crisis than the insurance sector, some initiatives and studies addressed the remuneration issue focusing only on credit institutions.[13] Most of them, however, adopted a global approach proposing measures for all financial institutions.

Even though there are significant differences between banks and insurance undertakings in terms of their activity and the type of risks they are exposed to, they have also many elements in common. They are both regulated sectors subject to a strong legal and supervisory system, in both risk is an inherent element of their activity, and in both the directors, when managing the company, must consider not only the shareholders' interest, but also the interest of the debtholders or the policyholders, respectively.

As pointed out, after the financial crisis the main trend has been to tackle the problems and come up with solutions in remuneration policies in the financial sector as a whole (without making any difference between banks and insurance undertakings). That is the case with the Commission Recommendation of 30 April 2009, on remuneration policies in the financial services sector,[14] the FSB Principles for Sound Compensation Practices of 25 September 2009, or the European Commission's Green Paper on Corporate Governance in Financial Institutions and Remuneration policies, of 2 June 2010.[15] While this joint treatment was the trend among non-compulsory instruments, the binding regulations of both financial sectors have followed separate paths so far (regarding the instruments used and the level of detail of the provisions rather than the content itself. As it can be observed most of the provisions envisaged for insurance undertakings since 2015 clearly follow those established for credit institutions in previous years).

As said, the central position of banks in the crisis led the European Legislator to focus their concern about remuneration issues in these financial institutions first. At this respect, CRD III Package included for the first time specific remuneration requirements. According to Recital 3 of Directive 2010/76/EU,[16] 'in order to address the potentially detrimental effect of poorly designed remuneration structures on the sound management of risk and control of risk-taking behaviour by individuals, the requirements of Directive 2006/48/EC should be supplemented by an express obligation for credit institutions and investment firms to establish and maintain, for

[12] Hopt (2013), p. 13.

[13] Basel Committee on Banking Supervision, op. cit.

[14] 2009/384/EC. In a non-binding way, the Recommendation includes already most of the principles that years later will be introduce in the CRD Framework.

[15] COM (2010) 284 final. Vid. also Commission Feedback Statement on Corporate Governance in Financial Institutions, of 11 November 2010.

[16] Directive 2010/76/EU, of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration.

categories of staff whose professional activities have a material impact on their risk profile, remuneration policies and practices that are consistent with effective risk management'.

The Directive included some express provisions in the main text and added one new section (11) on remuneration policies to Annex V of Directive 2006/48/EC (CRD I), where it already set out some basic principles, most of them coming from the previously cited soft-law instruments. Article 1.3.4 of the Directive 2010/76/EU itself required CEBS[17] to issue guidelines on sound remuneration policies which complied with the principles included in the amended Annex V of CRD I. These guidelines got published in December 2010.

The revision process launched in 2010 continued to progress with the CRD IV reform. Thus, Directive 2013/36/EU included a more complete regime on remuneration policies in the main text of the Directive (Articles 92 et seq.). Following the Lamfalussy scheme, these first level provisions were also developed through Regulation (EU) 604/2014,[18] which aimed to fix the criteria to identify those categories of staff whose professional activities have a material impact on an institutions' risk profile,[19] and Regulation (EU) 575/2013, Article 450 of which set out disclosure requirements for the remuneration policies of credit institutions. Two other three level instruments completed this regulatory structure: first, the EBA Opinion on the use of allowances,[20] and later the EBA guidelines[21] of 21 December 2015.[22]

[17] Committee of European Banking Supervisors. On 1 January 2011, the European Banking Authority (EBA) was established, taking over CEBS' ongoing tasks and responsibilities.

[18] Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile. It is a very useful instrument that does not exist for insurance undertakings' staff.

[19] The EBA recently published a draft for the revision of provisions included in Regulation 604/2014 that can be found under the reference EBA/RTS/2020/05, 18 June 2020.

[20] EBA/Op/2014/10, 15 October 2014, Opinion of the European Banking Authority on the application of Directive 2013/36/EU (Capital Requirements Directive) regarding the principles on remuneration policies of credit institutions and investment firms and the use of allowances.

[21] EBA/GL/2015/22, 21 December 2015, Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013.

[22] EBA proposed to revise the guidelines on sound remuneration policies in light of the amendments introduced by the fifth Capital Requirements Directive (CRD V); mainly, the gender-neutral requirement for remuneration policies. The consultation period ended on 29 January 29 2021, and the final guideline is expected to be published in the first half of 2021.

3.1 Means for Improvement in the Insurance Sector

As previously shown, the regulatory framework on remuneration policies and practices for insurance undertakings did not follow such a well-constructed structure as in the banking sector. Directive 2009/138/EC did not include any specific provision on this matter and, even though it has been already amended in the following years (mainly through Directive 2014/51/EU) no requirements were added so far in this regard. As mentioned, Regulation 2015/35 is a delegated act (level 2 of the Lamfalussy scheme) with a very weak connection with the Directive, considering that there are no high-level principles on remuneration for insurance undertakings. The link between both instruments, Directive and Regulation, is only indirect, and must be made through Articles 41 to 50 of the Directive, which relate to the system of governance of insurance and reinsurance undertakings, with no special reference to any remuneration requirement.[23]

The release of the EIOPA's Opinion *on the supervision of remuneration principles in the insurance and reinsurance sector* in 2020 did not solve the problem at all and left many loose ends in capital questions, as it has been showed. Whether a non-compulsory instrument like guidelines or an opinion can be found justified in the banking sector where there are already several level 1 and 2 provisions with quite detailed principles, the situation is not the same in the insurance field. Here, there is a need to amend Directive 2009/138/EU to include high level principles on remuneration policies. As it was mentioned in footnote 3, EIOPA's *Opinion on the 2020 review of Solvency II* proposes already an amendment in this respect, but only to include the remuneration policy within the policies that need to be written and periodically reviewed. In any event, the reform should be wider, considering the inclusion of an express reference to most of the remuneration principles laid out now in Regulation 2015/35. The reform would also require certain development via regulatory technical standards (RTS) to clarify concepts used in the Directive and the Regulation, as is the case with the concept of the staff whose professional activities have a material impact on the undertaking's risk profile. Same situation exists relating distinction between fixed and variable remuneration. Provisions in the insurance sector have a lack on determination at both aspects that cannot be found in the banking provisions, where those concepts are precisely defined and where any

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[23] A reference must be made to the Memo of the European Commission, 'Capital Requirements – CRD IV/CRR: Frequently Asked Questions', 16 July 2013, section 11, p. 28: '(. . .) for the sake of consistency and in order to avoid regulatory arbitrage between sectors, it will be necessary to review the existing legislation in other sectors (Solvency II, UCITS Directive) to align it, when necessary, to the outcome of the final text of the CRD IV package. Nevertheless, the specificities of each sector should be considered, and the rules should not necessarily be identical for banks, insurance companies and investment funds'. The revision of Solvency ii was not carried out regarding the amendments on remuneration policies included in the CRD IV.

compensation that falls outside the concept of fixed part of remuneration shall be considered variable with no room for a *tertium genus.*[24]

3.2 A Forward-Looking Approach to Supervision in the Financial Sector as a Whole

The convenience of the inclusion of specific first-level provisions on remuneration policies and practices for the insurance sector is a minimum requirement and is the only feasible one now. A brief mention to another forward-looking approach should however be made.

The financial market shows how in the last decades the boundaries between banking, insurance and securities have become increasingly blurred and how many of these activities are carried out now by financial conglomerates which get subject to different sectoral regulations and supervisory authorities depending on the type of transaction involved. Bearing that in mind, it should be questioned if there is still a point in having completely separate provisions for the banking and the insurance sector when in many cases, requirements set for both sectors are essentially the same, and in those cases where provisions differ considerably, this separate treatment does not always respond to an actual difference in the market.[25]

The forward-looking approach of cross-sectoral supervisory legislation for financial institutions also poses the question of the convenience of a new European financial supervisory model. As it is known, while the EU follows the sectoral supervisory model with three different supervisory authorities (ESAs) for banking (EBA), insurance (EIOPA) and securities (ESMA), some Member States, considering the above-mentioned blurring of lines between financial sub-sectors, have moved to either a single supervisory model or to the so-called twin peaks model.[26] According to the single supervisory model, there is only one supervisory authority in charge of the three financial sub-sectors (with some supervisory role of the Central Bank in some countries) as is the case in Germany, Poland or Sweden. The twin peaks model[27] divides the supervision into two separate authorities. One is in charge

[24] It may be recalled here that provisions included in the EIOPA's Opinion in this respect are merely for guidance purpose and distinguish between termination payments generally considered as variable remuneration and those which generally do not have this qualification.

[25] Vid. Al-Darwish et al. (2011), p. 40 et seq. See also footnote 23.

[26] Colaert (2015), p. 1586 et seq.

[27] This model was pointed out as the desirable system to evolve to in the so-known *Larosière Report* of 25 February 2009, of the High-level Group of Financial Supervision in the EU, section V, pp. 216 and 217 (P. 216: There may be merit, over time, in evolving towards a system which would rely on only two Authorities: The first would be responsible for banking and insurance issues, as well as any other issue which is relevant for financial stability (e.g. systemically important hedge funds, systemically important financial infrastructures). The second Authority would be responsible for conduct of business and market issues, across the three main financial sectors. Combining

of prudential supervision whereas the other supervises markets and conduct of business. This is the supervisory structure followed in Belgium, France, the Netherlands, or Portugal.[28] Among these, it is worth to refer expressly to the Netherlands regime. Differences arise there not only from the twin peaks supervisory model (adopted already in 2002), but also from the particular approach taken in the implementation of the CRD IV. The Dutch Act on Remuneration Policies of Financial Undertakings, February 2015 (*Wet beloningsbeleid financiële ondernemingen*), looking for the above-mentioned cross-sectoral supervisory legislation approach, broadened the scope of the Directive extending its provisions to all financial undertakings, including banks, insurers, investment firms, payment services providers, or premium pensions institutions. The Dutch case is also unique because the Legislator also carried out some 'gold-plating' amendments when transposing the remuneration requirements of the CRD IV. As key measures in this respect one can refer briefly to the bonus ceiling of 20% of the fixed salary of the employee—much more restricted than in the original European provision—the severance payment ceiling of one year's salary of directors, or the express inclusion of bonus clawback if circumstances require so.[29]

Even when a complete revision of the supervisory model would be neither possible nor appropriate now at the European level, one cannot ignore that this is the direction of any long-term evolution of the supervisory structures in the financial sector.

4 Implementation of European Provisions: Interplay with National Corporate Law

As pointed out in the introduction of this chapter, the application of the analysed special rules to insurance undertakings does not prevent these undertakings from being subject to general directives in corporate governance and to the company law of their country of origin.

In this respect, it must be distinguished between non-listed undertakings and those with shares admitted to trading on regulated markets on the one hand. On the other hand, differences arise from the varied board structures and what is considered

banking and insurance supervisory issues in the same Authority could result in more effective supervision of financial conglomerates and contribute to a simplification of the current extremely complex institutional landscape).

[28] A deeper analysis of the differences in the supervision structures of each Member state can be found in: Schoenmaker and Véron (2017), p. 1 et seq. The text of this policy contribution will be published as a chapter of Godwin and Schmulow (2021).

[29] For a deeper analysis, see Van Loopik and Ter Haar (2016), p. 389.

as key staff of the undertakings and the legal regime applicable to them at national level.[30]

All this leads frequently to difficulties in determining the scope and application of provisions contained in the above-mentioned insurance industry specific rules on remuneration policies.

As will be shown, national provisions also entail differences in the way in which remuneration principles of the Regulation and provisions of EIOPA's Opinion have been implemented (beyond what have been already exposed about supervisory models in the different Member States).

4.1 Listed Insurance Companies

Insurance undertakings with shares admitted to trading on a regulated market are subject to Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017, amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

Approval of the general remuneration policy by the AMSB body of the undertaking as required in Article 35.5 of the Solvency II Directive must be completed here with the vote of the policy at the general meeting as regards directors' remuneration. This vote is in principle binding, but Member States may provide for it to be merely advisory. In any case, submission to vote must be done at every material change and at least every four years (Article 9a of Directive (UE) 2017/828).

Difference is therefore significant and requires clarification of who should be considered directors, in order to submit their remuneration policy to the prior approval or control by the general meeting. According to Article 2.i) Directive (UE) 2017/828 'director' means: (i) any member of the AMSB of a company; (ii) where they are not members of the AMSB of a company, the chief executive officer and, if such function exists in a company, the deputy chief executive officer;[31] and (iii) where so determined by a Member State, other persons who perform functions similar to those performed under point (i) or (ii).

Again, there is room for national interpretation and, as will be shown, supervisory criteria and legal provisions show significant differences in this respect.

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[30] As Recital 28 of Directive (UE) 2017/828 points out.

[31] If CEOs are named among the members of the AMSB, they remain considered as directors, but under point (i) of the classification.

4.2 National Corporate Law and Implementation Measurements of the Specific Insurance Provisions Towards Remuneration

The remuneration policy must apply to the undertaking as a whole but include specific provisions considering the tasks and performance of the AMSB, persons who effectively run the undertaking or have other key functions, and other categories of staff whose professional activities have a material impact on the undertakings' risk profile (Article 275.1.c) Solvency II Directive). Further, provisions included in the EIOPA's Opinion apply only to AMSB members, other executive persons who effectively run the undertaking, key function holders and other categories of staff whose professional activities have a material impact on the undertakings' risk profile.

The application of these general rules to the corporate structure of each undertaking usually poses many questions about their scope and their application (or not) to some functions and individuals and receives frequently attention in guidelines prepared by the national supervisory authorities with quite different approaches in each case.

On the following paragraphs the chapter analyses the legal regime and criteria of some of the European Member States with more particularities in this respect, pointing out the differences among them. As one can observed, there are many aspects in which the supervision and the corporate governance requirements vary notably among Member States, with all the potential risk and legal uncertainty that this situation entails.

4.2.1 Belgium

Generally, Belgium allows both the monistic and the dualistic system of board structure (Article 7:85 et seq. of the *Code des sociétés et des associations*[32]). According to the first one, *le conseil d'administration* can carry out all acts needed for the fulfilling of the company purpose. Following a dualistic system, board is organized in two bodies: *le conseil d'surveillance* and *le conseil de direction*. Here, *le conseil de surveillance* develops the general policies and the strategy of the company, and the daily management belongs to *le comité de direction*.

Compared to the general rule, according to the Belgian Insurance Supervision Act,[33] insurance undertakings must use a special dualist model with two bodies: *le conseil d'administration* and *le comité de direction* with two main differences with the general dualistic system. On the one hand, powers of *le comité de direction* arise

[32] Loi du 23 mars 2019 introduisant le Code des sociétés et des associations et portant des dispositions diverses (M.B. 4 abril 2019, pp. 33239 et seq.).

[33] Loi du 13 mars 2016 relative au statut et au contrôle des entreprises d'assurance et de réassurance.

from a delegation of *le conseil d'administration*. On the other hand, at least three members of the *comité* are also members of *le conseil d'adminsitration* (in the pure dualistic models both bodies have completely different members).[34]

In this case, according to the *Circulaire 2016_31 relative aux attentes prudentielles de la Banque nationale de Belgique en matière de système de gouvernance pour le secteur de l'assurance et de la réassurance (version révisée en mai 2020)*[35] (point 8.1), both bodies, the supervisory and the management one, are subject to the provisions of the EU Regulation and the EIOPA's opinion.

Apart from listed companies, remuneration policies of insurance undertakings do not have to be submitted to the general meeting except in cases when that policy includes a notice period and a severance pay for non-executive members of *le conseil d'administration* (point 8.2 *Circulaire*, and its footnote 42).

The Belgian system entails very detailed provisions on insurance corporate governance supervision. The *Circulaire* embraces all proposals included in the EIOPA's Opinion and converses most of them into binding provisions requiring the undertakings for explanation to the supervisor (The National Bank of Belgium) when they do not comply with the provided benchmarks.

4.2.2 Germany

Remuneration policies of insurance undertakings are covered here by the *Aktiengesetz* (the German company law, mainly in Articles 87 and 113) and the *Versicherungsaufsichtsgesetz* (the insurance supervision law, mainly in Articles 33 and 189).

The governance structure is dualistic for all kinds of companies—included insurance undertakings—and is split into two bodies: *Aufsichtsrat* (supervisory board) and *Vorstand* (management board), whose members are completely different from each other.

While remuneration of the *Aufsichtsrat* must be included in the by-laws or approved by the general meeting, that of the *Vorstand* needs only the *Aufsichtsrat*'s approval.

Regarding insurance companies, the German Supervisor (BaFin[36]) has published two resolutions: The Decision *Aspekte der Vergütung (Art. 275 DVO (EU) 2015/35)*,[37] and the Circular 2/2017.[38] According to those provisions, even when remuneration principles included in the Delegated Regulation (EU) 2015/35 shall apply to the undertaking as a whole, restrictions considered in Article 275 of the Regulation

[34] Strypstein (2020), p. 59 et seq.

[35] Vid. Chhor (2020), p. 165 et seq.

[36] Bundesanstalt für Finanzdienstleistungsaufischt.

[37] VA 52-I 2510-2016/0006, 20 December 2016.

[38] Rundschreiben 2/2017 (VA)-Mindestanforderungen an die Geschäftsorganisation von Versicherungsunternehmen (MaGo), 25 Januar 2017.

and provisions included in the EIOPA's Opinion only get development with respect to the members of the management board, persons who run the undertaking or have other key functions, or other categories of staff whose professional activities have a material impact on the undertaking's risk profile. Considering that the Regulation refers to the administrative, management or supervisory body and that the Opinion focuses on the AMSB members and other executive directors, one can understand that both, supervisory and management boards in case they are split should be subjected to those provisions.[39] It must be considered that according to point G-18 of the German Corporate Governance Code[40] supervisory board remuneration should be fixed remuneration (in that case, provisions included in EIOPA's Opinion would not have impact in such policies). Nevertheless, it is only a recommendation and only applicable to listed companies, and in any case, it also bears the possibility of providing performance-related remuneration (thus, variable) to the members of the supervisory board (if so, that component should be geared to the long-term development of the company).

The German provisions towards insurance undertakings remuneration are otherwise very complete and include specific benchmarks regarding some of the principles included in the EU Delegated Regulation. With respect to the sufficiently high proportion of the total remuneration the BaFin's Decision recommends a minimum percentage of 40 for staff under the *Vorstand*, and a minimum of 60% in the case of members of that management board. Even when those provisions were foreseen in 2019, before EIOPA's Opinion, there is no contradiction in this respect considering that the Opinion allows supervisors to raise that threshold.

4.2.3 Italy

Remuneration provisions for insurance companies are found in the *Codice Civile*[41] (the Italian Civil Code, where these questions are addressed in Articles 2325 et seq.) and the *Codice delle assicurazioni private*[42] (the Insurance Code), and two resolutions of the Italian insurance supervisor, the IVASS:[43]: the Regulation 38/2018 of 3 July[44] and the Letter to the Market of 5 July 2018.[45]

[39] In this same direction vid. Scheidl (2019), p. 67.

[40] Corporate Governance Kodex, *Regierungskommission Deutscher Corporate Governance Kodex*, version of 16 December 2019.

[41] Royal Decree 16 March 1942, n°262, last updated with the Legislative Decree of 16 July 2020, n°76, and the Legislative Decree of 8 April 2020, n° 23, transformed in Law of 5 July 2020, n°40.

[42] Legislative Decree of 7 September 2005 n° 209, last updated with Legislative Decree of 17 March 2020, n° 18.

[43] *Istituto per la Vigilanza sulle Assicurazioni*.

[44] *Regolamento IVASS n. 38 del 3 luglio 2018*.

[45] *Lettera al Mercato*, *5 luglio 2018*.

Insurance undertakings can adopt here the three governance systems admitted in the Civil Code since 2003:[46] traditional, monistic, and dualistic. Among these, in the insurance sector, one finds mainly the traditional and the dualistic structures. According to the first one, there are two bodies in charge of the management and the supervision respectively: the *consiglio d'amministrazione* and the *collegio sindicale* (2380 *Codice Civile*). The general meeting chooses the members of both and fixes their remuneration. The management body can appoint delegated members or establish an executive committee.

According to the dualistic model (2409 bis *Codice Civile*), the governance structure is organized in a supervisory and a management board, but in this case the general meeting nominates only the members of the supervisory one (*consiglio di sorveglianza*) and is this body who chooses the components of the management board (*consiglio di gestion*). Pursuant to the general provisions of the Civil Code, the general meeting only decides the remuneration of the supervisory board. Under this structure, there is room for the designation of delegated members of the management board, but not for an executive committee.

On insurance undertakings, the IVASS Regulation (Articles 39 et seq.) follows the general regime and allows both systems, traditional and dualistic. The general meeting determines the retribution of the members of the bodies designed by it (*consiglio d'amministrazione* and *collegio sindacale* in the traditional model, and *consiglio di sorveglianza* in the dualistic one) and approves the remuneration policy prepared by the *consiglio di sorveglianza* for the management board (*consiglio di gestion*). Hence, the general meeting has a say in any case.

The remuneration of the supervisory boards—*collegio sindacale* and *consiglio di sorveglianza*—is limited in its variable components, and it shall not include compensation linked to results or based on financial instruments.

The Italian Supervisor establishes three governance systems (*rafforzato, ordinario and semplificato*) for insurance undertakings depending mainly on the level of life technical provisions and non-life insurance premiums. The Supervisor only envisages specific provisions developing remuneration principles of the EU Regulation in companies which require the reinforced—*rafforzato*—system (those with life technical provisions over 10 billion € or non-life premiums over 1 billion €). In that case, where Article 275 EU Regulation its applied, 50% of the variable component of the remuneration should consist of shares or other connected instruments,[47] and 40% of the total variable amount should be deferred not less than 3–5 years. If the proportion of variable components of the whole remuneration is especially high, then not less than the 60% of it should be deferred.

As shown, these limits do not apply when the governance system of the undertaking is ordinary or simplified, i.e. it does not come into play for companies with levels of technical provisions of 10 billion or less, or non-life premiums of one

[46] Vid. *Indagine conoscitiva: La Corporate Governance di Banche e Compagnie di Assicurazioni – IC36*, Autorità garante della concorrenza e del mercato, Roma, 2009.

[47] A new parameter not required at a European level.

billion or less. In these cases, provisions of the EU regulation and the EIOPA's opinion apply with no further interpretation.

4.2.4 Spain

The Spanish corporate law[48] follows a monistic system in the configuration of the governance structure of companies, and the situation remains unchanged when it comes to insurance undertakings.

In the governance structure, next to the general meeting one only finds another body: the *consejo de administración* (management board) whose members are appointed by the general meeting. The *consejo* itself can name one or several delegated executive administrators or appoint an executive committee. In that case, the *consejo* plays a supervisory role, even though there are some competences that cannot be subject of delegation (Article 249 bis TRLSC).

Over the last years, authors and case-law have argued about the scope of the power of the general meeting on remuneration of the *consejo de administración*. In particular, the terms used by the national legislator in Articles 216 et seq. have given rise to doubts about the competence of the general meeting for determining not only the remuneration of the *consejo de administración* itself, but also the compensations owed to the executive delegates or to the members of the executive commission.[49] In this respect, in the last two years, the Supreme Court (Ruling 494/2018[50]) and the Central Economic-Administrative Court (Resolution 3156/2019[51]) have solved the question considering that the powers of the general meeting on the remuneration of the *consejo de administración* must also reach the remuneration of the executive delegated members and of the members of the executive committee.

The Spanish insurance supervisor (DGSFP[52]) has reproduced[53] the orientations of EIOPA with no gold-plating measures and leaving, therefore, a wide margin for insurance undertakings to establish their policies.

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[48] Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital (TRLSC).

[49] In favour of that broader scope, as the most representative work vid. Fernández Del Pozo (2015), pp. 199–248. Against this extended interpretation, among others, vid. Paz-Ares (2018), full issue.

[50] Sentencia del Tribunal Supremo 494/2018, de 26 de febrero, Roj: STS 494/2018 - ECLI: ES: TS:2018:494.

[51] Resolución del Tribunal Económico-Administrativo Central, de 17 de julio de 2020, R.G. 3156/ 2019.

[52] Dirección General de Seguros y Fondos de Pensiones.

[53] Nota en relación con la aplicación de la Opinión y de las recomendaciones de la Autoridad Europea de Seguros y Pensiones de jubilación sobre las políticas de remuneración variable, DGSFP, 30 de junio de 2020.

5 Conclusion

The legal treatment of remuneration policies and practices in the insurance sector received attention of the European Legislator years later than in the banking sector and only, so far, through second level provisions in the Lamfalussy scheme. The remuneration principles appear in the Commission Delegated Regulation (EU) 2015/35, but no changes in the Solvency II Directive have been made with this aim.

As a short-term way for improvement of the insurance sector regime, an amendment of the text of the Solvency II Directive should be made as soon as possible, with inclusion of an express reference to most of the remuneration principles laid out now in Regulation 2015/35, in order to give consistency and clarity to the supervisory legal framework.

The use of a non-compulsory instrument to develop the remuneration principles as is the case of the EIOPA's Opinion *on the supervision of remuneration principles in the insurance and reinsurance sector* does not appear to be the most appropriate solution, especially when there are no first level provisions in this respect. Following the better constructed structure of the remuneration provisions in the banking sector would certainly solve much of the problems arisen from the inadequate insurance scheme.

As a forward-looking approach, considering that in the last decades the boundaries between banking, insurance and securities have become increasingly blurred, it should be questioned if there is still a point in having completely separate provisions for the banking and the insurance sector and if there would be convenient to evolve to a greater convergence in the financial supervision regulation, with hardly any difference between financial sub-sectors or, at least, with more similar schemes. As Larosière Report pointed out in 2009, it could also be desirable to change the European sectoral supervisory model to a twin peaks model because this is not a short-term evolution but a far future possible orientation of the supervisory structures in Europe.

In addition to problems resulting from the inadequate structure of the remuneration provisions at European level, the insurance market shows a complex situation regarding remuneration policies, arising mainly from two factors: on the one hand, the European insurance industry presents a wide range of organisational structures and business models, especially regarding size and risk profile. These differences demand a flexible application of the rules and, in some cases, the taking into account of the proportionality principle. On the other hand, the application of these special rules to insurance undertakings does not prevent these undertakings from also being subject to the company law of their country of origin. It is a known fact that the structure of the governing bodies of the companies and the legal regime applicable to them vary greatly between Member States, which makes it more difficult to determine the scope and application of provisions contained in the above-mentioned insurance industry specific rules on remuneration policies. Even when the aim is not the full harmonisation, the truth is that there are very deep differences between

national regimes, in particular, relating aspects like the power of the general meeting to approve directors' remuneration policies.

The current supervisory system on remuneration policies and practices in the insurance sector shows, in short, many areas for improvement, as previously shown in this chapter.

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