IRAIF
IREFI

Brussels, 24 January 2024

NOTICE TO THE ACCREDITED AUDITORS
NOTICE 2024 / 01

Dear Members,

On behalf of all Board members and the scientific secretariat, I wish you and your families a prosperous and peaceful 2024!

Attached, you will find the annual attention points letter, informing the accredited auditors of some highlights or key issues that might have an impact on the audit procedures as of 31 December 2023.

The NBB, the FSMA and the different IRAIF/IREFI working groups, supported by the scientific secretariat, have contributed to this letter, by providing and drafting the enclosed attention points.

These attention points have been compiled in the context of the current regulatory framework of cooperation of the accredited auditors to the prudential supervision by the FSMA and the NBB.

The first Capita Selecta session of the year 2024 took place on 15 January 2024. The slides of this training are available on the ICCI portal (Past events (icci.be)).

The IRAIF/IREFI working group dealing with the model reports is currently finalizing the templates for the prudential reporting as of 31 December 2023 to the NBB and the FSMA. The updated versions will be released as soon as practically possible.

Should you have any questions regarding this document, please do not hesitate to contact me, any member of the Board of the IRAIF/IREFI or Veerle Sablon.

Yours sincerely,

Olivier Macq
President

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pour les Institutions Financières ASBL
Institut Royal
ASBL agréée comme union professionnelle

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INTRODUCTION

The attention items presented in *italics* have been provided by the supervisory authorities (National Bank of Belgium (NBB) or the FSMA) and include their expectations regarding the auditor's specific attention points in the context of the 31 December 2023 audit procedures and the reporting thereon.

The other attention points have been identified by the respective working groups of the IRAIF/IREFI and consist of items for information of the accredited auditors.

Some of these items relate to topics that were already discussed in previous attention points letters. The accredited auditors will use their professional judgment and decide, based on facts and circumstances, whether these attention points need to be explicitly addressed in the reports to the prudential authorities.

1. ATTENTION MATTERS APPLICABLE TO ALL FINANCIAL INSTITUTIONS

1.1. CSRD, THE NON-FINANCIAL INFORMATION DISCLOSURES REQUIREMENTS

We would like to remind the accredited auditors of the timeline of the Corporate Sustainability Reporting Directive (CSRD) that entered into force earlier this year.

The companies will have to apply the new rules:

- as from 1 January 2024 (first reports in 2025) for companies that are already within the scope of the NFRD;
- as from 1 January 2025 (first reports in 2026) for other large companies;
- as from 1 January 2026 (first reports in 2027) for listed SMEs; and
- as from 1 January 2028 (first reports in 2029) for non-EU companies with branches/subsidiaries.

No specific intervention of the accredited auditors is expected in the context of the 31 December 2023 audit procedures. However, in view of the complexity of the regulation, accredited auditors are encouraged to proactively inquire with the institution's senior management about the specific requirements and timing applicable to the institution. In addition, we recommend getting acquainted with the institution's concrete project management set-up, timeline and deliverables, to discuss the scoping and double materiality exercise and to assess the level of preparedness in view of the upcoming (limited) assurance requirements.

2. CREDIT INSTITUTIONS

2.1. THE IMPACT OF THE CHANGING METRICS ON THE CREDIT INSTITUTIONS

Given the increased volatility in interest rates by Central Banks and the changed macro-economic environment with inflation and low economic growth, we recommend the accredited auditors to take into consideration the risks to which the financial sector is exposed, in particular related to interest rate risk, liquidity risk and credit risk.

It is suggested to put specific attention on the adequate identification, measurement and reporting of risks in the financial and prudential reporting. We recommend considering at least the following elements:

- Management of interest rate risk within an ALM context and the related hedge positions from an accounting and economical perspective (valuation of hedges and sustainability of hedge effectiveness);
- Management of liquidity risk within a competitive environment for higher interest rates on saving products, a high focus on reputational risk and more digital banking interactions (hedge relationship, and underlying duration assumptions of core current and savings accounts);
- Management of credit risk within a context of low economical growth and volatile macro-economic indicators, such as inflation levels and energy prices. It is suggested to put specific focus on:
    - the governance and the evolutions of the overlays recorded by the institutions to capture the ECL not picked up by the current models, including the evolution of the overlays that were previously recorded to cover the increased expected credit losses; and
    - the back-testing process implemented by the institutions and the related results, the scenarios used in the expected credit loss and any specific sector approaches that would be applied.

We furthermore refer to the sections 2.2, 2.3 and 2.4 below for the attention points of the NBB and the reporting requirements in relation to these attention points.

2.2. COUNTERCYCLICAL CAPITAL BUFFER

In its press release of 30 June 2023, the National Bank of Belgium (hereafter the Bank) announced that it would consider re-activating the Countercyclical Capital Buffer (CCyB) and lowering the sectorial systemic risk buffer for Belgian mortgage loans. As there is now less uncertainty regarding the impact of the rate hikes on the economy and given that the downturn in the credit and real estate cycles has been orderly thus far, the NBB confirmed, on 31 August 2023, this intention by means of a formal decision.

As the pass-through of tighter financial conditions to the real economy is a gradual and ongoing process, the Bank continues to believe that credit institutions remain potentially exposed to unexpected losses, whereas their provisions for expected credit losses have dropped back to pre-pandemic levels. Re-activating the Countercyclical Capital Buffer will heighten the banking sector's resilience to potentially higher-than-expected losses. The Bank has decided to set the Countercyclical Capital Buffer (CCyB) rate for Belgian exposures at 0.5% as from 1 April 2024, and at 1.0% starting on 1 October 2024. The Bank considers that the sudden and rapid hike in interest rates constitutes an exceptional circumstance that justifies setting the countercyclical buffer rate already at 0.5% as from 1 April 2024 (i.e., 6 months after its activation).

Given the generally high level of compliance with supervisory expectations for Belgian mortgage loans, the Bank believes that the sectorial systemic risk buffer for IRB mortgage loans may be lowered from its current level of 9% to 6%, effective 1 April 2024.

In a broader context, the Bank expects the accredited auditors to dedicate sufficient attention to credit risk and provisioning as well under IFRS as under Belgian GAAP. The relevant findings and related assessment of the accredited auditors will be comprehensively addressed and detailed in their year-end periodic and comprehensive reports.

2.3. EBA – IFRS 9 IMPLEMENTATION BY EU INSTITUTIONS REPORT (NOVEMBER 2023)

Since the publication of the last IFRS 9 Monitoring Report in November 2021 and following the staggered approach agreed in the IFRS 9 roadmap, the EBA published on 17 November 2023 its second IFRS 9 Monitoring Report on High Default Portfolios ("HDPs"). HDP exposures classes have been defined, in line with the credit risk benchmarking exercise, as Corporate (CORP), Corporates which are SMEs (SMEC), Other retail SME (SMOT), Other retail non SME (RETO), Retail SMEs secured by real estate (RSMS), Retail mortgages (MORT), and Retail Qualifying revolving (RQRR) exposures.

The report is meant to provide transparency on the practices which – following the publication of the last report in 2021 - continue raising prudential concerns and, therefore, need to be timely addressed by credit institutions. The report also addresses some specific concerns related to the HDPs and support supervisors' evaluation of the quality and consistency of the ECL frameworks.

The main findings of this third ad-hoc exercise remain similar to those of the previous round, i.e., are related to the areas of (i) the significant increase of credit risk ("SICR"), (ii) the incorporation of forward-looking information ("FLI") and of (iii) the use of overlays. Additionally, new findings have been made on (iv) the use of the low credit risk exemption ("LCRE") for HDPs and (v) backtesting practices.

More in particular, in the area of SICR, supervisory concerns are related to (i) the continuous lack of use of collective SICR assessment, (ii) the usage of the so called "quantile approaches" by a number of credit institutions to determine the SICR quantitative thresholds (generally expressed as relative changes in PDs since origination) and (iii) the large usage, especially given the nature of the HDPs, of the IFRS 9 low credit risk exemption (LCRE).

Another important observation stems from the increased reliance on model adjustments or overlays with quite different practices in terms of risks being considered and approaches followed by credit institutions to quantify those components. Moreover, different practices have been followed with regard to the level at which (risk parameters, final ECL) overlays are applied (i.e., risk parameter or final ECL amount). An overlay at ECL level raises supervisory concerns as it might not trigger the corresponding and appropriate transfers to stage 2 (meaning ECL will increase due to the overlay but the increase in risk might not always also be reflected in actual transfers from stage 1 to stage 2).

On the PD framework, an additional matter of concern relates to the usability of the observed 2021 (Covid period) low default rate for IFRS 9 purposes. This might impact the predictive power of the IFRS 9 PD estimates and might impair the results provided by the models used for the incorporation of forward-looking information. It was noted that credit institutions use different approaches to incorporate (or not incorporate) this data.

The benchmarking analysis has also confirmed for HDPs the quite limited effect of forward-looking information (FLI) and non-linearity on the final ECL figures. Some approaches that continue raising prudential concerns have also been flagged, namely: (i) the usage of one single scenario without further adjustments of non-linearity, (ii) the non-consideration of FLI elements in the IFRS 9 LGD (sometimes even without investigation), (iii) the use of excessively long forecasting horizons and (iv) the extended time horizon to revert back to long-term macroeconomic conditions. Finally, the analysis has also confirmed the usage of some smoothening practices by certain institutions in order to achieve more "through-the-cycle" figures, which would prevent duly reflecting the "point-in-time" and forward-looking nature of the ECL figures.

Finally, in the area of backtesting, the analysis has revealed that, while most credit institutions have generally developed ad-hoc methodologies for backtesting their ECL models, others are lagging behind, not yet backtesting any parameter or limiting the analysis only to few risk factors (e.g., 12m PD and/or LGD). The lack of usage of the backtesting results for the periodic review of ECL estimates have also been broadly observed, which raises additional prudential concerns on the effectiveness of the framework in use.

Given the potential significant impacts of the above issues on ECL and for so far similar practices are identified within the Belgian credit institutions, the NBB expects the accredited auditors to consider the above matters and report their findings (including a view on the level of conservatism involved) and recommendations in their reports addressed to the Bank (on prudential returns and comprehensive report) as of year-end 2023.

2.4. INTEREST RATE RISK AND CREDIT SPREAD RISK IN THE BANKING BOOK – NEW REPORTING OBLIGATIONS

In accordance with the requirements set out in Circular NBB_2023_07 dated 27 June 2023 – Guidelines on sound management practices and reporting concerning interest rate risk and credit spread risk arising from non-trading book activities, the accredited auditor is required to take up the reporting tables related to these topics in his audit and review scope and report to the NBB on the content and reporting of the relevant tables.

In its Circular NBB_2023_17 – Reporting obligations concerning interest rate risk and credit spread risk in the banking book, dated 19 December 2023, the Bank amended the reporting requirements and confirmed the new tables are to be taken up in the scope of the accredited auditors' audit work. A special attention is therefore required from the accredited auditors on the new reporting applicable as from 31 December 2023.

New regulatory expectations for the embedding of credit spread risk in Banking Book activities in the risk management framework have entered into force on 31 December 2023. As regards to the compliance with regulatory requirements relating to interest rate risk in the Banking Book, significant deficiencies were identified in the past by the Bank in the governance, the articulation of the risk appetite framework, the application of the standardized assumptions in the prudential regulatory metrics and in the development of measurement methods, in particular the modelling of non-maturing deposits and loan prepayment. The compliance by the credit institutions with the new regulatory requirements constitutes a significant attention point for the credit institutions on the one-hand and, within the scope limits of their assignment, the accredited auditors on the other-hand. The Bank requires the latter to address in due time the completeness and accuracy of the reported information in the relevant tables on interest rate risk and credit spread risk in the Banking Book that shall be submitted to the Bank and the compliance by the credit institutions with the new regulatory requirements as set-out in Circular NBB_2023_17 – Reporting obligations concerning interest rate risk and credit spread risk in the banking book.

The following matters are significant for the credit institutions and accredited auditors' reporting:

- *The 7 STE IRRBB-CSRBB reporting tables described in annexes 3 and 4 of Circular NBB_2023_17 shall be submitted by all Belgian Domestic Systemically Important Institutions which are considered significant under the Single Supervisory Mechanism (SSM). The tables shall be submitted with regard to the situation at the highest level of consolidation in Belgium on a quarterly basis. The first reporting shall relate to the situation on 31 December 2023.*
- *Unless the aforementioned reporting obligation applies, the reporting tables described in annexes 1 and 2 of Circular NBB_2023_17 shall be submitted by all institutions in scope of the Circular and considered significant under the SSM, and the Belgian subsidiaries of these institutions. The tables shall be submitted for reporting periods 4Q 2023, 1Q 2024 and 2Q 2024.*

- *The reporting tables referred to in Decision EBA/DC/501 - Decision of the EBA concerning ad-hoc collection by competent authorities to the EBA of institutions' IRRBB data and amendment of the Annex to EUCLID Decision, shall be submitted by all Belgian domestic systemically important institutions which are considered significant under the SSM. The tables shall be submitted with regard to the situation at the highest level of consolidation in Belgium for reporting periods 4Q 2023, 1Q 2024 and 2Q 2024.*
- *The reporting tables described in annexes 2 and 3 of Circular NBB_2023_07 shall be submitted by all institutions in scope of the Circular and considered less significant under the SSM. The tables shall be submitted for reporting periods 4Q 2023, 1Q 2024 and 2Q 2024.*
- *The reporting tables referred to in Decision EBA/DC/501 - Decision of the EBA concerning ad-hoc collection by competent authorities to the EBA of institutions' IRRBB data and amendment of the Annex to EUCLID Decision, shall be submitted by all Belgian domestic systemically important institutions which are considered less significant under the SSM. The tables shall be submitted with regard to the situation at the highest level of consolidation in Belgium for reporting period 4Q 2023.*

Given the materiality of the IRRBB risks for the Belgian credit institutions, the supervisory authority requires the accredited auditors to include these tables in their scope (review as of 30 June and audit as of 31 December).

Please also take into consideration the section C.I.A.4.2 of the Circular NBB_2017_20 on the cooperation of the accredited auditors for the precise scope of the procedures to be performed by the accredited auditor on internal models.

2.5. EBA CONSULTATION PAPER ON DRAFT GUIDELINES ON RESUBMISSION OF HISTORICAL DATA UNDER THE EBA REPORTING FRAMEWORK

On 18 April 2023, the EBA issued the consultation paper on the draft guidelines on resubmission of historical data, setting out a common approach to the resubmission by the financial institutions of historical data in case there are errors, inaccuracies or other changes in the data reported in accordance with the supervisory and resolution reporting framework developed by the EBA.

Under this general approach:

- The resubmission of historical data depends on the frequency of the original reporting affected by the corrections and the reference dates affected by the errors or inaccuracies that require corrections and resubmissions;
- The financial institutions are expected to resubmit the corrected data for the current reporting date and historical data for past reference dates going back at least one calendar year (except for the data with monthly reporting frequency); and
- The resubmission of historical data is equally relevant to all types of financial institutions, meaning that no specific proportionality elements (apart from those that are already built in into the underlying reporting requirements) have been embedded.

Although the finalized guidelines have not yet been published by the EBA, the consultation paper mentions that the guidelines would apply as from 31 December 2023 onwards.

We recommend the accredited auditors to discuss with management whether resubmissions have been reported so far and, if so, to assess whether these might have an impact on the financial reporting.

2.6. SECTOR AGREEMENT ON ENERGY EFFICIENT MORTGAGES

Increasingly, credit institutions are confronted with national and international obligations to report the degree to which their activities are sustainable. The EU Taxonomy Regulation, setting out the criteria and the factors to be considered for a product or activity to be deemed "sustainable", is one of these obligations.

Febelfin currently assesses that Belgian credit institutions are unable to meet the Taxonomy requirements with respect to their mortgage loans and related collaterals. For instance, Belgian credit institutions do not have access to the regional databases with EPC/PEB data, that are required to demonstrate compliance.

Nevertheless, to achieve some uniformity in the way Belgian credit institutions approach the notion of "energy efficient mortgage", the Belgian financial sector, through BVK/UPC and Febelfin, has worked out a uniform definition of "energy efficient mortgage". This definition is as much as possible in line with European Taxonomy rules, but still allows for practical application in the context of reporting obligations.

We understand that this sector definition of "energy efficient mortgage" has been validated by the boards of Febelfin and BVK/UPC, and has been informally endorsed by the NBB for the completion of the bi-annual PHL reporting. However, we would like to point out that, despite leveraging on certain elements of the EU Regulation, this sector position was not intended to comply with the EU Taxonomy. For example, the sector position does only consider the element of energy efficiency, but does not assess the Minimum Social Safeguards requirements. As a result, for the purpose of the EU Taxonomy, the credit institutions should carry out their own analysis and the "energy efficient mortgages" should not automatically be included in the Green Asset Ratio.

The accredited auditors are recommended to proactively discuss the above with the credit institution's management in the context of the upcoming CSRD and Taxonomy deadlines, as mentioned under section 1.1 above.

2.7. ACCOUNTING TREATMENT OF THE IRREVOCABLE PAYMENT COMMITMENTS (IPC) TO THE SRF AND OF THE RELATED CASH COLLATERAL

EU legislation requires banks to make an annual contribution to the Single Resolution Fund ("SRF"), that has been established to ensure financial stability. Banks have been allowed to settle a portion of their contribution in the form of Irrevocable Payment Commitments ("IPC").

An uncalled IPC would be extinguished and the cash collateral returned if the bank ceases to be within the scope of the relevant legislation (i.e. stops being a bank). That understanding was based on article 7 §3 of EU 2015/81 which explicitly states: "The irrevocable payment commitments of an institution that no longer falls within the scope of Regulation (EU) No 806/2014 are cancelled and collateral backing these commitments is returned".

The market consensus was that the collateral posted was a financial asset in the scope of IFRS 9 that met the Solely Payments of Principal and Interest ("SPPI") test and was held in the Hold To Collect ("HTC") business model. Therefore, it should be measured initially at nominal value and be measured subsequently at amortized cost. The IPC would fall into IFRIC 21 and would only be expensed once the bank meets the conditions for payment, i.e. until the commitment would be called by the Fund and the institution was still a bank at that time (IFRIC 21§8).

Certain banks that lost their banking license have asked the SRF to return the cash collateral. The SRF stated they will only return the collateral back when the bank will have paid all its remaining IPC which contradicts with article 7 §3 of EU 2015/81. BNP Paribas Public Sector SA, the Fédération bancaire française (FBF) and the French Republic took this issue to court and a first decision was made on 25 October 2023, concluding that the Single Resolution Board did not have to return the collateral unless the bank paid all its remaining IPC following the lost of a banking license. That decision is based on the principle that paragraph 3 of article 7 contradicts paragraph 1 of that same article which, in the view of the EU court of justice, should take precedence. The banks involved have appealed to this decision meaning that the final positions currently remains undecided.

In the context of the above, the following should be considered:

- The classification and measurement of the collateral;
- The recognition of a (contingent) liability for the uncalled IPC; and
- The adequacy of the disclosures of the accounting treatment in the financial statements.

Pending the resolution of the appeal, and considering the above elements, the accredited auditors should, taking into account materiality, insist on a clear disclosure note informing the readers on the nature of the context and its possible impact, and the magnitude of this (contingent) liability.

2.8. ANNUAL TAX ON CREDIT INSTITUTIONS

2.8.1. Ruling of the Belgian Constitutional Court on the retroactive application

On 3 August 2016, the Belgian government introduced a new single annual tax on credit institutions, aiming at bringing simplification by replacing several bank levies that existed at that time. Several credit institutions sought repayment of the new annual tax paid in 2016 with the Belgian treasury, arguing that the retroactive application of the Law of 3 August 2016 that introduced the new single tax on credit institutions was not justified.

On 27 October 2022 the Belgian Constitutional Court ruled that the retroactive application of certain provisions within the Law of 3 August 2016 is not justified and incompatible with the principles of equality and non-discrimination as well as the general principle of non-retroactivity. The most important message from the ruling of the Constitutional Court is that the retroactive application of the single annual tax on credit institutions for assessment year 2016 cannot be upheld.

It is important to note that the Court has only issued a ruling with respect to the retroactive application of the annual tax on credit institutions for 2016. No ruling was made on the application of the tax as from assessment year 2017 onwards. Therefore, the annual tax on credit institutions still stands today and a potential refund may only be claimed for the transitional period in which the single levy was applied retroactively (assessment year 2016).

In the context of the above, the accredited auditors are recommended to follow-up with management on the concrete actions taken and the effect thereof on the financial reporting.

2.8.2. Limitation of tax deduction of the annual banking tax to 20% and 0%

Applicable as from 1 January 2023 onwards (income year 2023, assessment year 2024), the deductibility of the annual banking tax is limited to 20% to taxes due. In addition, the possibility to deduct the DBI/RDT of the year from the disallowed part was removed.

Applicable as from 1 January 2024 onwards (income year 2024, assessment year 2025), the deductibility of the annual banking tax has been fully removed.

3. INSURANCE SECTOR

3.1. IMPLICATIONS OF RISING INTEREST RATES FOR INSURERS

In view of the current economic climate and in particular the increasing interest rates and the inversion of the yield curve, the accredited auditors are expected to give due consideration to the impact thereof on valuation aspects, impairment testing, and the risks associated.

In particular in the context of the audit procedures of the 31 December 2023 (Solvency II) reporting, the parameters used in marked-to-model or alternative valuation methods should be adequately reviewed for the items on both sides of the balance sheet.

3.2. FLASHING LIGHT PROVISION

The accredited auditors are expected to pay particular attention to the compliance with the rules governing the allocation to (or the reversal of) the supplementary life provision ("flashing light" provision).

3.3. IFRS 17

IFRS 17 Insurance Contracts is an International Financial Reporting Standard that was issued by the International Accounting Standards Board in May 2017. For financial reporting relating to closings as from 1 January 2023, IFRS 17 is applicable and hereby replaces IFRS 4 on accounting for insurance contracts.

As a reminder, IFRS 4 gave insurance companies the possibility to measure their insurance assets and liabilities at book value in line with their statutory accounts, except for the accounting of some general provisions.

Under IFRS 17, the measurement of the insurance liabilities is to a much greater extent based on the current value and new concepts, like the contractual service margin (CSM) and risk adjustment, were introduced. The valuation principles under IFRS 17 are however not identical to an economic valuation (or a Solvency II valuation), which insurance companies have to include in their regulatory reporting. As a result, valuation differences will remain between the statutory, IFRS and Solvency II reporting of insurance companies.

The implementation of the accounting standard has been a significant journey for insurers creating an important degree of change. Data flows, actuarial models, IT systems, processes and controls had to be revised. This in combination of preparing the IFRS 17 open transition balance as of 1 January 2022 and the preparation of comparative figures for 2022 resulted in an increased workload for staff and management of insurance companies. Also, the interpretation and analysis of the results under this new standard turned out to be more difficult than expected.

As the implementation of IFRS 17 impacts to a large extent the whole control environment of insurance companies that are (or are part of a group) preparing consolidated financial statements, accredited auditors have to obtain a clear view on these processes, the related internal controls and its consequences on their audit approach. Therefore, audit procedures were required to be initiated in the period before 2024.

The financial year ending on 31 December 2023 will be the first annual reporting whereby insurers will prepare the full set of IFRS 17 disclosures. Auditors are therefore required to pay sufficient attention to auditing this new set of information.

3.4. PERMANENT INVENTORY AND COVERING ASSETS

We would like to remind the accredited auditors of the provisions with respect to the permanent inventory and the covering assets as specified in articles 194 and 195 of the law of 13 March 2016 on the legal status and supervision of insurance or reinsurance companies.

These provisions are discussed in more detail in circular NBB_2017_10 'Circulaire betreffende de voorrechten van de schuldeisers uit hoofde van verzekering, de doorlopende inventarissen en de samenvattende opgave van de doorlopende inventarissen' / 'Circulaire relative aux privilèges des créanciers d'assurance, aux inventaires permanents et à l'état récapitulatif des inventaires permanents'.

Following the significant increase of interest rates as from the year 2022 onwards, specific attention was paid by the supervisor to the reporting of the covering assets ratio. It was noted that, in many cases, the increase of interest rates resulted into a decrease of the covering assets ratio, as the fair value of the assets backing the technical provisions decreased.

We remind that the permanent inventory reporting is in scope of the reports prepared by the accredited auditor in accordance with article 333 of the above mentioned law. Therefore, based on the individual facts and circumstances of the insurer, the accredited auditor is expected to <u>pay attention to the impact of the evolutions of the financial markets on the covering assets ratio</u>.

3.5. <u>CIRCULAR NBB 2022 27 ON THE VALUATION OF DTA AND THE ADJUSTMENT FOR LAC DT</u>

We would like to remind the accreditor auditors of the circular NBB_2022_27 on the valuation of deferred tax assets (DTA) and the adjustment for the loss-absorbing capacity of deferred taxes (LAC DT), that has entered into force for the first time to the SCR calculation as of 31 December 2023.

This circular does not only clarify certain concepts and principles of article 207 of the Delegated Regulation 2015/35 on the adjustment for the loss-absorbing capacity of deferred taxes, it also introduces proportionality.

Accredited auditors are <u>recommended to discuss with management</u>, in the context of the year-end audit procedures, the expected impact of the application of this circular on the SCR calculation of the undertaking, especially in view of the changing tax rules with respect to the timing and extent of deductibility of the components of tax losses carried forward.

3.6. <u>FLOODS OF JULY 2021 – REMINDER OF AGREED-UPON PROCEDURES</u>

As mentioned in previous communications, protocols have been entered into by Assuralia, the insurance companies and the different Regions to formally agree on the financial compensations in favor of the insured victims of the floods of 14 to 16 July 2021.

By means of these protocols, the large insurers are committed to raise the limit of their own intervention to the double of the amount required by law. The Regions will then cover the costs exceeding the intervention limit of the insurance companies. These costs, however, are prefinanced by the insurance companies.

The modalities of the reimbursement of this prefinancing are described in the respective addendum documents, including the <u>agreed-upon procedures to be performed by the accredited auditor</u> on the reimbursement schedule prepared by the insurance company. We refer to our notice 2022 / 08 for more detailed information with respect to these procedures.

The reimbursement request, prepared by the insurance company and accompanied by the auditor's AUP report, can be submitted to the respective Regions each year, starting from:

- The year 2022 (based on 2021 information) for the Flemish Region and the Brussels-Capital Region;
- The year 2022 (based on 2021 information) for the small insurers prefinancing the Walloon Region; and
- The year 2024 (based on 2023 information) for the large insurers prefinancing the Walloon Region.

Reimbursement requests, including the auditor's report, need to be submitted to the respective Regions by 31 March of the year. Incomplete applications will be returned for completion to the insurance company, to allow the effective reimbursement before 1 August (Flemish Region and Brussels-Capital Region) or 1 September (Walloon Region) of the same year.

As the reimbursement requests from the large insurers with respect to the Walloon Region will be submitted in 2024, we encourage the accredited auditors to proactively discuss the planning with the senior management of the respective institutions.

4. INSTITUTIONS OF OCCUPATIONAL RETIREMENT PROVISION (IORPS)

4.1. THE IMPACT OF THE CHANGING METRICS ON THE SECTOR OF THE PENSION FUNDS

The FSMA expects accredited auditors to continue devoting particular attention to the prudence of the calculation of the technical provisions, and especially to the discount rate(s) used and the calculation methods applied (ABO plus buffer, PBO, ...).

Irrespective of increasing interest rates, the FSMA draws the attention on the volatility of financial markets and expects IORPs to remain cautious when increasing discount rates (step by step approach).

The FSMA wishes, furthermore, to draw the attention of accredited auditors to the following points:

- *the valuation of unlisted investments;*
- *the codification of the investments according to the reporting instructions;*
- *the verification of the total market value of the List of Assets reporting with the balance sheet total;*
- *the compliance of the asset allocation with the boundaries foreseen for each investment category in the strategic asset allocation of the SIP;*
- *if so, the follow-up of the existing recovery measures (financing of the minimum targets set out in the recovery measures);*
- *confirming, if applicable, the payment of recovery contributions that took place before 31 January 2024; and*
- *any infringements of the social legislation on supplementary pensions (signal function in the social legislation on occupational pensions, cf. article 51 of the Law of 28 April 2003).*

Accredited auditors are requested to consider the above points in their year-end audit procedures and to include relevant findings, if any, in their reporting to the FSMA.

5. Regulated Real Estate Investment Companies (GVV – SIR)

5.1. Valuation of real estate

The valuation of real estate is subject to significant judgement and is based on a number of assumptions. The uncertainties associated with the estimates and judgements, combined with the fact that a small percentage difference in the valuation of real estate could have a significant impact on the income statement and balance sheet of regulated real estate investment companies, justify particular attention of auditors during their audits.

In particular, valuation of real estate is considered an important attention point for this year-end audits due to:

- *Current macroeconomic environment: Investor's sentiment on real estate has shifted in recent years. Currently, most regulated real estate investment companies trade at a significant discount to their Net Asset Value (NAV). In the current macroeconomic situation, an increased level of uncertainty exists with respect to the determination of the fair value of real estate. Current macroeconomic conditions (e.g. high interest rates, yields and vacancy expectations) should be reflected in the fair value measurement of real estate and in the disclosures provided (e.g. on major sources of estimation uncertainty). In particular, attention should be given to the impact that recent increases in interest rates have on applicable capitalization and discount rates. With a decline in the activity in real estate markets, there may be limited information on comparable transactions in recent periods. Furthermore, prices observed in the past may not reflect the macroeconomic conditions at the end of the reporting period. If this is the case, additional valuation methods may need to be applied to ascertain that the price estimated using a comparable transactions approach is within a reasonable range of values.*
- *Climate change and sustainability: Given the impact of climate change on our society and the increasing impact on the real estate industry, property valuation should adequately take into account the extent to which these factors affect market behavior. In order to improve transparency on this matter, information needs to be disclosed on how and to what extent climate change and sustainability related factors have specifically influenced the (judgements made for the) determination of the fair value of investment property (IFRS 13, §91 and IAS 1). It is also important that information is provided on the sustainability risk profile of the investment property and how this may potentially impact property values over time.*

In this regard, reference is also made to the European common enforcement priorities for 2023 annual financial reports published by ESMA.

5.2. Refinancing risk

Taking into account the higher interest rates and the macroeconomic situation, (re)financing the regulated real estate investment companies and maintaining a healthy solvency position may also become more challenging. Adequate disclosures on this and on the risks associated with financial instruments is therefore necessary.

6. Undertakings for Collective Investment (UCI)

6.1. The role of the accredited auditor in the context of the SFDR

With respect to the Sustainable Finance Disclosure Regulation, the accredited auditors are expected to:

- monitor the compliance of the investments with the investment policy of the undertaking, including the non-financial aspects, in accordance with circular FSMA_2022_08 on the cooperation of the accredited auditors to the supervision of the undertakings for collective investment;
- for undertakings without management company, take the sustainability risks into consideration in the context of the assessment of the internal control; and
- carry out the signal function.

We refer to the slides of the Permanent Learning with respect to the UCIs, organized on 23 November 2023, for the presentation of the FSMA on this topic. The slides have been communicated electronically to all participants. Should you not have received these slides, do not hesitate to contact our scientific secretariat.

ACRONYMS	
ABO	Accumulated Benefit Obligation
AICB	Alternative Undertakings for Collective Investments
ALM	Asset and Liability Management
AUP	Agreed-Upon Procedures
Belgian GAAP	Belgian Generally Accepted Accounting Principles
BVK/UPC	**NL:** Beroepsvereniging van het Krediet **FR:** Union Professionnelle du Crédit
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1
COREP	Common Reporting
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSM	Contractual Service Margin
CSRBB	Credit Spread Risk in the Banking Book
CSRD	Corporate Sustainability Reporting Directive
DBI/RDT	**NL:** Definitief Belaste Inkomsten **FR:** Revenus Définitivement Taxés
DTA	Deferred Tax Assets
DTL	Deferred Tax Liabilities
EAD	Exposure at Default
EBA	European Banking Authority
ECB	European Central Bank
ECL	Expected Credit Loss
EIOPA	European Insurance and Occupational Pensions Authority

EPC/PEB	**NL:** Energieprestatiecertificaat **FR:** Performance Energétique des Bâtiments
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EUCLID	European Centralised Infrastructure of Data
FINREP	Financial Reporting (templates requested by the ECB)
FLI	Forward-looking Information
FSMA	Financial Services and Markets Authority
GVV	Gereglementeerde Vastgoed Vennootschap
HDP	High Default Portfolio
HTC	Hold To Collect
IAS	International Accounting Standards
ICB	**NL:** Instelling voor Collectieve Belegging (Undertakings for Collective Investment (UCI))
IFRIC	IFRS Interpretation Committee
IFRS	International Financial Reporting Standards
IORP	Institutions for Occupational Retirement Provision
IPC	Irrevocable Payment Commitment
IRAIF/IREFI	**FR** : Institut des Réviseurs Agréés pour les Institutions Financières **NL**: Instituut van de Revisoren Erkend voor de Financiële Instellingen
IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
LAC DT	Loss Absorbing Capacity of Deferred Taxes
LCRE	Low Credit Risk Exemption
LGD	Loss Given Default
LSI	Less Significant Institution

MiFID	Markets in Financial Instruments Directive (2014/65/EU)
NAV	Net Asset Value
NBB	National Bank of Belgium
NFRD	Non-Financial Reporting Directive
NPL	Non-Performing Loans
OPC	**FR**: Organisme de Placement Collectif (Undertakings for Collective Investment (UCI))
ORA	Own-Risk Assessment
PBO	Projected Benefit Obligation
PHL	Prêts Hypothécaires-Hypothecaire Leningen (templates requested by the NBB)
PD	Probability of Default
QRT	Quantitative Reporting Templates
REIT	Real Estate Investment Trust (see also GVV and SIR)
RWA	Risk Weighted Asset
SCR	Solvency Capital Requirement
SFCR	Solvency and Financial Condition Report
SFDR	Sustainable Finance Disclosure Regulation
SI	Significant Institution
SICR	Significant Increase in Credit Risk
SIP	Statement of Investment Principles
SIR	Société Immobilière Réglementée
SME	Small and Medium-sized Enterprise
SPPI	Solely Payment of Principal and Interest
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process

SRF	Single Resolution Fund
SSM	Single Supervisory Mechanism
STE	Short Term Exercise (templates requested by the ECB)
UCI	Undertakings for Collective Investment
UCITS	Undertakings for Collective Investment in Transferable Securities