Brussels, July 4, 2018

NOTICE TO ALL ACCREDITED

AUDITORS NOTICE 2018-7

Dear members,

The Management Board of IRAIF/IREFI has the pleasure to provide you in appendix the list of attention points as of 30 June 2018. The list is structured according to the relevant working groups of IRAIF/IREFI.

The FSMA and the NBB also provided their input.

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

Yours sincerely,

Olivier Macq
President IRAIF/IREFI

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Institut des Réviseurs Agréés
pour les Institutions Financières
Institut Royal
Union professionnelle reconnue

Instituut van de Revisoren Erkend
voor de Financiële Instellingen
Koninklijk Instituut
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I. General

Currently the professional standard on the cooperation of accredited auditors to prudential supervision dated 8 October 2010 is being updated.

In several meetings, the supervisors (NBB and FSMA) emphasized the importance of the signal function and the need to consider the signal function from a larger perspective. In that respect, the accredited auditor needs to demonstrate that the signal function is effective. If the accredited auditor believes that the reports to the NBB or to the Audit Committee do include the messages to be given, the NBB expects the auditor to underline the key messages. The IREFI Board is currently working on a elucidated modus operandi vis-à-vis either the NBB and the FSMA.

As mentioned in our Q4 2017 attention points, a new Law on Anti-Money Laundering (AML) has been introduced on September 18, 2017. Via Circular NBB_2018_02 of January 24, 2018 the NBB provides information on her expectations with respect to the general risk assessment on AML to be performed. It is expected that the accredited auditors discuss with their clients the status of the implementation of the new provisions introduced by this new legislation and circular.

As explained in the communication NBB_2018_05, the NBB requests the insurance institutions and financial institutions to provide on an annual basis a report including an assessment by the Board of Directors on the appropriate functioning of the Compliance function. It is expected that the accredited auditors acquaint themselves with this assessment and take into consideration the results of this analysis in their risk assessment.

II. Data Quality

The NBB issued on October 12, 2017 the Circular NBB_2017_27 explaining the expectations of the NBB on data quality of the prudential financial reporting issued by - amongst others - financial institutions, insurance institutions and payment institutions.

The NBB expects that the quality of the data is verified against the following dimensions:

- accuracy
- reliability
- completeness
- consistency
- plausibility
- timeliness

The NBB also defined its prudential expectations regarding internal organization related to data quality. These expectations are described in detail based upon three principles:

- Governance: a solid and documented governance framework for the prudential reporting including amongst others roles and responsibilities and the provision of sufficient human resources;
- Technical capacity: an adequate data-architecture and IT infrastructure ensuring amongst others that instructions are always respected and errors and inconsistencies timely detected and remediated;
- Processes: documentation of existing processes including amongst others the involved persons with their roles and responsibilities and the key controls in place.

In a first stage the institutions in scope of this circular had to prepare for the Q4 2017 prudential reporting a self-assessment to what extent the institution already meets the expectations of the NBB as described in the abovementioned circular. For the Q2 2018 prudential reporting it is expected that the institutions comply with the provisions of the abovementioned circular.

In his Q4 2017 report to the NBB on the periodical financial information, the accredited auditor had to evaluate the above mentioned self-assessment. As from 2018, the data quality controls identified by the institutions in their self-assessment have to be tested for the first time by the accredited auditor as part of the review procedures/audit procedures with regard to the 2018 periodical financial information. The NBB also expects that the accredited auditors follow-up on the remediation plan designed by the institutions as a result of the self-assessment carried out in the first semester of 2018. Given the importance of these requirements and expectations from the NBB, it is recommended that in our reporting on the Q2 2018 periodic returns we report on the procedures we have carried out, the status of the undertaking's implementation of the remediation plan and a follow-up of our observations reported to the NBB as part of our review of the Q4 2017 self-assessment.

III. IFRS 9

First time application of IFRS 9

For most financial institutions IFRS 9 "Financial Instruments" and IFRS 15 "Revenue from Contracts with Customers" have become applicable as from January 2018. IFRS 9 represents an important change for classification and measurement of financial assets, the additional transition disclosures required by IFRS 9 will need to be provided in the annual financial statements. For the review as of 30 June 2018, there are a number of attention points to be considered. These attention points are presented in section VIII (Main attention points of the NBB).

Presentation of interest revenue for financial instruments not accounted for under the effective interest method

The IFRIC received a request about the effect of the consequential amendment that IFRS 9 made to paragraph 82(a) of IAS 1. That consequential amendment requires an entity to present separately, in the profit or loss section of the statement of comprehensive income or in the statement of profit or loss, interest revenue calculated using the effective interest method. The question was whether that requirement affects the presentation of fair value gains and losses on derivative instruments that are not part of a designated and effective hedging relationship.

The Committee concluded that the requirement to present separately an interest revenue line item calculated using the effective interest method applies only to those assets that are subsequently measured at amortized cost or fair value through other comprehensive income (subject to any effect of a qualifying hedging relationship applying the hedge accounting requirements in IFRS 9 or IAS 39).

IV. Main attention points for the Insurance Sector

Cost allocation model for best estimate calculations

Following an analysis performed by NBB on the cost allocation model applied for the calculations of the best estimate technical liabilities of the 7 major insurance institutions, the NBB issued Communication NBB_2017_32 of December 29, 2017, which provides for all insurance institutions further instructions, guidelines and clarifications on this topic. This communication covers amongst others the following topics:

- granularity of the cost centers;

- allocation of overhead expenses;
- increase of transparency and objectivity;
- treatment of non-recurring expenses;
- application of contract boundaries on the costs;
- timing of modelling of the costs in the cash-flow projections;
- inflation of costs;
- back-testing;
- documentation of the cost allocation model.

The NBB expects that the insurance institutions prepare an action plan including the planned modifications to meet the provisions of this communication. The 7 insurance institutions subject to the analysis by the NBB as discussed above were expected to introduce their action plan at the NBB by May 31, 2018. The other institutions are expected to have their action plan available for the NBB. Awaiting of the implementation of the measures of the action plan, the NBB expects that the insurance institutions perform an impact analysis and apply the most prudent approaches.

It is expected that the accredited auditors take the results of the action plan and impact analysis into consideration in their audit plan and conclusions and report their findings to the NBB as part of their reporting on the periodic financial information.

<u>Validation checks between Solvency II reporting and statutory reporting</u>
Via an e-mail communication of May 3, 2018 the NBB provided the insurance institutions with an overview of additional validation controls which should ensure consistency of the reported figures between the QRT's and the statutory accounts. Some of the validation controls are mandatory to be respected while others can be explained if any differences would arise.

The accredited auditors are expected to discuss with their clients the results of these validation checks. If any differences would arise, they are expected to report these to the NBB as part of their reporting on the periodic financial information.

<u>NBB stress tests for 2018</u>
In 2018, the Belgian insurance sector is subject to a stress test consisting of two scenarios and a questionnaire on cyber risk. The scenarios and the questionnaire have been developed by EIOPA for their 2018 European insurance stress test and are adopted by the NBB and applied to a significant part of the Belgian insurance sector.

The first scenario (Yield Curve Down) assumes a persistent low yield environment and a significant increase in the average life expectancy across the entire population. The second scenario (Yield Curve Up) assesses the impact of a sudden and sharp increase in yields, an instantaneous increase in lapses and higher than expected claims inflation on the solvency position of an insurer.

The submission of the results to the NBB is expected by August 31, 2018.

The accredited auditors are expected to acquaint themselves with the results of the stress tests and to take these into consideration in their risk assessment.

<u>Interest rate risk and liquidity reporting</u>
Circulars NBB_2018_16 and NBB_2018_17 update the prior issued circulars including the instructions for completion and reporting.

Application of IFRS 17/IFRS 9.
Considering the impact of the introduction of IFRS 17 and IFRS 9 (see also infra), we recommend that the accredited auditor closely monitors the implementation of these IFRS standards to ensure that the deadlines will be met.

We also want to draw your attention to the fact that entities applying the deferral approach for IFRS 9 already have to prepare disclosures including the following information:

- Fair value information separately for:
  - Financial assets that meet the SPPI test unless held for trading or managed on a fair value basis; and
  - all other financial assets;
- Credit risk and quality information.

We recommend the accredited auditors to verify the appropriate disclosure of the information mentioned here above and to verify the results of the SPPI test.

Topics covered in previous communications that remain valid.
We also want to draw your attention at the following points which have been communicated in the prior communications and which remain valid:

- The impact of the introduction of GDPR in May 2018;
- The persistent low interest rate environment;
- The guidelines introduced by the NBB on the use of the loss absorbing capacity of deferred taxes.

V. Main attention points for Payment Institutions and Institutions for Electronic Money

The Payment Services Directive 2 (Directive 2015/2366) on payment services in the internal market got transposed in Belgium into the law of 11 March 2018 that was published and entered into force on the 26th March 2018.

PSD2 comprises a number of Guidelines (partly already transposed into Circulars) and Regulatory Technical Standards (directly applicable) mandated to the EBA around different topics such as incident reporting, home-host cooperation or security measures.

The Regulatory Technical Standards on Strong Customer Authentication and Secure Communication will enter into force in September 2019. This RTS imposes to Account Servicing Payment Service Providers (ASPSPs) to open their infrastructure and to provide access to the customer's accounts to provide two new services: payment initiation and account information services. Finally, it also defines the requirements for Payment Service Providers (PSPs) to obtain a license or be exempted.

All existing payment institution and electronic money institution’s licenses and registrations are under review by the NBB, through the submission of a PSD2 grandfathering file, to ensure that new obligations are complied with. We recommend to the auditors of payment institutions to follow-up on the status of their grandfathering file.

Title III and IV of PSD2, related to consumer protection and code of conduct, will be transposed into a separate law which will amend Book VII of the Belgian Economic Law Code.

VI. Main attention points regarding REITs and UCI

To apply for an authorization as a portfolio management and investment advice company, the FSMA has prepared a brochure that sets out concisely the applicable rules. There is a checklist accompanying the brochure (https://www.fsma.be/en/news/apply-authorization-portfolio-management-and-investment-advice-company).

VII. Main attention points of the FSMA for the audits of institutions of occupational retirement provision

The FSMA confirms that it expects accredited auditors to devote particular attention to the prudence with which the technical provisions are calculated, and especially to the discount rate(s) used.

The FSMA wishes, furthermore, to remind the following points:

- generally speaking, greater clarity in the annual reports submitted to the FSMA as regard the aspects examined by the accredited auditor, in order to give assurance that the absence of a remark about a given point means that that point was indeed verified by the accredited auditor but that the latter had no particular remark to make;
- the information in the "P40" reporting (on the governance and on the activities and financial structure of the IORPs) presenting inconsistencies vis-à-vis the information at the disposal of the accredited auditor;
- the valuation of the unlisted investments;
- the codification of the investments in securities of the IORPs based on the FSMA circular on reporting (Circular FSMA_2016_01 of 26 January 2016 on the communication of annual accounts, statistics and related documents for the 2015 financial year);
- the impact of the amendments to the Law of 28 April 2003 on Supplementary Pensions (LPC/WAP) introduced by the Law of 18 December 2015 to guarantee the sustainability and social nature of supplementary pensions and to reinforce their supplementary nature in comparison to occupational pensions and
- article 51 of the Law of 28 April 2003, pursuant to which accredited auditors "must bring to the FSMA's attention any fact or decision they may have become aware of in the course of their audit mission and that constitutes an infringement of the provisions" of the LPC/WAP and its implementing decrees.

VIII. Main attention points of the NBB

Except for IFRS 9, the previous attention points per 31 December 2017 are still relevant for the review as of 30 June 2018. For the Banking sector the attention points related to Digitalisation /Fintechs, preparedness new regulation, conditions article 36 bis, interest rate risk position 90.30, hedge effectiveness IAS 39, impairment loans, FVH associated with portfolio fair value hedging cf article 112 and 147(2) CRR. For the Insurance sector, the NBB focused on the impact of persistence low interest rate environment, use of the loss absorbing capacity of deferred taxes.

End of last year, the ECB communicated its supervisory expectations regarding a high-quality implementation of IFRS 9. The ECB also issued some specific recommendations on an individual basis after the thematic review performed for SIs. The ECB also indicated that particular attention should be paid to possible misuse of regulatory IFRS9 transitional arrangements.
On 10 October 2017, the NBB published a circular letter (NBB_2017_26) that implemented in Belgium the EBA Guidelines on credit institutions' credit risk management practices and accounting for

expected credit losses. The NBB expects all credit institutions to comply with these guidelines in their IFRS9 implementation. Henceforth, accredited auditors should consider these guidelines as part of the applicable supervisory instructions and should assess, as part of their audit work, the credit institution's compliance with the EBA Guidelines.
The attention points listed below are considered as specifically relevant for the accredited auditors' assessment of the credit institutions' implementation of IFRS 9. Accredited auditors are expected to report any attention point that would be relevant from a prudential perspective in the context of their review as of 30 June 2018. The NBB indicates that this list should not be considered as exhaustive; nor should it be considered as a check list. Accredited auditors are expected to apply their professional judgement for identifying and reporting to the NBB all relevant issues emerging from their review of the credit institution's supervisory reporting.

General considerations regarding IFRS 9

- Is the governance in place surrounding IFRS 9 implementation adequate and sufficiently documented? Does the Bank have clear and formalized description of responsibilities, specifically for the ECL measurement?
- Are the underlying assumptions & economic forecasts used for IFRS 9 consistent with those used for the budget, capital planning and DTA impairment tests?
- Do you assess the management knowledge of their ECL model as sufficient?
- Are there still pending implementation issues to be completed, as not fully implemented yet? Which simplifications, proxies or overlays have you observed? Are they compliant with the EBA guideline 2017/06?
- For subsidiaries with a group centralised implementation of IFRS 9: what is the level of ownership/understanding at the subsidiary level? Is the tool developed for the group tailored to consider local specificities (portfolio's characteristics, economic assumptions, legal context…)? Does the subsidiary use thresholds different from those used by the group?
- In case of outsourcing to external providers: are there appropriate controls in place on the external provider? What is the degree of dependence on the external provider (in particular in terms of knowledge and understanding of the data/models/methodologies…)?
- Has the institution effectively updated its credit processes/policies and internal control framework to IFRS9 and has it been correctly formalised/approved and communicated to the stakeholders concerned? Are there appropriate model validation processes in place?
- Is an audit trail of the first time adoption bookings and their impact on the retained earnings available in the systems?

Business Model Assessment

- Has the business model allocation been approved by the appropriate levels or committees?
- Are the defined business models relevant and truly representing the characteristics of the institution and its management of financial instruments?
- What are the key judgemental features of the business models; have these judgements been substantiated and documented in a satisfactory way?
- Has the institution implemented processes for periodically reviewing the business model and the documentation of existing business models?

Solely Payment of Principal and Interest (SPPI)

- Has the SPPI analysis been documented in a satisfactory way, reviewed and approved by the appropriate levels or committees?

- What are the key judgemental areas and have these judgements been substantiated and documented in a satisfactory way?
- Where a sample methodology has been used, do you assess the selection criteria as appropriate and documented in a satisfactory way? Are the selected samples sufficiently representative of the portfolio's characteristics (unbiased view)?
- Did the institution consider the following areas (among others):
    a. Prepayment penalties, how does the institution define 'reasonable' compensation for early termination?
    b. Guidance on contractually linked assets (look through analysis)?
    c. Effects of a modified time value of money element in certain instruments? (documentation)
    Update of the SPPI analysis based on the evolution of the portfolios

<u>Modified loans</u>

- Has the institution a process to assess the impact of modifications or renegotiations of existing loans on their classification at any time (existence of an appropriate process to guarantee that modifications or renegotiations do not obscure increases in credit risk)?

<u>Impairment & ECL modelling</u>

Accredited auditors are expected to report any relevant issue considering the application of the IFRS9 requirements and the EBA guideline 2017/06 and in particular, the staging process, the measurement and modelling of ECL and the evolution of the stock of allowances compared with IAS39.
Among the items to be verified in their review, the following points are specifically expected to be reported in case of relevant issues:

- Is the institution's definition of default in line with the EBA guideline 2017/06 on credit risk management practices and accounting for expected credit losses and the CRR?
  Are there discrepancies between the default definition used for the prudential reporting and for the public financial statements?
- Has the institution appropriately assessed the scope of off balance sheet items for ECL calculation (i.e. financial guarantees and loan commitments)?
- Is the data quality of inputs for the ECL models- including proxies used in the absence/lack of historical data- sufficient (in particular for determining the assets that, at first time application, had to be considered as showing a significant increase in credit risk)? Has the institution set-up a remedial action plan for remaining data quality issues if any?
- Is the inclusion of expert judgment documented in a satisfactory way? Has it been challenged?
- Are the ECL models properly documented (assumptions, input data,…) and validated by an independent function based on objective data? Is there a validation process planned in case of changes in the models (methodology or input parameters)?
- Is the Point-in Time and forward looking aspect appropriately considered in the models?
- Is the process to select the forward looking factors to be included in the ECL measurement documented? Is there a mix of internal and external data? How many scenarios are considered and why? Are they sufficiently documented (including the probability weighting process)?
- Are there remaining issues regarding ECL models. If yes, please explain. What is the target date to solve them?
- To what extent are manual interventions/overlays/temporary adjustments still necessary? Are they documented in a satisfactory way?

- In case of lower allowances for credit risk under IFRS9 compared with IAS39, is this evolution justified and documented?

Hedge Accounting

- Will the institution keep applying IAS 39 for hedge accounting (until the completion of the IASB project for dynamic risk hedging)?
- If applying IAS 39 for hedge accounting, has the institution addressed the additional related disclosure requirements mandated by IFRS 7 / IFRS 9? Have hedge accounting relationships been redefined following the reclassifications of assets? If yes, please explain and mention the impact.

Acronyms	
AML	Anti-Money Laundering
APM	Alternative Performance Measures
BE	Best Estimate
BGAAP	Belgian Generally Accepted Accounting Principles
CBF(A)	**NL**: Commissie voor het Bank-, Financie- en Assurantiewezen Banking, Finance and Insurance Commission
CCP	Central counterparty
CIS	Collective Investment Schemes
COREP	Common Reporting
CRR	Capital Requirements Regulation
CSSF	Commission for the Supervision of the Financial Sector
DTA	Deferred Tax Asset
EBA	European Banking Authority
ECB	European Central Bank
ECL	Expected Credit Loss
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
FiMiS	Financial Institutions and Markets Information System
FINREP	Financial Reporting
FSMA	Financial Services and Markets Authority
FVH	Fair Value Hedging
GDPR	General Data Protection Regulation
GVV/SIR	NL : Gereglementeerde Vastgoed Vennootschap FR : Société Immobilière Réglementée Regulated Real Estate Institution
IAS	International Accounting Standards
IBNR	Incurred But Not Reported
IAS	International Accounting Standards
ICB	**NL**: Instelling voor Collectieve Belegging Undertakings for Collective Investment (UCI)
IFRS	International Financial Reporting Standards
IORP	Institutions for Occupational Retirement Provision
LPC/WAP	Law of 28 April 2003 on Supplementary Pensions
LPF	Level Playing Fields
MiFID	Markets in Financial Instruments Directive
NBB	National Bank of Belgium
QRT	Quantitative Reporting Templates
REIT	Real Estate Investment Trust (GVV/SIR - NL: Gereglementeerde Vastgoed Vennootschap; FR: Société Immobilière Réglementée)
SII	Solvency II
SPPI	Solely Payment of Principal and Interest
UCI	Undertakings for Collective Investment
UCITS	Undertakings for Collective Investment in Transferable Securities