

Zaventem, 28 June 2022

NOTICE TO THE ACCREDITED AUDITORS
NOTICE 2022 / 09

Dear Members,

On a six-monthly basis, the IRAIF/IREFI informs the accredited auditors of some highlights or key issues that could influence their work.

The supervisory authorities 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.

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

On 17 June 2022, a Capita Selecta session was organized in close cooperation with the NBB, and detailing some of the topics mentioned in the attached letter. The slides of this training are available on the ICCI portal ([Past events \(icci.be\)](https://www.icci.be)).

The IRAIF/IREFI working group dealing with the model reports has finalized the templates for prudential reporting as of 30 June 2022 to the NBB and the FSMA. The updated versions will be communicated shortly.

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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INTRODUCTION

The attention points have been identified and drafted by the respective working groups of the IRAIF/IREFI and, subsequently, confirmed by the National Bank of Belgium (NBB). To the extent that the accredited auditor identifies elements that, based on professional judgement, are considered relevant for the prudential authorities, these findings will be reported to the NBB as per 30 June.

The attention point presented in *italics* has been provided by the FSMA and clearly includes the expectations with regard to the auditor's procedures in the context of the half-year 2022 reviews and the reporting thereon.

1. ATTENTION MATTERS APPLICABLE TO ALL FINANCIAL INSTITUTIONS

1.1. COVID-19 PANDEMIC RELATED MATTERS

The pandemic has changed our lives over the course of the last two years. It has impacted every industry, as well as our society and the macro-economic metrics. One such metric is inflation, which has been increasing significantly during the last couple of months, reaching 8.1% in May 2022 in the Eurozone. In addition to the increased inflation, the interest rates are expected to rise in the near future as well.

Accredited auditors should remain highly alert to the impacts of this changing economic climate to which the financial institutions are exposed in the context of their half-year review.

1.2. IMPACT OF THE INVASION OF UKRAINE

We would like to remind the accredited auditors of our notice 2022 / 05 dated 18 March 2022, in which we referred to the communications issued by the ESMA, the EBA and the NBB on the restrictive financial measures taken in the context of the conflict in Ukraine, and the responsibilities of the financial market participants and the financial institutions in this respect. The accredited auditors are expected to take these measures into consideration in performing their 30 June review procedures.

Recently, the European Securities and Markets Authority (ESMA) has issued per 13 May 2022 a statement to promote transparency and consistent application of European requirements for information provided in half-yearly financial reports with regards to Russia's invasion of Ukraine. In addition, ESMA provided an update per 9 June 2022 of its risk assessment to account for the impacts on financial markets of the invasion of Ukraine and the deteriorating economic environment.

ESMA states among others that the risk remains at the highest level, with political event risk, surging inflation and jumps in market volatility negatively impacting the outlook. More specifically, the ESMA refers among others to the fact that:

- Following the Russia invasion and the resulting sanctions, funds and investors with exposures to Russian assets have faced substantial valuation issues. They observe significant asset repricing, with riskier assets falling in value (particularly equities, corporate bonds and emerging market debt).
- Prices of commodities and related derivatives have jumped sharply and are adding to pre-existing inflation pressures.
- There are increasing market expectations of higher interest rates and growing likelihood of far-reaching rebalancing of portfolios as investors adjust to the new environment.
- Cyber risk is very high and remains a key concern for financial markets, as attacks targeting infrastructures and firms could be very disruptive.

- Crypto assets have experienced sharp falls in value. It refers to the importance of the recently published ESAs joint warning on crypto assets (reminding consumers of the highly volatile and speculative nature of many crypto markets).

ESMA references to their observation that Russia's invasion of Ukraine and the sanctions imposed against Russia and Belarus pose significant challenges to business activities and introduce a high degree of uncertainty on the expected development of those activities and the associated knock-on effects on the economic and financial system, at both European and international level. It highlights the need to provide information that is useful to users and adequately reflects the current and, to the extent possible, expected impact of Russia's invasion of Ukraine on the financial position and performance of entities.

A significant risk of material adjustment to the carrying amounts of assets and liabilities may have arisen according to ESMA. Therefore they consider a need to update the assessment made at year-end on significant judgements, on the assumptions about the future and other major sources of estimation uncertainty. ESMA reminds also on the importance of updating the disclosures relating to the sensitivity analyses.

Related to IFRS 9, ESMA reminds that in assessing the impairment of the debt securities and loans, as well as of lease and trade receivables and contract assets entities may need to consider the effect of invasion-induced events on whether there has been a significant increase in credit risk (SICR) and on the measurement of expected credit losses (ECL) taking into account forward-looking information. ESMA also states that those entities who rely to a large extent on historical information should carefully reassess whether their ECL-measurement models reflect the impact of the invasion of Ukraine and related events on credit risk and ECL-measurement.

Accredited auditors are invited to discuss the assessment of the restrictive financial measures taken and the risk elements commented by ESMA.

2. CREDIT INSTITUTIONS

2.1. IMPACT OF COVID-19 PANDEMIC – CREDIT RISK

Taking into account the persistence and the magnitude of the Covid-19 pandemic, combined with the previously mentioned impact of the invasion of Ukraine by Russia and the changing macro-economic climate, we recommend the accredited auditors to remain highly alert to the risks to which the financial sector is exposed, in particular the credit risk and its measurement in the financial and prudential periodic reporting as 30 June.

As the pandemic appears to remain under control, the accredited auditors are requested to discuss the evolutions of the overlays, if any, that were previously recorded to cover the increased expected credit losses. In the context of their review, it is recommended the accreditors auditors read and further discuss the back-testing exercise conducted by the institutions and the related results, the scenario used in the expected credit loss and any specific sector approaches that would be applied.

Accredited auditors are invited to discuss the impact assessment performed by the institution's management about the risks related to the increased inflation and interest rates and the impact on the ECL as of 30 June 2022.

2.2. DEROGATION ARTICLE 36BIS

As already mentioned in our Attention Points Letter per 31 December 2021, we would like to remind the accredited auditors of the issuance of the circular NBB_2021_20 on the practical rules for the application of the Article 36bis of the Royal Decree of 23 September 1992 on the financial statements of credit institutions. This circular relates to the accounting treatment of forward interest rates transactions (derivatives) as amended by the Royal Decree of 29 August 2021 and provides detailed information on the transitional period and the submission of an application file to the Bank.

Accredited statutory auditors shall inquire with credit institutions' senior management about (i) the status of the approval of the new authorization's application files, (ii) the potential impact of the (non-)approval on the 30 June 2022 situation, if any, and (iii) the analysis of the effectiveness testing.

2.3. SECTORAL SYSTEMIC RISK BUFFER FOR IRB BELGIAN RESIDENTIAL REAL ESTATE EXPOSURES

Through the Royal Decree of 21 February 2022, the National Bank of Belgium introduced as from 1 May 2022 a new macroprudential measure for retail exposures of IRB banks on Belgian residential real estate, replacing an earlier measure introduced in 2018 that expired on 30 April 2022.

The macroprudential measure imposes the constitution of a CET1-capital buffer in the form of a sectoral systemic risks buffer for Belgian residential real estate exposures of banks that use internal models for the computation of risk-weighted exposures (IRB banks). The targeted exposures are exactly the same as the ones targeted by the previous measure applied until 30 April 2022, according to article 458 CRR. That is, the relevant real estate exposures targeted by the measure are retail exposures secured by residential real estate located in Belgium. They also include exposures partially or fully secured by mortgage mandates and cover both defaulted and non-defaulted loans.

This sectoral systemic risk buffer is computed by multiplying the risk-weighted assets (RWAs) related to the abovementioned relevant exposures by 9%. Contrarily to the previous article 458 CRR measure, this measure does not result in an increase of the RWAs but in the constitution of a specific CET1-capital buffer, called (sectoral) systemic risk buffer. Reporting Banks are required to report the amount of this sectoral systemic risk buffer in COREP Table C04.00, row 0780 and count it as part of the Combined Buffer Requirement (COREP Table C04.00, row 0740), starting with the reporting cycle of June 2022.

We recommend the auditors of IRB banks to take this into consideration when performing their 30 June review procedures on the prudential reporting.

3. INSURANCE SECTOR

3.1. THE IMPACT OF THE INFLATION RATE ON THE INSURANCE SECTOR

With reference to the increased inflation rate as mentioned in section 1.1, we would like to draw your attention to its specific impact on the insurance sector. A higher inflation rate will most likely result in increased costs for insurance undertakings, notably with respect to the claims compensation in Property & Casualty insurance but also to the expenses for both Life and Non-life products. Insurance undertakings should assess the impact of high inflation on the carrying amount of claims provisions in the context of the statutory, IFRS and Solvency II framework. A specific line of business that is directly impacted is workmen's compensation and the related indexation provision (as defined by art 34 sexies §9 of the Royal Decree of 17 November 1994 related to the annual accounts of insurance undertakings).

Based on their professional judgment, accredited auditors should remain highly alert to the impacts of the increased inflation to which the insurance undertakings are exposed in the context of the half-year review procedures.

3.2. UNDERTAKING SPECIFIC PARAMETERS (USP)

The NBB would like to remind the accredited auditors of the issuance on 22 December 2020 of the circular NBB_2020_040 on the use of Undertaking Specific Parameters. This circular provides information on the Bank's guidelines for the use of Undertaking Specific Parameters (USP) in the calculation of the Solvency Capital Requirement.

When calculating the Solvency Capital Requirement, undertakings may replace a subset of parameters (standard parameters) within the standard formula by parameters specific to them, if the standard formula does not provide an appropriate representation of their underlying risks. This should help to promote sound risk management within insurance and reinsurance undertakings.

The circular provides further specification on the data quality criteria that should be taken into account during the process of calculating undertaking specific parameters and group-specific parameters.

As stated in the circular, accredited auditors are expected to explicitly address the verification of the USP parameters in their reporting with respect to Solvency II and comment specifically the key findings in their reporting as per 31 December.

3.3. FLOODS OF JULY 2021 - UPDATE

As mentioned in our notice 2022 / 02 dated 2 February 2022, 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. The following protocols have been concluded:

- protocol dated 11 August 2021 between the Walloon Region, Assuralia and the insurance companies (in the process of being signed by the Walloon Region);
- protocol dated 2 September 2021 between the Brussels-Capital Region, Assuralia and the insurance companies (signed); and
- protocol dated 3 September 2021 between the Flemish Region, Assuralia and the insurance companies (signed).

By means of these protocols, the large insurers are committed to raise the limit of their intervention to the double of the amount required by law and to prefinance the interventions of the Regions. The modalities with respect to the reimbursement of this prefinancing are described in the respective addendum documents, including the agreed-upon procedures to be performed by the accredited auditor of the insurance company. We refer to our recent notice 2022 / 08 for more detailed information with respect to these procedures.

It is to be noted that in the protocol with the Walloon Region, new negotiations on the cost allocation are anticipated in case the total amount of the financial compensations would exceed EUR 1.700 million. As the financial interventions already exceed this limit, new negotiations will take place. At the date of this Letter, these negotiations have, however, not yet been initiated.

Accredited auditors are expected to pay attention to the impact of this uncertainty in the context of the 30 June review procedures.

4. PAYMENT INSTITUTIONS (PI) AND E-MONEY INSTITUTIONS (ELMI)

4.1. SAFEGUARDING OF CLIENT FUNDS

As already reminded by the NBB in the Attention Points Letter of 31 December 2021, the PI/ELMI must safeguard the funds used for payment until these funds are (i) received by the beneficiary or (ii) received by the beneficiary's payment service provider. However, the results from on-site inspections have demonstrated that these principles are not always complied with. On this basis, the Bank decided to clarify the timing of safeguarding obligations, and more specifically when these end for the payment service provider (PSP) in case of the use of external parties (often outside the EEA) in the new circular 2022_13.

On 17 June 2022, the NBB presented this topic during our Capita Selecta training. The slides are available on the ICCI portal ([Past events \(icci.be\)](#)).

The accredited auditors are expected to discuss this topic with the institutions in the context of the 30 June review procedures.

5. REGULATED REAL ESTATE INVESTMENT COMPANIES (GVV – SIR)

5.1. ATTENTION POINTS WITH RESPECT TO COVID-19, THE AFTERMATH

In some sectors, real estate investment companies quote at significant discounts to net asset value in the aftermath of the Covid-19 pandemic. The FSMA draws attention to changed habits after Covid-19 (e.g. teleworking, new hybrid working models) and the changing economic climate (e.g. rising interest rates and inflation) and the impact this may have on the valuation of real estate.

In the context of their review, the accredited auditors are expected to give due consideration to the impact of Covid-19 and the changing economic climate when reviewing (the valuation of real estate in the) interim financial reports and to report relevant findings to the FSMA.

<u>ACRONYMS</u>	
AICB	Alternative Undertakings for Collective Investments
AIFMD	Alternative Investment Fund Managers Directive
AML/CTF	Anti-Money Laundering Legislation
APM	Alternative Performance Measures
BE GAAP	Belgian Generally Accepted Accounting Principles
CIS	Collective Investment Schemes
CIU	Collective Investment Undertakings
COREP	Common Reporting
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
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
ELMI	Electronic Money Institution
ESG	Economic Scenario Generator
FINREP	Financial Reporting (templates requested by the ECB)
FSMA	Financial Services and Markets Authority
GDPR	General Data Protection Regulation
GVV	Gereguleerde Vastgoed Vennootschap
ICAAP	Internal Capital Adequacy Assessment Processes

ICB	NL: Instelling voor Collectieve Belegging Undertakings for Collective Investment (UCI)
IFRIC	IFRS Interpretation Committee
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Processes
IORP	Institutions for Occupational Retirement Provision
IPC	Irrevocable Payment Committee
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 and Deferred Tax
LGD	Loss Given Default
LPC/WAP	Law of 28 April 2003 on Supplementary Pensions
LSI	Less Significant Institution
LTRO	Long-Term Refinancing Operation
MiFID	Markets in Financial Instruments Directive (2014/65/EU)
MMF	Money Market Funds
NAV	Net Asset Value
NBB	National Bank of Belgium
NPL	Non-Performing Loans
OPC	FR : Organisme de Placement Collectif Undertakings for Collective Investment (UCI)
ORA	Own-Risk Assessment
P2G	Pillar 2 Guidance

PD	Probability of Default
PI	Payment Institution
PSD	Payment Services Directive
PSP	Payment Service Provider
QRT	Quantitative Reporting Templates
REIT	Real Estate Investment Trust (see also GVV and SIR)
RICS	Royal Institute of Chartered Surveyors
RSR	Regulatory Supervisory Report
RWA	Risk Weighted Asset
SFCR	Solvency and Financial Condition Report
SI	Significant Institution
SICR	Significant Increase in Credit Risk
SIR	Société Immobilière Réglementée
SME	small and medium-sized enterprises
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
TCWG	Those Charged With Governance
TLTRO	Targeted Longer-Term Refinancing Operations
TRIM	Targeted Review of Internal Models
UCI	Undertakings for Collective Investment
UCITS	Undertakings for Collective Investment in Transferable Securities