# Preface

The purpose of this working program is to document possible audit/assurance procedures planned and performed in respect of the capital requirement for counterparty default risk.

This audit program contains procedures relating to internal controls, substantive audit procedures and analytical procedures. The extent of detailed testing is not specified and should be determined based on the nature of the procedure, the inherent risk assessment and the outcome of internal control testing.

We note that this program is based on the assumption that sufficient testing (both internal controls and substantive) has been performed on the underwriting, claims, actuarial, reinsurance and other operational processes of the insurance undertaking by the auditor during the audit of the statutory accounts and/or periodic returns. As a result, this working program only covers the additional procedures to be performed by the auditor in order to obtain reasonable assurance on the calculation of the SCR Counterparty Default Risk in accordance with the Solvency II Framework.

This working program is composed of two parts. The first part deals with the reliance that can be placed on internal controls. For the various components of the process, typical internal controls that can be expected to be in place have been listed. These lists are however not to be considered as exhaustive and should be tailored to each specific assignment. Three different categories of controls are used: operating controls, IT controls and model governance controls. The auditor’s evaluation over internal controls covers the both the evaluation of the design and implementation of the internal control identified and the evaluation of the operating effectiveness of internal controls for which the design has been assessed as effective.

Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of a control means that the control exists and that the entity is using it. Procedures to obtain audit evidence about the design and implementation of relevant controls may include inquiring of entity personnel, observing the application of specific controls, inspecting documents and reports and tracing transactions through the relevant information system (walk through). Inquiry alone, however, is not sufficient to evaluate the design and implementation of relevant controls. When evaluating the design and implementation of a control, the auditor considers the objective of the control (which also addresses the risk, including fraud risk, it helps to mitigate), how it is performed and documented, including the nature and size of the potential misstatements addressed and end-user computing considerations, the nature of the control, whether the control addresses a fraud risk, how frequently it is applied, the knowledge, experience and skills of the person performing it (if a manual control or a manual control with an automated component), the related IT application, if any, size and complexity of the entity, the auditor’s existing knowledge of the entity's internal controls and the nature and extent of changes in the systems and operations.

Testing the operating effectiveness of controls is performed only on those controls for which the auditor believes that those are suitably designed to prevent, or detect and correct, a material misstatement in an assertion. The following audit procedures may be used, often in combination, to obtain audit evidence about the operating

effectiveness of controls: inquiry, observation, inspection, re-performance and recalculation. Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry.

The second part deals with the additional substantive procedures to be performed. The determination of the extent of substantive procedures is dependent on the operating effectiveness of internal controls. This part of the program is based on the assumption that full reliance can be placed on internal controls identified in the first part of this working program (given the fact that both the Solvency II framework and Law of 13 March 2016 require that the insurance undertaking must have a system of internal control adapted to the nature, size and complexity of the business). In case that certain internal controls would be missing or that certain internal controls are not operating effectively, these substantive procedures require further completion, by designing and performing procedures (based on the controls identified in the first part of this document) substantively by reference to known sampling methods (statistical sampling, non-statistical sampling, attribute sampling). This part also requires further customization to the specific characteristics of the insurance company. In appendix, a non-exhaustive list of substantive procedures has been attached to this working program that the auditor can use for the selection of additional substantive procedures in case for certain internal controls the design and/or operating effectiveness would be evaluated as “non-effective”.

It is also to be noted that for quarterly reports, insurance and reinsurance undertakings may calculate Best Estimate and Risk Margin using simplifications. In addition they are not required to calculate a Solvency Capital Requirement on a quarterly basis and where the calculation of the Minimum Capital Requirement does not coincide with an annual calculation of the Solvency Capital Requirement, undertakings should use the last calculated Solvency Capital Requirement in accordance with Article 102 of Directive 2009/138/EC. For those undertakings using quarterly simplifications, the working program should be adapted and focus on the review of the last Solvency Capital Requirement reported and the validation of the assumption that the risk profile of the undertaking has not been altered since the date on which the Solvency Capital Requirement was last reported.

Abbreviations used in this document

For the assertions C, E, A, V, O, P: Completeness, Existence, Accuracy, Valuation, Ownership, Presentation

EUC: End User Computing

EBS: Solvency II Economic Balance Sheet RoSM: Risk of Significant Misstatement

During the execution of the audit/assurance procedures on the SCR calculations, the statutory auditor will contact, inquire and review the reports of the different independent control functions in order to ensure that recommendations / remarks issued by these control functions have been properly addressed by the insurance undertaking for the calculation of the best estimate.

It is required that the statutory auditor inquires the internal audit function in order to assess to what extent internal audit has performed any audit assignments with respect to the SCR calculations performed by the insurance undertaking.

When the statutory auditor decided to rely (partly) on the work performed by internal audit, the actuarial function or any other (management) expert, it follows the requirements set forth in ISA 610 “Using the work of internal audit and/or ISA 500 “Audit Evidence” (which is broadly consistent with ISA 620 “Using the work of an auditor’s expert”). In this context, it is to be noted that the auditor has the sole responsibility for the assurance report expressed, and that responsibility is not reduced by the auditor’s use of internal audit and/or expert. Once the auditor has determined to use the work of internal audit or an expert, it will:

* evaluate the competence and capabilities of the internal audit function/expert;
* evaluate the objectivity of the internal audit function/expert;
* obtain an understanding of the internal audit function’s /expert’s field of expertise;
* agree terms of the collaboration (in particular the scope of the work, which should be consistent with the procedures indicated in this working program);
* evaluate the adequacy of the work performed (including review of working papers prepared and if deemed necessary re-performance of procedures).

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| **Control reference** | **Anti - fraud control** | **Significant account/ disclosure** | **C** | **E** | **A** | **V** | **O** | **P** | **Evaluation of the control’s design and implementation** | | **Evaluation of the control’s operating effectiveness** | | | |
| **Results of evaluation of design and implementation** | **W/P Ref** | **Control description** | **Results of test(s) of operating effectiveness** | **Done by and date** | **W/P Ref** |
| IC 01 |  | SCR  Counterparty Default Risk |  |  |  |  |  |  |  |  | **General**   * Understand the undertaking’s process of calculation, analyzing, validation and approving SCR Counterparty Default Risk.   Identify and test key internal controls in this process. Verify that the documentation is up to date and adapted to the latest version of Solvency II requirements.   * Review decision and documentation process for correctly applying the Solvency II requirements for calculating SCR Counterparty Default Risk (interpretations, decision process for applying simplifications, …). Notably, if simplification Article 112 of Delegated Acts is used, conditions of Article 214 of Delegated acts should be fulfilled and documented   **IT related controls**   * General IT controls. * Automated controls on interfacing between administrative / accounting / modelling systems used for the calculation of the SCR Counterparty Default Risk. * Controls for data input into EUC applications (if any). |  |  |  |

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| IC 01 |  | SCR  Counterparty Default Risk |  |  |  |  |  |  |  |  | **Input data**   * Controls relating to data quality policy, self-assessment and action plan (Circular NBB\_2017\_27) Data governance controls (ownership of data). * Assess adequacy of inputs used for SCR calculation. * Verify whether at each reporting date a full reconciliation exercise with thorough documentation is carried out between the data inputs for EBS and the data inputs for risk calculations. * Data Governance controls on decisions in the data structuring process, especially on authorization, documentation and rationale. * 4-eyes principles (e.g. on major corrections, adjustments and manual entries).   **Calculation**   * Assess adequacy of SCR calculation with Solvency II requirements * Manual calculation steps:   4-eyes principle on performed manual calculation steps.   * Automated SCR calculation steps:   + Test and approval process of the automated model scope & design.   + Review of conceptual design incl. comparison to the initial scope and assessment on implications to the overall model environment   + Test and approval of the model implementation.   + Checks and controls based on the company’s model change guidelines: |  |  |  |

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| IC 01 |  | SCR –  Counterpart Risk |  |  |  |  |  |  |  |  | Validation controls and assessment of results   * Governance controls on authorization & review. * Documentation and rationale especially regarding sufficient assessment of stability and robustness of results. * Plausibility checks on results. * Management review on results. |  |  |  |

# PART II - SUBSTANTIVE TESTING

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|  | **Rationale for risk of significant misstatement assessment** | **Risk of significant misstatement (ROSM)** |
| Inherent risk | Inherent risk is assessed as significant.  Due to the significant uncertainty and judgments involved, there is inherent risk in the calculation of SCR Counterparty Default Risk under the standard formula, including lack of controls over inputs / outputs, capital adequacy and the going concern assumption. | LOW MEDIUM  HIGH |
| Control risk | To assess the control risk based on the audit team’s evaluation over the design, implementation and operating effectiveness of  controls identified in the reserving process (see chapter I Working program control testing). |

| **AP**  **Reference** | **Nature, timing and extent of audit/assurance procedures** | **Reference to Solvency II framework.** | **Significant account**  **/ disclosure** | **Done by and date** | **W/P Ref** |
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| SCR\_CPTY | Review reconciliations of the data for which an error would have a material impact on the results used within the SCR. Follow up where differences have been found.  Make a reconciliation between each submodule output and the EBS to ensure that all assets are taken into account as required by Solvency II requirements. | NBB\_2017\_27 | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | Ensure that all inputs used have been properly audited during the audit of the statutory / consolidated accounts / periodic return or during the review of other QRT’s. Would this not be the case, perform additional procedures to obtain sufficient reasonable assurance. | NBB\_2017\_27 | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | For inputs, checks are to be performed on the key data including notably:   * Amounts; * Credit Quality Step; * Counterparty and counterparty group.   All these inputs were audited as part of the SII Balance Sheet audit, the Market Risk audit and the Underwriting Risks audit and should be checked for consistency with that audit. | In the Delegated Acts:   * Determination of Single Name Exposure: art. 190 * Parameters for LGD calculation: art. 192, 193-195 (pooling arrangements)   NBB\_2017\_27 | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | Assess whether assumptions are in line with the requirements set forth in the Delegated acts (for example. type 1 and type 2 classifications, impact on PD of guarantees provided by specific counterparties).  Following items should be taken into account:  - Assets of external pension funds (EIOPA-BoS-14/174)  - Risk mitigation  - Repo’s/reverse repo’s | In the Delegated Acts:   * General scope – Type 1 and 2 classifications: art. 189 * Risk-mitigation character: * Definition: art.208-210 (effective transfer of risk) and 213 * Reinsurance – SPV: art. 211 * Financial: art. 212 * Calculation impact: art. 196 * Collaterals & guarantees: * Conditions: art.214-215 * Risk-adjusted value collateral: art. 197 * Mortgage loans * Classification as type 2: art. 191 * Risk-adjusted value: art. 198 * PD Type 1 exposures: art.199-201 * PD Type 2 exposures: art. 202 | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | Document new type of counterparty exposure of the year, and consider how they are treated under the reporting period (for the first year, also the existing exposures). | In the Guidelines NBB circular NBB\_2016\_16:   * Guideline / orientation / richtlijn 1:employee benefits * Guideline / orientation / richtlijn 9: estimation of missing nominal value for commitments, which may create payment obligations. | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | Review / perform the variation analysis of calculated counterparty default risk with the preceding period. Ensure that all items referred to in this variation analysis have been assessed for reasonableness and/or reconciled with audited data. |  | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | Update and amend, if appropriate, the assessment of RoSM and the rationale, and re-evaluate the planned audit/assurance procedures. |  | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | Assess interaction between Long-Term Guarantee adjustments and calculation of Solvency Capital Requirement sub-module for counterparty default risk: check computation of SCR counterparty default risk performed without LTG measures.  In addition, one should assess effects of long term guarantee adjustments and transitional measures on policyholders’ behavior when reviewing assumptions on the likelihood of exercising contractual options. | NBB\_2016\_25 | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | Verify aggregation of LGD’s per PD bucket  recalculate V\_inter, V\_intra, type I counterparty default risk, type II counterparty default risk and diversification effects, |  | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | **IM:** The control of the respect of the conditions of approval of the internal models is not the responsibility of the auditor, except for the tasks specifically mentioned in articles 332 and 333 of the Control Law.  The (“Statutory Auditor or “Accredited Auditors”, as appropriate)’s engagement does not encompass the review of the internal models which are used for the computation of the regulatory capital requirements nor of the models, the outcome of which is used as input for the computation of the regulatory capital requirements. The NBB does not require any reporting from the (“Statutory Auditor” or “Accredited Auditor”, as appropriate) on these internal models. The approval of the said internal models as well as the compliance with the conditions for this approval are, for prudential purposes, followed-up directly by the NBB.  The (“Statutory Auditor or “Accredited Auditors”, as appropriate) has however to perform the procedures as required by the circular of the NBB NBB\_2017\_20 to the (“Statutory Auditor” or “Accredited Auditor”, as appropriate), being the review of the accuracy of the data entered in the internal models and the review of the correct insertion of the data output of the internal model in the annual periodic reports. | NBB\_2017\_20 | SCR Counterparty Default Risk |  |  |
| SCR\_CPTY | If the **simplified formula** is applied, evaluate whether criteria for simplification have been met and verify that the correct formula has been applied | New simplifications brought with the Amendment to Delegated Acts EC/2019/981.  In the Delegated Acts   * Article 110 * Article 111 * Article 111a * Article 112 * Article 112a * Article 112b | SCR Counterparty Default Risk |  |  |