Zaventem, 19 January 2021

NOTICE TO THE ACCREDITED AUDITORS
NOTICE 2021 / 01

Dear Members,

On a six-monthly basis, the Management Board of the IRAIF / IREFI informs the accredited auditors of main highlights or attention points, which could influence their work.

The NBB, the different IREFI / IRAIF Working Groups and the Technical Director have contributed to this letter, by providing a list of their attention points. The FSMA informed us that it would not communicate new attention points to be reported in the 31 December 2020 reporting but confirmed that the attention points reported as of 31 December 2019 and 30 June 2020 are still applicable. We refer to the relevant IREFI / IRAIF communications.

The attention points have been compiled in the context of the current legal and regulatory framework of cooperation of the accredited auditors to the supervision by the FSMA and NBB. Although reflections and preparatory work are taking place in order to draft a new standard for the cooperation of accredited auditors to the prudential supervision by the NBB, the current framework still applies until further notice.

On 13 January 2021, a *"Capita Selecta"* session is scheduled at the IBR/IRE. It will be held in cooperation with the NBB and the FSMA, and some of the topics mentioned in the current letter will be further detailed during that training session. As a reminder, the FSMA organized its permanent training sessions on 27 November and 4 December 2020.

The IRAIF/IREFI Working Group *"Model Reports Templates"* is currently updating the templates for prudential reporting to the NBB and the FSMA. The updated versions should be released early 2021.

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

Yours sincerely,

Olivier Macq (Signature) Digitally signed by Olivier Macq (Signature)

Olivier Macq
President IRAIF / IREFI

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

Instituut van de Revisoren Erkend voor de Financiële Instellingen
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INTRODUCTION

The attention points marked by an asterisk (*) are those for which the NBB has informed us that accredited auditors should perform a follow up in the context of their year-end 2020 audit and explicitly report upon in their reporting to the NBB.

The FSMA indicated that the attention points it communicated as at 31 December 2019 and 30 June 2020 are still applicable. These points are also marked by an asterisk (*)

Attention points without an asterisk are points for information of the accredited auditors and for which it is not mandatory to report in the reporting to the NBB and the FSMA. The accredited auditors will use their professional judgment and decide, based on facts and circumstances, whether these need to be explicitly addressed in the semi-annual reports to the prudential authorities.

Texts is italics have been provided by the NBB and/or the FSMA.

1. COVID-19 CRISIS & BREXIT – PRUDENTIAL REPORTING AND AUDIT CONSIDERATIONS

In setting this year-end attention points, the IREFI / IRAIF has focused on the need to provide insights regarding the consequences of the Covid-19 pandemic which, due to its pervasive nature, are expected to affect the entire economy and all the financial institutions.

Consequently to the persistence of the pandemic and its impacts, the attention points as of 30 June 2020 reported in the IREFI / IRAIF Communication 2020/06 dated 29 June 2020 are still applicable for all the sectors that fall under the supervision of the NBB and the FSMA. The relevant requirements of these points apply "*mutatis mutandis*" for the attention points as of 31 December 2020. The accredited auditors will refer to the above-mentioned publication for the 31 December 2020 closing and reporting.

The attention of the accredited auditors is drawn to the additional measures that have been taken by the federal government and the Belgian financial sector in support of the economic resilience as well as the prudential measures adopted in this framework.

1.1. ISA 540 (REVISED) – AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

The IAASB revised ISA 540 – *Auditing Accounting Estimates and Related Disclosures* (effective for financial statements audits for periods beginning on or after 15 December 2019) with the aim of establishing more robust requirements and appropriately detailed guidance to apply when auditing accounting estimates. The revision was driven, in part, by changes in accounting standards that have increased the complexity, subjectivity and uncertainty of accounting estimates, and their importance and interest to users of financial statements (e.g. Expected Credit loss - ECL- in IFRS 9).

Key changes to the revised standard include:

- more emphasis on the need for the auditor to exercise professional skepticism;
- more granular assessments regarding the risk that accounting estimates are materially misstated;
- a focus on appropriately responding to the levels of estimation uncertainty, complexity and subjectivity in accounting estimates;
- revised audit requirements that are more specifically directed at the components of an accounting estimate, such as methods (including models), assumptions and data;
- clearer linkage of audit procedures to assessed risks and significant judgments to the auditor's determination of whether accounting estimates and related disclosures are reasonable; and
- more emphasis on auditing accounting estimate disclosures in the financial statements.

1.1.1. Impact of ISA 540 (Revised) on the audit of IFRS 9

During the first year of application of ISA 540 (Revised), special consideration will be required when determining how to apply the enhanced requirements of the revised standard.

Because these enhancements were developed with complex estimates (like ECL) in mind, incremental work effort will be required by the auditor to apply and evidence compliance with the requirements.

The following key enhancements were made to ISA 540 (Revised):

- Introduced the concept of inherent risk factors, including not only estimation uncertainty but also complexity, subjectivity and others (ISA 540 (Revised) paragraphs 2, 4 and 16).
- Enhanced risk assessment procedures relating to obtaining an understanding of the entity and its environment, including the entity's internal control (ISA 540 (Revised) paragraph 13).
- Introduced a separate assessment of inherent risk and control risk for accounting estimates (ISA 540 (Revised) paragraph 16).
- Emphasized the importance of the auditor's decisions about controls relating to accounting estimates by highlighting relevant requirements in ISA 315 (Revised) and ISA 330 (ISA 540 (Revised) paragraphs 19 and 20).
- Introduced objectives-based work effort requirements directed to methods (including specifically when complex modelling is involved), data and assumptions, to design and perform further audit procedures to respond to assessed risks of material misstatement (ISA 540 (Revised) paragraphs 7, 19 and 22–25).
- Enhanced the 'stand back' requirement, by adding an evaluation of the audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence (ISA 540 (Revised) paragraphs 33–35).
- Enhanced disclosure requirements to obtain audit evidence about whether the related disclosures are 'reasonable' (ISA 540 (Revised) paragraphs 26(b), 29(b) and 31).
- Introduced more detailed written representations (ISA 540 (Revised) paragraph 37).
- Introduced a new requirement to consider matters regarding accounting estimates when communicating with those charged with governance (ISA 540 (Revised) paragraph 38).

These enhancements may have a significant impact on the approach to auditing the ECL estimate. Two keys enhancements are particularly significant, these have been explored below: inherent risk factors; and objectives-based work effort requirements directed to methods, data and assumptions.

(i) <u>Inherent risk factors</u>

Inherent risk factors are characteristics of conditions and events that may affect the susceptibility of an assertion to misstatement, before consideration of controls.

In the identification and assessment of the risks of material misstatement requirements, ISA 540 (Revised) acknowledges the following inherent risk factors:

- estimation uncertainty;
- complexity;
- subjectivity; and
- other inherent risks (i.e. change in nature or circumstance of the relevant financial statement items or susceptibility to misstatement due to management bias or fraud in making the accounting estimate).

These inherent risk factors play a central role in the risk assessment and throughout ISA 540 (Revised)

What are these inherent risk factors?

- estimation uncertainty (ISA 540 (Revised), Appendix 1 – Inherent Risk Factors – paragraph 4)
- estimation uncertainty is the susceptibility to an inherent lack of precision in the measurement of an accounting estimate.
- complexity (ISA 540 (Revised), Appendix 1 – Inherent Risk Factors – paragraph 8)

- complexity refers to the complexity inherent in the process of making an accounting estimate, such as when multiple data sets or assumptions are required.
- subjectivity (ISA 540 (Revised), Appendix 1 – Inherent Risk Factors – paragraph 12)
- subjectivity arises from inherent limitations in the knowledge or data reasonably available about valuation attributes.

(ii) Objectives-based work effort requirements directed to methods, data and assumptions

In line with the existing ISA 540, the auditor's response to assessed risks includes one or more testing strategies:

- obtaining audit evidence from events occurring up to the date of the auditor's report;
- testing how management made the accounting estimate; or
- developing an auditor's point estimate or range.

However, for these testing strategies ISA 540 (Revised) has introduced specific objective-based requirements that separately address the work effort required to audit:

- method;
- assumptions; and
- data.

The aim of these objective-based requirements is to allow scalability in the nature, timing and extent of the procedures performed, recognizing that the higher the assessed risks of material misstatement, the more persuasive the audit evidence needs to be.

These requirements create additional complexity in the audit of ECL due to the interdependency of the components of the ECL calculation as well as the volume of data and assumptions that a banking institution employs to calculate ECL under IFRS 9.

1.2. COVID-19 – IMPACTS ON AUDITS AS OF YEAR-END 2020

In addition to the attention points raised by the IREFI / IRAIF in its communication of the attention points as of 30 June 2020 and which remain applicable for the audits as of year-end 2020, we recommend the accredited auditors to take into consideration, when applicable, the provisions of the IBR / IRE statement 2020/03 dated 8 December 2020 (https://www.ibr-ire.be/fr/actualites/news-detail/avis-2020-03 for the French version and https://www.ibr-ire.be/nl/actueel/news-detail/advies-2020-03 for the Dutch version).

The IBR / IRE highlights the key attention points for the attention of the auditors in several perspectives and in the context of the Covid-19 pandemic. The accredited auditors will use their "*professional judgment*" in the application of these attention points.

Additional Covid-19 attention points are also included in section 3 and section 4 for credit institutions and insurance companies respectively.

1.3. BREXIT & RELATED DISCLOSURES (*)

The United Kingdom (UK) became a third country since 1 February 2020. During the transition period, the UK continues to apply European Union law and to benefit from the EU's Single Market passporting arrangements until 31 December 2020.

Much uncertainty remains about future relations between the European Union (EU) and the UK. At the end of the transition period, European financial institutions will no longer be able to provide services to the UK via the European passport system. Likewise, British financial institutions will no longer be able to provide financial services to the EU market unless they have obtained the required authorizations within the EU. Financial Institutions should have adapted to the post-Brexit regulatory reality, in order to avoid business disruptions or the implications for risk management (risk liquidity, access to capital markets and market infrastructures, continuity of derivative contracts, etc.). We also refer in this respect to the guidance issued by the EBA on 9 November 2020 (https://eba.europa.eu/eba-reminds-financial-institutions-need-readiness-view-brexit-transition-period-ending-31-december) in which the EBA reminds the financial institutions of the need for readiness in view of the Brexit transition period ending on 31 December 2020 . Finally, financial institutions should inform their customers about their contingency planning and post-Brexit service offerings.

The long-awaited treaty between EU and the UK, which will govern their relationship after the completion of the UK's exit from the EU, was finally agreed on 24 December 2020. Financial services are covered only briefly in the new "*Trade and Cooperation Agreement*". Hence, businesses have to consider how the new agreement affects their organizations, including the potential impact on accounting and reporting. In particular, this can include, amongst others: the impact on impairments, valuations and disclosures on the Brexit related risks. Clear and comprehensive disclosures on this matter are required.

2. NBB - CROSS-SECTORAL ATTENTION POINTS & EARLY WARNING FUNCTION(*)

The NBB refers to the different statements published by national and international bodies regarding the specific audit considerations in the context of the Covid-19 crisis.

In particular, the NBB would like to highlight the following concerns on which, the accredited auditors are invited to report to the NBB where relevant:

- *the need to adapt audit approaches to the current circumstances due to travel restrictions as well as the limited availability of personnel that may impair the accredited auditor's ability to obtain sufficient appropriate audit evidence and may create a potential scope limitation;*
- *due attention paid to the situation around potentially weak internal control of institutions and undertakings in the current situation and its implication on the prudential reporting process;*
- *uncertainty around the forecasts for economies worldwide as well as increased uncertainty around the outlook for many entities, which may increase a risk of material misstatement as well as pose a challenge to the auditors' going concern assessment;*
- *Operational issues relating to the practical implementation of government support measures that have an impact on the accredited auditor's mission; and,*
- *IT-, cyber- and operational risks and incidents which may have materialized given the increased reliance on IT systems (e.g., teleworking, remote connections, usage of digital channels by institutions' clients) which may involve heightened risks for the institutions (system unavailability, increased times of response, lower reactivity of IT support…).*

The NBB also stresses the importance of the early warning function ("signal function") in the current Covid-19 context, which must cover much broader content than the impending discontinuity of a business and must cover information known by the accredited auditors that may have an important impact on the prudential supervision.

3. MAIN ATTENTION POINTS FOR THE CREDIT INSTITUTIONS

3.1. Covid-19 – Related Matters – ECB & NBB Letters

The persistence and the magnitude of the Covid-19 crisis make it necessary for 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 of end 2020. The lockdown measures might have an important impact on the economy and consequently on the credit worthiness of some business sectors. The accompanying national measures (moratoria & state guarantees) have mitigated this impact for some time but the inevitably coming end of these measures should be duly and timely considered to avoid a "cliff effect".

Considering these circumstances, the ECB decided on 4 December 2020 to send to all the Significant Institutions (SI) a letter that follows-up and complements its previous Covid-19 related communications. In this letter, the ECB highlights the importance of ensuring that risk is adequately assessed, classified and measured in credit institutions' balance sheets while excessive pro-cyclicality is also limited. As recommended by the ECB, the NBB decided on 15 December 2020 to send the same letter to a selection of Less Significant Institutions (LSI).

Both letters remind the institutions of existing regulations and guidelines which are therefore expected to be incorporated into the current years' regulatory reporting and future budget and strategic planning. The letters invite the addressee to respond in writing with enough qualitative and quantitative details for the supervisor to understand the institution's approach on each of the issues reviewed in the letter.

The accredited auditors concerned should

- *read the letter received by the credit institutions with whom they are the statutory auditor;*
- *become aware and analyze in depth the answers provided to the ECB / NBB by the credit institution and become aware of the feedback given by the supervisor; and,*
- *communicate to the ECB / NBB any problem observed in the answers and / or declarations of the credit institution (such as incomplete or incorrect information). Depending on the circumstances (such as those linked to urgency) and the materiality of the observed issues, the accredited auditors will report their findings immediately to the supervisors as part of its early warning function*

3.2. Credit Risk & IFRS 9 - Expected Credit Losses (ECL)

3.2.1. Basel Committee on Banking Supervision – Guidelines "Audit of Expected Credit Losses"

The Basel Committee on Banking Supervision issued on 7 December 2020 a supplemental note to its 2014 guidance "*External audits of banks*" following the implementation of expected credit loss (ECL) accounting frameworks in various jurisdictions that have brought about significant changes for credit institutions and their external auditors (https://www.bis.org/bcbs/publ/d513.htm)

The objective of this guidance is to contribute to the high-quality audits of internationally active banks by communicating supervisory expectations for the audit of ECL estimates and providing questions that banks' audit committees may ask to the external auditor. The guidance may be most useful for 2021 year-end audits, as Audit Committees and external auditors require time to consider the guidelines in the context of planning and executing an audit. Nevertheless, Audit Committees and external auditors may find the guidance helpful for 2020 year-end audits, particularly as they consider the use of forecasts and forward-looking information, the construction of macroeconomic scenarios and weightings, and model performance (including data availability and the need for post-model adjustments).

3.2.2. IDENTIFICATION OF UNLIKELINESS TO PAY (UTP)(*)

With the outbreak of the Covid-19 pandemic, the EBA guidelines on moratoria (EBA/GL/2020/02)[1] *clarified the application of the definition of default and classification of forbearance. In Belgium, aligned with the amended guidelines (EBA/GL/2020/08)*[2]*, institutions could provide eligible (second) moratoria until 31 March 2021..*

The EBA Guidelines clarified that whereas eligible moratoria must not automatically trigger forbearance classification and the assessment of distressed restructuring[3]*, institutions must continue to adequately identify those situations where obligors may face longer term financial difficulties and classify them in accordance with the existing regulation (i.e. IFRS 9 staging, unlikeliness-to-pay (UTP) classification).*

The challenge for this identification is that moratoria freeze the arrears, which is one of the drivers triggering, sometimes automatically, the UTP/degradation of rating in internal rating approaches (IRB approaches). Some banks may have IRB approaches that use additional information that can still identify adequately degradation of their exposures' credit quality. However, the majority of banks had to put into place had hoc systems or adjustments to their IRB approaches (direct contacts with clients, additional behavioral information from clients, 360 degrees with on clients' risks, etc.) to be able to identify it adequately.

Therefore, the NBB does expect external auditors to verify whether banks comply with the EBA Guidelines on moratoria4 and specifically identify adequately their obligors with longer term financial difficulties and classify them in accordance with the existing regulation. This must ensure that banks provide true information about the quality of their portfolios to market participants, and that they are adequately capitalized.

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[1] Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the Covid-19 crisis (EBA/GL/2020/02 of 2 April 2020).

https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20legislative%20and%20nonlegislative%20moratoria%20on%20loan%20repayments%20applied%20in%20the%20light%20of%20the%20COVID-19%20crisis/882537/EBA-GL-2020-02%20Guidelines%20on%20payment%20moratoria.pdf

[2] Guidelines amending Guidelines EBA/GL/2020/02 on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/08 of 25 June 2020). https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20legislative%20and%20nonlegislative%20moratoria%20on%20loan%20repayments%20applied%20in%20the%20light%20of%20the%20COVID-19%20crisis/886608/EBA-GL-2020-%2008%20Guidelines%20amending%20Guideline%20EBA%20GL%202020%2002%20on%20payment%20moratoria.pdf

[3] in all other cases the assessment must be done on a case-by case basis

[4] For example: whether the exposures that receive a payment holiday meet the requirements of a moratoria according to the EBA guidelines and are granted in accordance with the Febelfin charters for mortgage and company loans or the law of 27 May 2020 for consumer loans. If not, these should be classified as forbearance measures.

3.2.3. IFRS 9 – Expected Credit Loss (ECL)(*)

The specific issues mentioned below have been identified considering preliminary supervisory reviews and 30 June 2020 reports of the accredited auditors.

***The accredited auditors are recommended to report on all these issues in a systematic way (including with a "nihil" indication if no problem has been observed). The purpose is indeed to allow the NBB to assess if (on the different issues) the accredited auditor is satisfied with what the credit institution is doing or whether concerns arose**. The overall concern of the NNB is that credit institutions apply IFRS 9 in a robust and consistent way.*

The following list of questions is not exhaustive, and the accredited auditor is expected to exercise his / her professional judgment when deciding on the need to report on additional issues.

3.2.3.1. Modeling, Forward Looking Information and Control Issues

- *Have weaknesses in underlying models and data limitation (such as out-of-date nature) as a result of the Covid-19 pandemic been identified and, if so, how have they been addressed?*
- *Has increased reliance on post-core model adjustments (PMAs or "overlays") been observed (or recommended by the accredited auditor) to compensate for issues such as low modelled provision cover (in particular for mortgages)? If so, what was the nature and materiality of these PMAs, and have they been properly documented and substantiated by the institution (considering the subjective nature of PMAs)?*
- *Have changes been made or programmed to modelling approaches that are likely to stay for the longer term to reduce the reliance on PMAs (especially considering the importance of the long-term forward-looking dimension of ECL estimates)?*
- *Have the model risk controls been effective under the current situation? Have any deficiencies been observed in this regard? Has the institution made additional reviews, analysis or comparison to compensate for it?*

3.2.3.2. Economic Scenarios

- *Has the credit institution modified the nature and weighing of the scenario used under IFRS 9? How do they compare with those used for internal strategic planning and / or for the prudential calculation of EL where relevant? Has the accredited auditor observed problems in the definition, application, documentation and substantiation of the scenarios?*
- *Has the credit institution performed additional validity check around its scenarios (such as sensitivity analysis)? If so, are the conclusions and follow up of these checks satisfactory at the opinion of the accredited auditor or are other analysis needed?*
- *Has the credit institution considered the official ECB or NBB projections in their scenario, and documented the reasons for deviating from them? The same question arises in relation to the credit institution own stress test information and to market information (notably, how the credit institution is consistent with market consensus or deviating from them).*
- *Has the weighting of scenario been documented and substantiated in a proper way (including the above question on additional checks and comparisons?*

3.2.3.3. Significant Increase in Credit Risk (SICR)

The NBB has observed discrepancies in the treatment of moratoria and consideration of the EBA & ECB statements on the non-automatic classification in IFRS 9 stage 2 of exposure subject to moratoria (the issue is even more concerning for payment holidays granted outside eligible moratoria).

- *The NBB expects the accredited auditors to challenge the classification of exposures per stage, in particular, in case of public or private moratoria and to report any issues that could possibly hinder the timely migration of exposures to a riskier category / stage (e.g., regarding the counting of days past due, the analysis of forbearance measures, or management overlays).*
- *Has the credit institution considered the EBA and ECB statements indicating that the application of public or private moratoria, should not be considered by themselves as an automatic trigger to conclude that a significant increase in credit risk has occurred? If so, (a) did it result in material delays in transferring exposures to stage 2 (or 3 where relevant) and (b) has the credit institution, nonetheless, properly assessed the credit quality of the exposures benefiting from these measures and identified any situation of significant increase in credit risk of the exposures accordingly?*
- *Have corrections been applied at collective level (in a "top-down" approach) and if so, has the credit institution taken additional steps to identify significant increase in credit risk at the level of individual exposures and thereby been able to distinguish among debtors those that are only facing short term liquidity problems from those whose credit quality deteriorates or is expected to deteriorate notably because of the prolonged crisis?*
- *Did credit institutions using DPD (Days Payment Due) as main quantitative indicator adapt their methodology for exposures with moratoria? Are improvements expected with impacts for 31 December 2020? Have rebutted IFRS 9 presumptions been properly documented?*
- *Has the credit institution used (satisfactorily) qualitative SICR indicators to capture risks not otherwise captured in loan-level probability of default (PD)? Has IFRS 9 collective assessment of SICR been consistently applied?*
- *Have modification losses (or de-recognitions) been recognized when due?*
- *Has the IFRS 9 low credit risk exemption been used? For which type of portfolio? Has it been properly documented and substantiated?*

3.2.3.4. Other Matters

- *How have State guarantees correctly been accounted for (as part of ECL calculation or separately accordingly)? Was the methodology for the projection appropriate?*
- *For credit institutions that are subsidiaries, are there any corrections driven at Group level? If so, what additional steps have been taken at the entity level by the credit institution ?*
- *When the credit institution makes use of the CRR transitional measures for IFRS 9 (article 473.a as amended through the CRR Quick Fix in the context of the Covid-19 crisis), has the credit institution done the calculation properly (as these is quite complex)?*

3.3. MORATORIA AND PUBLIC GUARANTEES

On 20 November 2020, the EBA published a first assessment of the use of Covid-19 moratoria and public guarantees across the EU banking sector. The use of moratoria was particularly widespread for SMEs and commercial real estate but were also important for mortgage loans in several countries. While public guarantees were used to a lesser extent, they allowed credit institutions to provide new lending to many companies impacted by the crisis. The EBA will be closely monitoring the evolution of moratoria and public guarantee schemes in the following quarters (https://eba.europa.eu/banks-report-significant-use-covid-19-moratoria-and-public-guarantees). In the follow up of the second Covid-19 wave, the EBA reactivated its Guidelines on legislative and non-legislative moratoria on 2 December 2020.

On 8 December 2020, the Belgian authorities decided to again allow a general deferral of payment for individuals and companies, as well as to extend and prolong the second guarantee scheme for SME's. Consequently, the NBB has updated on 4 January 2021 its Q&A on Moratoria and Guarantee Scheme in Belgium. Accredited auditors should refer to these Q&A in case of questions in the framework of their work:https://www.nbb.be/en/financial-oversight/prudential-supervision/areas-responsibility/credit-institutions/qas-moratorium

3.4. BENCHMARK RATE REFORMS

Despite Covid-19, the benchmark rate reforms' end of 2021 deadline still stands, and regulators globally have increased the pressure to change and to comply. With regard to this benchmark rate reforms causing the introduction of new benchmarks and/or the replacement of existing benchmarks in the short and mid-term, the NBB continues to raise awareness and ensure that Belgian credit institutions are adequately prepared. Hence, credit institutions are expected to continue analyzing potential implications for their business practices and risk management.

Significant new disclosures are required, including quantitative information disaggregated by significant IBOR subject to reform showing separately non-derivative financial assets and liabilities, and derivatives. It is also clear that changes required by IBOR Reform can be made without discontinuing hedge accounting. The NBB expects that accredited auditors should consider the level to which the credit institutions are prepared, as an attention point.

The accredited auditor should discuss with Management the preparedness of the credit institution and report key observations or issues, if any, in the report on the situation as of 31 December 2020.

3.5. CHANGES IN THE PRUDENTIAL TREATMENT OF SOFTWARE ASSETS5

On 14 October 2020, the EBA published its final report on the *"Draft Regulatory Technical Standards on the prudential treatment of software assets under Article 36 of Regulation (EU) N) 575/2013 (Capital Requirements Regulation – CRR)"* (EBA/RTS/2020/07), introducing a simple approach to prudential amortisation of software assets.

In compliance with the dispositions of Article 36 of the Capital Requirements Regulation (CRR) intangible assets are to be deducted from Common Equity Tier 1 (CET1). As software assets become increasingly important for credit institutions in the current digital era, the application of the aforementioned deduction creates a competitive disadvantage for credit institutions, compared to the non- regulated (technological) companies.

[5] https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2020/RTS/933771/Final%20Draft%20RTS%20on%20prudential%20treatment%20of%20software%20assets.pdf

As part of the Risk Reduction Measures (RRM) package adopted by the European legislators, Article 36 (1) (b) of the CRR has been amended, introducing, amongst others, an exemption from the deduction of intangible assets from CET1 for prudently valued software assets, the value of which is not negatively affected by resolution, insolvency or liquidation of the institution.

The EBA has been mandated to issue technical standards on the subject, resulting in the guidelines on the methodology to be applied for determining the prudent valuation of these software assets issued in October 2020.

The amount to be deducted is to be determined based on the prudential accumulated amortisation. The RTS introduces a simple standardised method to determine the amount of prudential amortisation, that can be applied as from the date the software is available for use and amortisation for accounting purposes starts. Until the date on which the software asset is available for use and begins to be amortised for accounting purposes, the full carrying amount is to be deducted from CET1.

The prudential amortisation is calibrated over a 3- year period, expressed in days. If the useful lifetime of the software assets for accounting purposes would be shorter than 3- year, the shorter period is to be applied.

The amount to be deducted from CET 1 is the positive difference, if any, between the prudential accumulated amortisation of a software asset and the accumulated amortisation period, including any accumulated impairment losses of that software asset recognised for accounting purposes. The residual portion of the carrying amount of software is to be risk- weighted. The prudential amortisations and deductions are to be made separately for each software asset.

The final standards have been sent to the European Commission for their adoption as European regulation and will directly be applicable in all member states.

Accredited auditors should pay attention to the application of this amendment regarding the calculation of own funds as per 31 December 2020 subject to the timely adoption by the European Commission for year-end prudential reporting.

3.6. TLTRO-III ACCOUNTING TREATMENT(*)

The third TLTRO program (TLTRO-III) consists of a series of seven ECB targeted longer-term refinancing operations, each with a maturity of three years, starting in September 2019 at a quarterly frequency. On 30 April 2020, the ECB recalibrated targeted lending operations to further support the real economy in the framework of the Covid-19 pandemic.

The Governing Council of the European Central Bank (ECB) decided on 30 April 2020 on a number of modifications to the terms and conditions of its targeted longer-term refinancing operations (TLTRO-III) in order to support further the provision of credit to households and firms in the face of the current economic disruption and heightened uncertainty.

In TLTRO-III the interest rate to be applied is linked to the participating banks' lending patterns. The more loans participating banks issue to non-financial corporations and households (except loans to households for house purchases), the more attractive the interest rate on their TLTRO-III borrowings becomes. For the period from 24 June 2020 to 23 June 2021, the borrowing interest rate on all TLTRO-III operations will now be 50 basis points below the average rate applied in the Euro-system's main refinancing operations over the same period. The interest rate on the main refinancing operations is currently 0%. For counterparties whose eligible net lending reaches the lending performance threshold, the interest rate applied from 24 June 2020 to 23 June 2021 on all TLTRO-III operations will be 50 basis points below the average interest rate on the deposit facility prevailing over the same period, and will be floored at -1%.

The ESMA has established that there is currently diversity in practice at a European level on how to account for the 50 basis points below the average rate granted by the ECB. Some credit institutions consider that this is in scope of IFRS 9 and should be accounted for as part of the Effective Interest Rate, while others consider this to be in the scope of IAS 20 – Accounting for Government Grants. ESMA is still considering whether it will issue further guidance on the matter.

On 6 January 2021, the ESMA issued a public statement[6] promoting transparency in the IFRS financial statements of credit institutions. Accredited Auditors are required to pay attention to the accounting treatment of the TLTRO-III operations (including the related disclosures).

3.7. IMPACT OF THE COVID-19 PANDEMIC ON THE CALCULATION OF THE AVA'S

In the context of the global Covid-19 pandemic, the EBA issued on 22 April 2020 its "*Final Draft Regulatory technical Standards on Prudent Valuation under Article 105 (14) of Regulation (EU) N° 575/2013 (Capital Requirements Regulation – CRR)*"[7](EBA/RTS/2020/04). The global pandemic resulted in an unprecedented systemic risk and extreme market volatility affecting multiple asset classes, which has generated exceptional increases in asset price dispersion and bid-offer spreads, affecting exit costs, that need to be appropriately reflected in AVA's.

Credit institutions using the core approach compute, for market price uncertainty, close-out costs and model risk category-level AVAs, individual AVAs for separate valuation exposures, which are then aggregated to provide total category-level AVAs using the formulae in the Annex to the Delegated Regulation. As a result of the Covid-19 pandemic, it has become clear that rules for prudent valuation should be revised so that, besides providing for an aggregation factor to be used under normal market conditions, set at 50% (which was already provided for in the formulae contained in the Annex to Delegated Regulation (EU) No 101/2016), these conditions also provide that credit institutions should apply a higher aggregation factor for this specific period of extreme volatility in market prices and systemic shock due to the Covid-19 pandemic.

Based on first estimations taking into consideration the expected impact of the increase in volatility and market dislocation, a value of 66% of the aggregation factor is calibrated to mitigate the excessive procyclical effect of the current prudent valuation aggregation part of the framework. With the exception of applying the 66% aggregation factor, institutions are required to continue computing AVAs in accordance with the requirements included in the Delegated Regulation and with the principles prevailing before the crisis.

As it is expected that such extreme market volatility due to the Covid-19 pandemic might continue during the next months, such provision should be of a transitional nature and apply for the currently expected duration of that extreme market volatility combined with systemic shock.

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[6]https://www.esma.europa.eu/sites/default/files/library/esma32-339-149_public_statement_targeted_longer-term_refinancing_operations_iii.pdf

[7]https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2020/RTS/882753/EBA-RTS-2020-04%20Amending%20RTS%20on%20Prudent%20Valuation.pdf

3.8. EXPECTATIONS REGARDING DIVIDEND POLICY AND REMUNERATION POLICY AS OF 2 JANUARY 2021

Following the recent statements and recommendations by the EBA, the ECB and the ESRB, the NBB reiterated in its communication NBB_2020_049[8] its expectations on dividend policy and remuneration policy, with effect as from 2 January 2021. European supervisory authorities and the NBB are closely monitoring the impact of this Covid-19 crisis on the financial sector. As indicated in previous communications, financial institutions must continue to hold enough capital to manage systemic risks and are expected to contribute to the recovery of the economy.

The EBA, in its communication of 15 December 2020, reiterated its message for credit institutions to maintain a prudent policy with regard to the payment of dividends and other distributions, including variable remuneration. Furthermore, on 15 December 2020 both the ECB and the ESRB (taken up as annexes to the communication of the NBB) issued a new recommendation on credit institutions' dividend policy for the period from 2 January 2021 to 30 September 2021. In addition, the NBB considers the own funds margin available above own funds requirements, taking into account each institution's specific risk profile and the level of uncertainty, is an important assessment factor.

The NBB requests in this communication institutions to notify their intentions in terms of dividends to the supervisory authority by 15 January 2021. Finally, specifically with regard to remuneration policy, the NBB also wishes to reiterate its earlier recommendation to moderate variable remuneration, in particular for persons whose professional activities have a significant impact on the institution's risk profile, as explained in the previous communication NBB_2020_ 33 of 30 July 2020.

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[8] The NBB communication and the EBA, ECB and ESRB communications can be found with the following links:

https://www.nbb.be/nl/artikels/mededeling-nbb2020049-maatregelen-het-kader-van-het-coronavirus-verwachtingen-betreffende;

https://www.nbb.be/fr/articles/communication-nbb2020049-mesures-dans-le-cadre-du-coronavirus-attentes-concernant-la

4. MAIN ATTENTION POINTS FOR THE INSURANCE SECTOR

4.1. COVID-19 RELATED MEASURES

We present below a list of the most significant Covid-19 related measures taken by the EIOPA and/or the NBB and focus on the particularly relevant for the accredited auditors.

- We also remind the reader that our Attention Points as of 30 June 2020 were including the reference to the communication NBB 2020_008 relating to the reporting on the impact of the Covid-19 and the communication NBB_2020-020 relating to the provisions of the regulation on the valuation of assets when markets are inactive (TO COMPLETE CLAUDE). These 2 communications remain applicable as of 31 December 2020.
- The EIOPA statement on dividend distribution and variable remuneration in the context of the Covid-19 of 2 April 2020 and the following NBB circulars, which should be reflected where relevant, in the reporting per year-end 2020. In the circular NBB_2020_034 *Distributions of dividends, variable remunerations and profit sharing in the context of the Covid-19 crisis*, dated 15 August 2020 which replaces the circular NBB_2020_012 dated 7 April 2020, the NBB specifies its expectations regarding dividends, variable remunerations and profit sharing distributions in the context of the Covid-19 crisis. In this circular, the NBB stresses the point that, given the current uncertainties on the Covid-19 crisis and its impact on the economy and financial position of the insurances companies, the distribution of dividends should be temporarily suspended up to 1 January 2021 (this situation is currently under review). Regarding the distributions of variable remunerations and profit sharing, the NBB recommends adopting a prudent approach and even to postpone these distributions in case the financial situation on the insurance company is too uncertain.

4.2. LONG TERM EQUITY (LTE)

The NBB wants to clarify a few points concerning LTE:

- *In the event that the average holding period is less than 5 years (criterion (e), article 171 bis), the application of Long Term Equity prevents the insurance undertaking from reselling any investment in shares in this LTE subset as long as the 5-year holding period has not expired. The application of this criterion has already raised several questions from insurance undertakings, the NBB has therefore invited them to be careful in the application of LTE. It can lead to a loss of availability of these assets. In the event of a sale, LTE's reduced SCR could no longer be applied to the entire equity for 36 months.*
- *Further although in the context of the revision of Solvency II review, some criteria could be deleted / simplified, it is understood that the current framework is still applicable. In this sense, it is the current criteria that must be verified at year-end 2020.*

4.3. MORTGAGE LOANS

Since the start of the Covid-19 crisis, an asset class has seen its investments grow continuously. These are loans and mortgages. This trend is not recent but continues significantly.

The NBB wishes to focus on the valuation of these assets. Indeed, their valuation is influenced by the interest rate curve in an explicit way, but the other parameters must be taken into account and also updated. The NBB is targeting here the spread, expected / unexpected losses, the liquidity premium, the impact of repayments, costs……

The NBB therefore draws the accredited auditors' attention to ensuring that these parameters are properly taken dealt with so that this asset class, whose weight is increasingly important, is correctly assessed at its market value.

4.4. COMMUNICATION NBB_2020_043 ON HOSPITALIZATION INSURANCE

On 28 July 2020, a horizontal analysis was presented to the Board of Directors of the NBB, that carried out a market comparison of the valuation of the technical provision for individual medical expenses insurance policies and more specifically medical inflation. In the context of this horizontal analysis, the NBB had also developed its own scenario (the so-called "6th scenario") for which companies were asked to calculate the impact of the scenario. This analysis showed the great diversity between the undertakings. Based on the results of the horizontal analysis, the NBB decided to issue a communication NBB_2020_043 to ensure a level playing field for hospitalization.

This communication elaborates on the scenario of the horizontal analysis in which this will serve as a lower limit for the "Best Estimate" for individual medical expenses insurance policies and as a basis for estimating imbalances in the pricing of these insurance products. The good practices of the analysis were also communicated to the sector.

This scenario is based on a short-term market consistent inflation curve increased by a wedge to account for the specific increase in medical costs. In the long term, the macroeconomic assumptions of the Study Commission on Aging of the European Commission used for the projection of public health expenditure. Finally, both elements are connected with the interpolation technique that EIOPA uses for the interest curve.

The communication was consulted and the feedback from the sector (Assuralia, IA|BE and IREFI) was incorporated into the communication. The communication was published on 18 November 2020, a response was formulated to the comments from the sector and individual feedback was send to the health insurers.

4.5. "BEST ESTIMATE" – IREFI / IRAIF COMMUNICATION 2020/07 – TRANSMISSION OF / ACCESS TO THE ACCREDITED AUDITORS' WORKING PAPERS

In the context of the cooperation of the accredited auditors to the prudential supervision of the NBB, the latter might wish to obtain, in certain circumstances, copy and / or access to specific working papers regarding some audit procedures performed by the accredited auditors on the "Best Estimate" of insurance undertakings. In such cases, the IREFI / IRAIF Board recommended in its communication 2020/07 to use the transmission / access letter that has been prepared in this respect and which is available on the IREFI / IRAIF website.

5. PAYMENT INSTITUTIONS AND E-MONEY INSTITUTIONS

5.1. OUTSOURCING & ACCREDITED AUDITORS' REPORTING ON OUTSOURCING

As reported in the IREFI – IRAIF Attention Points as of 31 December 2019 (Communication IREFI – IRAIF 2019/09 dated 9 December 2019), the outsourcing of activities by payment institutions and e-money institutions continues to be a key attention point for the NBB.

In this context, the accredited auditor will pay specific attention on the outsourcing aspects as part of his / her report on Management's report on internal control and report attention points to the NBB. In particular, it is recommended that the accredited auditor discusses with Management and verifies that:

- the description of the outsourced functions and activities is coherent with the understanding of the institution the accredited auditor gained during his / her audit;
- there is a proper risk management and follow-up of the risks related to outsourcing with Management; and,
- the outsourcing does not affect the quality of the organization or the internal control, does not increase the operational risks without being properly managed, nor does it impair the possibility to verify full compliance with the Law of 11 March 2018, the PSD II Directive and its applicable regulation by the NBB. Outsourcing cannot lead to a decreased substance of the institution and adequate substance including descriptions and relevant internal control framework be discussed in detail in the Management' s report on internal control.

In addition, when relevant in the context of his / her audit, the accredited auditor should focus on reporting findings based on a critical reading of the document prepared by Management and in particular any inconsistency with the information or evidence collected during our audit. In such a case, the accredited auditor should consider the provisions of ISA 402 – *Audit considerations relating to an entity using a service organization* in the performance of his / her audit work.

During the year 2020, the IREFI – IRAIF discussed with the NBB about the reporting by the accredited auditor on the outsourcing. The following agreement has been reached: there is no need for the accredited auditor to prepare a separate report for the outsourcing. However, this matter should be specifically treated by the accredited auditor in his / her report on Management's report on internal control in which this matter is presented by the institutions. To highlight the importance of the matter, a specific paragraph has been taken up in the NBB model reports for payment institutions and e-money institutions. These NBB model reports will be released shortly. Further, the NBB agreed that the accredited auditors also upload, in OneGate, their report on Management's report on internal control, once for the internal control reporting and once for the reporting on outsourcing.

5.2. COMPLIANCE WITH SEGREGATION OF CLIENTS' FUNDS REQUIREMENTS

Starting January 2020, the NBB started a transversal inspection on the respect and compliance with the segregation of clients funds requirements due to its importance. We understand this inspection is not yet completed.

Therefore, accredited auditors are required to continue to focus on the compliance with the regulatory requirements on this matter and report their findings to the NBB in their prudential reporting as of 31 December 2020 or by the use of the early warning function if any important issues are identified.

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

6.1. RESULTS DISTRIBUTION & LIMITATIONS AND RESULTS APPROPRIATION

On 2 July 2020, the FSMA issued its communication FSMA_2020_08 for REITs on results distribution and limitations and results appropriation. During the FSMA Permanent Learning organized on 4 December 2020 a comprehensive presentation of the attention points on this matter has been provided.

The accredited auditors are expected to review the compliance of the REITs they are auditing with the provisions of the above-mentioned communication and to report their (material) findings to the FSMA.

7. UNDERTAKINGS FOR COLLECTIVE INVESTMENT (UCI)

7.1. COVID-19 – FSMA COMMUNICATIONS & PERMANENT LEARNING

The FSMA confirmed that the points taken up in the Attention Points as of 30 June 2020 are still valid and require appropriate attention and follow up in the reporting to the FSMA. We refer therefore to IREFI - IRAIF Communication 2020/06 dated 29 June 2020.

We also refer hereafter to the FSMA Permanent Learning provided on 4 December 2020 for the UCI, management companies of UCI and SIR/GVV: *https://www.fsma.be/sites/default/files/public/content/formation/2020_formation_permanente_opc_sir.pdf*.

The FSMA closely monitors these different aspects and requires accredited auditors to report through their prudential reports and/or through their early warning function the attention points to the FSMA.

7.2. NEW FSMA MODEL REPORTS FOR UCI REPORTING

Recently, the IREFI - IRAIF provided the FSMA with a draft new report of the accredited auditors to the FSMA on the working procedures performed on the statistics of the UCITs/AIFs.

In the past, the accredited auditors' reports included a scope exclusion for the AIF tables that are included in these statistics. Based on discussions with the FSMA, the latter informed the IREFI – IRAIF it recommended to remove this scope exclusion in order to comply with its European obligations. As a result of this, a detailed working program was developed for these statistics. Consequently the draft report provided to the FSMA contains 3 separate sections :

- an audit opinion in accordance with the ISA relating to the data included in the CIS_SUP_2 table;
- a limited assurance report in accordance with ISAE 3000 relating to the data included in the AIF and the CIS_SUP_1 tables; and
- additional confirmations as requested in the legislation for UCITs/AIFs.

Currently, discussions are still going on between the FSMA and the IREFI – IRAIF. Once an agreement has been reached, the IREFI - IRAIF will provide feedback to its members. The new reports will be taken up and published in the Model Reports update as of 31 December 2020 as soon as possible.

8. INSTITUTIONS OF OCCUPATIONAL RETIREMENT PROVISION (IORP'S)

8.1. TECHNICAL PROVISIONS' PRUDENT VALUATION & FSMA ATTENTION POINTS

The FSMA expects accredited auditors to devote 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 plus buffer, etc.).

Further, the FSMA confirmed that the points taken up in the Attention Points as of 30 June 2020 are still valid and require the attention and follow up in the reporting to the FSMA*. We refer therefore to IREFI - IRAIF Communication 2020/06 dated 29 June 2020.*

Finally, we also refer hereafter to the FSMA Permanent Learning provided on 27 November 2020 for the IOPR's:
https://www.fsma.be/sites/default/files/public/content/formation/2020_permanente_vorming_ibp.pdf

8.2. COVID-19 IMPACTS & CONSEQUENCES

The accredited auditors are expected to take into consideration the matters below in the framework of their year-end audit and report their findings in their FSMA reporting

- *The financial and organizational impacts of the Covid-19 pandemic can be important. They might affect the IORP's net equity, its financial position and its results as of year-end 2020. The FSMA recommends an increased attention at least on the following areas:*
  - *prudence in calculating technical provisions, the discount rate(s) used but also other assumptions used;*
  - *the adequate valuation of investments, including the ones on the real estate sector; and*
  - *the credit quality and timeliness of the contributions, including a potential thorough challenge of the funding plan; and*
  - *the appropriateness and timeliness of the measures taken by the IORP to meet its short-term commitments (recovery plan).*
- *As reported in previous attention points, accredited auditors will also focus on the IORP's compliance with the regulation transposing the IORP II Directive (key functions including those of risk management, ORA, remuneration policy, ESG criteria and investment policy, transparency, etc.) and report non-compliance findings to the FSMA in their prudential reporting.*

ACRONYMS	
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
ESG	Economic Scenario Generator
FINREP	Financial Reporting (templates requested by the ECB)
FSMA	Financial Services and Markets Authority
GDPR	General Data Protection Regulation
GVV	Gereglementeerde 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
PSD	Payment Services Directive
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