

**Consultation Paper
on
the proposal for
Implementing Technical
Standards
on internal models approval
processes**

Table of Contents

1. Responding to this paper..... 3
2. Consultation Paper Overview & Next Steps 4
3. Draft Technical Standard 5
Annex I: Impact Assessment..... 15

1. Responding to this paper

EIOPA welcomes comments on the draft Implementing Technical Standards on internal models approval processes.

The consultation package includes:

- The Consultation Paper
- Template for comments

Please send your comments to EIOPA in the provided Template for Comments, by email CP-14-005@eiopa.europa.eu, by 30 June 2014.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

EIOPA invites comments on any aspect of this paper. Comments are most helpful if they:

- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with EIOPA's rules on public access to documents¹. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by EIOPA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eiopa.europa.eu under the heading 'Legal notice'.

¹ [Public access to documents](#)

2.Consultation Paper Overview & Next Steps

EIOPA carries out consultations in the case of drafting Technical Standards in accordance to Articles 10 and 15 of the EIOPA Regulation.

This Consultation Paper is being issued on the approval process of an internal model, as well as the approval of major changes to the internal model and changes to the policy for changing the internal model.

This Consultation Paper presents the draft Technical Standard.

The analysis of the expected impact from the proposed policy is covered under the Annex I (Impact Assessment).

Next steps

EIOPA will consider the feedback received and expects to publish a final report on the consultation and to submit the Implementing Technical Standard for endorsement by the European Commission by 31 October 2014.

3.Draft Technical Standard



EUROPEAN COMMISSION

Brussels, XXX
[...] (2011) XXX draft

COMMISSION IMPLEMENTING REGULATION (EU) No .../..

of []

**COMMISSION IMPLEMENTING REGULATION (EU) No .../... laying down
implementing technical standards with regard to the approval procedures to be followed
concerning an internal model according to Directive 2009/138/EC of the European
Parliament and of the Council**

of []

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2009/138/EC of 19 December 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)² and in particular Article 114(2)(a) and (b) thereof.

Whereas:

- (1) Under Solvency II an insurance or reinsurance undertaking applying for the use of an internal model to calculate the Solvency Capital Requirement has to comply with the Directive 2009/138/EC requirements for internal models as further specified in the [Implementing Measures].
- (2) Insurance and reinsurance undertakings may change their internal model. This change should be done in accordance with the approved policy for changing the model.
- (3) Major changes to the internal model, a combination of minor changes that is considered a major change, and changes to the policy for changing the model are subject to prior supervisory approval. The provisions set out in this Regulation for the approval process for internal models should apply on a consistent manner to the approval of major changes to the internal model and changes to the policy for changing the model.
- (4) The inclusion of new elements in the internal model are subject to supervisory approval as laid down in Article 112 of Directive 2009/138/EC.
- (5) The procedure to be followed for the approval of an internal model and major changes to the internal model should envisage on-going communication between the supervisory authorities and the insurance or reinsurance undertaking. It is considered best practice to begin the communication before the formal application is submitted to the supervisory authorities. The communication should continue after the internal model or major change is approved through the supervisory review process.
- (6) During the approval process supervisory authorities should be able to give recommendations on the need of adjustments to the internal model or for a transitional plan as set out in Article 113 of Directive 2009/138/EC.
- (7) The provisions in this Regulation are closely linked, since they deal with the supervisory approval of an internal model as stated in Article 112 of Directive 2009/138/EC, as well as the supervisory approval of major changes to the model and of changes to the policy for changing the model as stated in Article 115 of Directive 2009/138/EC. To ensure coherence between those provisions, which should enter into force at the same time, and to facilitate a comprehensive view and compact access to them by persons subject to those obligations, it

² OJ L 335, 17.12.2009, p. 1–155

is desirable to include both implementing technical standards required by Directive 2009/138/EC in a single Regulation.

- (8) The provisions set out in this Regulation on the procedures to be followed concerning the approval of an internal model, the approval of changes to the internal model and the approval of the policy for changing the model for internal models used at individual level should apply in a consistent manner to the procedures for internal models for the calculation of the consolidated group Solvency Capital Requirement and for group internal models.
- (9) This Regulation is based on the draft implementing technical standards submitted by the European Insurance and Occupational Pensions Authority to the Commission.
- (10) The European Insurance and Occupational Pensions Authority has conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Stakeholder Group established by Article 37 of Regulation (EU) No 1094/2010.

HAS ADOPTED THIS REGULATION:

Article 1 - Subject matter

- (1) This Regulation specifies:
 - (a) the procedure to be followed referred to in Article 112 of Directive 2009/138/EC as regards the approval of applications submitted by insurance and reinsurance undertakings to use full and partial internal models for the calculation of the Solvency Capital Requirement.
 - (b) the procedure to be followed as regards the applications submitted by insurance and reinsurance undertakings for approval of a major change to the internal model and of changes to the policy for changing the internal model according to Article 115 of Directive 2009/138/EC.

Article 2 - Application to calculate the Solvency Capital Requirement using an internal model

- (1) The application by an insurance or reinsurance undertaking to calculate the Solvency Capital Requirement using an internal model shall be provided to the supervisory authorities in writing in one of the official languages of the Member State in which the insurance or reinsurance undertaking has its head office or in a language that has been agreed with the supervisory authorities.
- (2) Where applying to use an internal model to calculate the Solvency Capital Requirement, insurance and reinsurance undertakings shall submit, as a minimum, documentary evidence that the internal model fulfils the requirements set out in Articles 101 and 120 to 125 of Directive 2009/138/EC and in the case of a partial internal model also Article 113 of Directive 2009/138/EC.
- (3) The information referred to in paragraph 2 shall include, at least, the following:
 - (a) a cover letter including:
 - i. a request for approval to use an internal model to calculate the Solvency Capital Requirement starting from a specified date and a general explanation of the internal model including a brief description of the structure and the scope of the model.

- ii. a confirmation of the period prior to the application for which the internal model has been used in the risk management system and decision making processes in accordance with the requirements set out in Article 120 of Directive 2009/138/EC.
 - iii. a confirmation that the application is complete and includes an accurate description of the internal model and that no relevant facts have been omitted.
 - iv. a confirmation on whether the insurance or reinsurance undertaking is part of a group using an internal model for the calculation of the consolidated group Solvency Capital Requirement or whether an application to use any internal model for calculating the consolidated group Solvency Capital Requirement was submitted without having received the notification of the decision.
 - v. information of other applications submitted by the insurance or reinsurance undertaking or currently foreseen within the next six months for approval of any of the items listed in Article 308(a)(2) of Directive 2009/138/EC, together with the corresponding application dates.
 - vi. contact information of the relevant personnel within the insurance or reinsurance undertaking involved in the activities related to the internal model, as well as to the relevant personnel within this undertaking to whom the requests for supplementary information can be submitted.
- (b) an explanation of how the internal model covers all the material and quantifiable risks of the insurance or reinsurance undertaking Where the application for the approval relates to a partial internal model, the explanation shall be limited to the material and quantifiable risks within the scope of the partial internal model and the insurance or reinsurance undertaking shall also provide an explanation of how the additional conditions referred to in Article 113 of Directive 2009/138/EC have been satisfied.
 - (c) an explanation of the adequacy and effectiveness of the integration of the internal model into the risk management system and the role it plays in the system of governance, including how the internal model allows the insurance or reinsurance undertaking to identify, measure, monitor, manage and report risks on a continuous basis; for this purpose, the application shall include the relevant extracts of the risk management policy referred to in Article 41(3) of Directive 2009/138/EC.
 - (d) an assessment and a justification by the insurance or reinsurance undertaking of the material strengths, weaknesses, and limitations of the internal model, including a self-assessment of the compliance with the requirements referred to in paragraph 2; the insurance or reinsurance undertaking shall also outline its plan for the future improvement of the internal model in order to address identified weaknesses or limitations or to develop or extend the internal model.
 - (e) where the insurance or reinsurance undertaking is part of a group using an internal model for the calculation of the Solvency Capital Requirement or where an application to use any internal model for calculating the consolidated group Solvency Capital Requirement was submitted without having received the notification of the decision, a justification on why the group internal model is not fit for the risk profile of the undertaking and the differences between the internal model to be used at individual level and the group internal model.
 - (f) the technical specifications of the internal model, including a detailed description of the structure of the internal model, together with a list and justification of the

assumptions underlying the internal model where an adjustment to these assumptions would have a significant impact on the Solvency Capital Requirement.

- (g) an explanation of the adequacy of the internal control system of the insurance or reinsurance undertaking taking into account the structure and coverage of the model.
- (h) an explanation of the adequacy of the resources, skills and objectivity of the personnel responsible for the development and validation of the internal model.
- (i) the policy for changing the internal model referred to in Article 115 of Directive 2009/138/EC.
- (j) a description of the process which ensures the consistency between the methods used to calculate the probability distribution forecast with the methods used to calculate technical provisions according to Article 121(2) of Directive 2009/138/EC.
- (k) a directory of data used in the internal model, specifying their source, characteristics and usage and a description of the process which ensures that data are complete, adequate and appropriate.
- (l) the results of the last profit and loss attribution and the specification of the profit and loss attribution in accordance with Article 123 of Directive 2009/138/EC including the profit and loss, the major business units of the undertaking and the attribution of the overall profit or loss to the risk categories and major business units.
- (m) a description of the independent validation process of the internal model and a report of the results of the last validation in accordance with Article 124 of Directive 2009/138/EC, including what recommendations were made and how they were acted upon.
- (n) the inventory of the documents that form part of the documentation of the internal model set out in Article 125 of the Directive.
- (o) where an insurance or reinsurance undertaking uses a model or data obtained from a third party as referred to in Article 126 of Directive 2009/138/EC, a demonstration that the use of such external model or data does not impair the ability of the insurance or reinsurance undertaking to meet the requirements set out in Articles 101 and 120 to 125 of Directive 2009/138/EC and in the case of a partial internal model Article 113 of Directive 2009/138/EC, the suitability for the use of that model or data within the internal model and an explanation of the preference of external models or data to internal models or data.
- (p) an estimation of the Solvency Capital Requirement at the most granular level according to the insurance or reinsurance undertaking risk categorisation, calculated with the internal model and with the standard formula for the last point in time prior to the date of the submission of the application where the Solvency Capital Requirement was calculated with the standard formula; or, in case of an application before any Solvency Capital Requirement is calculated, an estimation of the Solvency Capital Requirement at the most granular level according to the insurance or reinsurance risk categorisation, calculated by using the internal model and the standard formula with the standard formula parameters and not parameters specific to the insurance or reinsurance undertaking.

- (q) an identification of those parts of the business of the insurance or reinsurance undertaking which have been classified as a major business unit and a justification for this classification.
 - (r) in the case of partial internal models, a description and a justification of the integration technique proposed.
- (4) The insurance and reinsurance undertaking shall submit documentary evidence of the approval of the application by the administrative, management or supervisory bodies as set out in Article 116 of Directive 2009/138/EC.
 - (5) The insurance or reinsurance undertaking shall provide an inventory of all the documents and sets of evidence included in the application. Where there are connections between different documents the insurance or reinsurance undertaking shall highlight these connections and include cross-references.

Article 3- Policy for changing the internal model

- (1) The supervisory authorities shall only approve the policy for changing the internal model if it meets the following conditions:
 - (a) it includes the procedure to be followed to determine whether a change in the internal model is needed as a consequence of any relevant change:
 - i. in the system of governance;
 - ii. in the compliance with the requirements to use the internal model;
 - iii. in the appropriateness of the technical specifications of the internal model;
 - iv. in any relevant change to the risk profile of the undertaking; and
 - v. that would impact the Solvency Capital Requirement of the undertaking.
 - (b) it does not cover the inclusion of new elements in the internal model, such as the inclusion of additional risks or business units.
 - (c) it specifies when a change to the internal model shall be considered as major or minor and when a combination of minor changes shall be considered a major change.
 - (d) it sets out the governance requirements in relation to changes to the internal model, including internal approval of changes, internal communication, documentation and validation of changes.

Article 4- Assessment of the application

- (1) The supervisory authorities shall confirm receipt of the application of the insurance or reinsurance undertaking.
- (2) The supervisory authorities shall determine whether the application is complete within 30 days from the date of the receipt of the application. An application to use an internal model to calculate the Solvency Capital Requirement shall be considered as complete if it includes all the documentary evidence set out in Article 2(2).
- (3) Where the supervisory authorities determine that the application is not complete, they shall immediately inform the insurance or reinsurance undertaking which has submitted the application that the six month approval period has not begun and specify the reasons why the application is not complete.

- (4) Where the supervisory authorities determine that the application is complete, they shall inform the insurance or reinsurance undertaking which has submitted the application that the application is complete and the date from which the six months period starts. That date shall be the date on which the complete application was received.
- (5) The fact that the supervisory authorities have determined an application to be complete shall not prevent the supervisory authorities from requiring, at any time of the approval process, any further information from the insurance or reinsurance undertaking which has submitted the application that is necessary to assess the application to use the internal model.
- (6) The insurance or reinsurance undertaking shall ensure that all documents referred to in Article 125 of Directive 2009/138/EC are made available, including in electronic form, to the supervisory authorities throughout the assessment of the application.
- (7) The assessment of the application shall involve ongoing communication with the insurance or reinsurance undertaking and may include requests for adjustments to the internal model and for a transitional plan as set out in Article 113 of Directive 2009/138/EC.
- (8) If the supervisory authorities determine that it could be possible to approve the internal model subject to adjustments to the internal model being made, they may notify this to the insurance or reinsurance undertaking.
- (9) Where the supervisory authorities request further information or adjustments to the internal model, the insurance or reinsurance undertaking may request a suspension of the six months approval period referred to in Article 112(4) of Directive 2009/138/EC. That suspension shall end once the insurance or reinsurance undertaking has made the necessary adjustments and the supervisory authorities have received an amended application providing documentary evidence of the adjustments. The supervisory authorities shall then inform the insurance or reinsurance undertaking of the new expiry date of the approval period.

Article 5- Right to withdraw the application

- (1) The insurance or reinsurance undertaking which has submitted the application to use the internal model to calculate the Solvency Capital Requirement may withdraw that application in writing by notifying to the supervisory authority at any time before the decision on the application is reached.

Article 6- Decision on the application

- (1) The supervisory authorities shall reject the application for the use of an internal model if they are not satisfied that the systems of the insurance or reinsurance undertaking for identifying, measuring, monitoring, managing and reporting risk are adequate, and in particular if they are not satisfied that the internal model fulfils the requirements set out in Articles 101, 112 and 120 to 125 of Directive 2009/138/EC and in the case of a partial internal model Article 113 of Directive 2009/138/EC.
- (2) Insurance and reinsurance undertakings shall only consider their application for an internal model approved upon receipt of the decision from the supervisory authorities.
- (3) The application for the use of an internal model shall not be considered as approved where the supervisory authorities fail to make a decision within the period referred to in Article 112 of Directive 2009/138/EC.

- (4) Where the supervisory authorities have assessed the application and decided on it, they shall, without delay, notify its decision to the insurance or reinsurance undertaking. The decision shall include:
- (a) when the supervisory authorities approve the application, the starting date from which the model shall be used to calculate the Solvency Capital Requirement.
 - (b) any terms and conditions together with the reasons for those terms and conditions.
 - (c) when the supervisory authorities reject the application, the reason on which the rejection is based.
 - (d) where the supervisory authorities have required a transitional plan in accordance with Article 113 of Directive 2009/138/EC, a decision about the approval of the transitional plan referred to in Article 7.
- (5) The supervisory authorities shall disclose on their website the fact that the use of an internal model has been approved, the start date from which the model shall be used to calculate the Solvency Capital Requirement and the scope of the internal model, in terms of risk categories and business units.
- (6) The supervisory authorities shall not disclose that an insurance or reinsurance undertaking has applied to use an internal model to calculate the Solvency Capital Requirement, or that an application was rejected or withdrawn.

Article 7- Transitional plan to extend the scope of the model

- (1) In the case referred to in Article 113(2) of Directive 2009/138/EC, the supervisory authorities shall explain the reasons for requiring a transitional plan and set the minimum scope which the internal model must cover after the implementation of the transitional plan.
- (2) The transitional plan shall be approved by the administrative, management or supervisory body of the insurance or reinsurance undertaking and shall clearly identify the period for implementing the plan, the extension of the scope and the measures and resources necessary to extend the scope of the internal model. Supervisory authorities shall evaluate the plan presented by the undertaking. Supervisory authorities may, where necessary require an amended plan approved by the administrative, management or supervisory body to be submitted for approval.
- (3) When the undertaking fails to implement the transitional plan to extend the scope of the model, the supervisory authorities may, without prejudice to any other available supervisory measures, take the following measures:
- (a) extend the time period to implement the plan;
 - (b) extend the time period to implement the plan, subject to amendments to the plan;
 - (c) require the insurance or reinsurance undertaking to calculate the Solvency Capital Requirement according to the standard formula set out in the Title I, Chapter VI, Section 4, Subsection 2 of Directive 2009/138/EC; or
 - (d) allow the use of a partial internal model with a more limited scope than the minimum scope referred to in paragraph 1.

Article 8- Changes to the internal model

- (1) The insurance or reinsurance undertaking shall include in the application for approval of a major change to the internal model documentary evidence that, after applying the major change to the internal model, the requirements set out in Articles 101, 112 and 120 to 126 of Directive 2009/138/EC, and in the case of a partial internal model Article 113 of Directive 2009/138/EC, are complied with.
- (2) The insurance or reinsurance undertaking shall include in the application for approval of a major change to the internal model the documents set out in Article 2 where their content would be affected by the major change to the internal model, together with an indication of the changes made to them, and a detailed description of the qualitative and quantitative impacts of the major change to the approved internal model and its results.
- (3) The insurance or reinsurance undertaking shall report minor changes to the internal model to the supervisory authorities quarterly or more frequently where appropriate. Minor changes to the internal model shall be communicated in a summarised report that describes both the quantitative and qualitative impacts of changes and the cumulative quantitative and qualitative effects of the changes on the approved internal model.

Article 9- Changes to the policy for changing the internal model

- (1) The insurance or reinsurance undertakings shall include in the application for approval of changes to the policy for changing the internal model the reason for changing the policy for changing the internal model and evidence that, after applying the changes, the requirements set out in Article 3 are complied with.
- (2) Supervisory authorities shall approve the application to change the policy for changing the internal model only if they are satisfied that the scope of the policy is comprehensive and that the procedures described in the policy for changing the internal model ensure that the internal model meets on a continuous basis the requirements set out in Articles 101, 112 and 120 to 125 of Directive 2009/138/EC and in the case of a partial internal model Article 113 of Directive 2009/138/EC.

Article 10- Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, []

*[For the Commission
The President]*

[On behalf of the President]

[Position]

Annex I: Impact Assessment

In the course of the policy drafting each provision in the ITS, an analysis has been carried out with respect to the expected costs and benefits generated by these texts.

When analysing the impact from proposed policies, the impact assessment methodology envisaged that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered.

Baseline

The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention. The baseline is based on the current situation of the market, which is considered to be composed of:

- The progress towards Solvency II that insurance and reinsurance undertakings have already achieved at this stage, considering the average state of art of EU insurance and reinsurance undertakings,
- Progress for the implementation of Solvency II envisaged by any other elements of its framework.

In particular the baseline for this ITS includes:

- The content of Directive 138/2009/EC and any amendment already agreed to it,
- Where there is evidence of its public availability at the date of approval of the consultation of these technical standards by EIOPA, any reliable background on the likely content of the draft of level 2 delegated act and technical standards developing the aforementioned Directive.

Policy Analysis

This analysis below presents the EIOPA's considerations on the expected costs and benefits with respect to the **key areas** of this ITS:

- 1.** Approval process of internal models, including
 - a) the application submitted by the undertaking;
 - b) the assessment by supervisory authorities;
 - c) the decision on the application.
- 2.** Conditions for the approval of the policy for changing the internal model;
- 3.** Transitional plan to extend the scope of the model; and
- 4.** Approval process of major changes to the internal model and of changes to the policy for changing the internal model.

Key area 1 a). The provisions on application establish a set of evidence that has to be provided by the undertaking in order to demonstrate compliance with the relevant requirements to use an internal model which already set out in the Directive 2009/138/EC and the corresponding Implementing Measures. Some specific requests to the undertaking are also included, like the need to provide contact information of the relevant people involved in the activities related to the internal models and an

inventory of the documents and sets of evidence included in the application. These requests can generate some limited costs to the undertaking, but have the benefit of increasing the efficiency of the process, as they will make easier the communication between the undertaking and the supervisory authority during the whole approval process and will facilitate the assessment of the application by the supervisory authority.

Key area 1 b). Regarding the assessment of the application, on the criteria to assess the completeness of the application by the supervisory authority, there is no discretion incorporated in the ITS as the policies are mainly consistent with the provisions set out in Implementing Measures for internal models for groups, with the only difference of the number of days needed to assess the completeness (30 days for solo internal models, 45 days for group internal models). This difference does not generate material costs, as in principle, group internal models are more complex than solo ones, so the assessment of completeness would be easier for solo models. Regarding the possibility of supervisory authorities to request further information or adjustments to the internal model, this is normal in any approval process and is beneficial both for supervisory authorities and undertakings, as it facilitates the assessment and makes sure that a final decision on the application can be made. The request of further information or adjustments can be seen as a potential cost for the undertaking, but in this case the undertaking has the possibility to request a suspension of the six months for the approval.

Key area 1 c). With respect to the decision, the proposed policies specify the provisions already set out in Article 112(4), (5) and (6) of the Directive 2009/138/EC. The specific ITS policies give certainty both to the supervisory authorities and undertakings regarding the decision on the application and the reasons to be given by the supervisory authority. The possibility of having terms and conditions subject to the decision is in line with Article 231 of the Directive which foresees this possibility in case of group internal models.

EIOPA considers that the proposed policies for the first key area ensure a consistent application of the Directive 2009/138/EC, in particular Article 112, and contribute to a more efficient approval process of internal models and to a more efficient allocation of resources, for both supervisory authorities and undertakings. The proposed ITS is also consistent with Implementing Measures, which set out specificities for the approval process of internal models for groups.

In this respect, it can be concluded that the policies do not generate material incremented costs compared to the baseline.

Key area 2). The ITS aims to clarify the conditions for approval of the policy for model changes and the content of this policy. It develops the provisions set out in Article 115 of the Directive. No material costs are foreseen as the conditions set out in the ITS refer to various essential aspects that the policy shall have in order to be able to be compliant with the requirements set out in the Directive 2009/138/EC, in particular Article 112 and Articles 120-126.

EIOPA is of the opinion that the proposed ITS text facilitates the understanding and approval of the policy for changing the internal model by supervisory authorities, and at the same time is beneficial for undertakings, as it helps them developing the policy in an accurate manner.

Key areas 3) and 4). With regard to key areas 3 and 4, the analysis of potential costs and benefits shows that the proposed policies do not generate material incremental costs due to the fact that there is no discretion incorporated in the respective areas. For instance the proposed requirements on the transitional plan to extend the scope of the model in fact only makes explicit and operational the requirements set out in Article 113(2) of the Directive 2009/138/EC. EIOPA is of the opinion that the ITS provisions improve the effectiveness of the request for a transitional plan by national supervisory authorities setting out the process which shall be followed; they also clarify the consequences in case the undertaking fails to act according to the plan. On the approval process of major changes and changes to the policy for changing the internal model, the proposed policies develop Article 115 of the Directive 2009/138/EC. EIOPA is of the view that more specific provisions on these areas improve the consistency and the efficiency of the process, both for undertakings and supervisory authorities.