

# **Guidelines on Pre-Application of Internal Models**

# Guidelines on Pre-Application of Internal Models

## Introduction

- 1.1. According to Article 16 of Regulation (EU) 1904/2010 of 24 November 2010 (hereafter, EIOPA Regulation)<sup>1</sup> EIOPA is issuing Guidelines addressed to national competent authorities on how to proceed in the preparatory phase leading up to the application of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)<sup>2</sup>.
- 1.2. The present Guidelines apply to the pre-application process for internal models, where national competent authorities are expected to form a view on how prepared an insurance or reinsurance undertaking is to submit an application for the use of an internal model for the calculation of the Solvency Capital Requirement under Solvency II and to meet the internal models requirements set out in the Directive, in particular in Articles 112, 113, 115, 116, and 120 to 126.
- 1.3. In the absence of Preparatory Guidelines European national competent authorities may see the need to develop national solutions in order to ensure sound risk sensitive supervision. Instead of reaching consistent and convergent supervision in the EU, different national solutions may emerge to the detriment of a good functioning internal market.
- 1.4. It is of key importance that there will be a consistent and convergent approach with respect to the preparation of Solvency II. These Guidelines should be seen as preparatory work for Solvency II by fostering preparation with respect to key areas of Solvency II in order to ensure proper management of undertakings and to ensure that supervisors have sufficient information at hand. These areas are the system of governance, including risk management system and a forward looking assessment of the undertaking's own risks (based on the Own Risk and Solvency Assessment principles), pre-application for internal models and submission of information to national competent authorities.
- 1.5. Early preparation is key in order to ensure that when Solvency II is fully applicable undertakings and national competent authorities will be well prepared and able to apply the new system. For this, national competent authorities are expected to engage with undertakings in a close dialogue.
- 1.6. As part of the preparation for the implementation of Solvency II, national competent authorities should put in place from 1st of January 2014 the Guidelines as set out in this document so that insurance and reinsurance

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<sup>1</sup> OJ L 331, 15.12.2010, p. 48-83

<sup>2</sup> OJ L 335, 17.12.2009, p. 1-155

undertakings take appropriate steps for the full implementation of Solvency II.

- 1.7. National competent authorities should send to EIOPA a progress report on the application of these Guidelines by the end of February following each relevant year, the first being by 28 February 2015 based on the period 1 January 2014 to 31 December 2014.
- 1.8. The EIOPA Guidelines on Pre-application for Internal Models aim to provide guidance on what national competent authorities and an insurance or reinsurance undertaking engaged in a pre-application process should consider in order that national competent authorities are able to form a view on how prepared this insurance or reinsurance undertaking is to submit an application for the use under Solvency II of an internal model for the calculation of the Solvency Capital Requirement. Therefore the pre-application process is not a pre-approval of the internal model. Under Solvency II an insurance or reinsurance undertaking applying for the use of an internal model to calculate the Solvency Capital Requirement will have to comply with the Directive requirements as further specified in the Delegated Acts when issued.
- 1.9. The Guidelines aim to increase convergence of supervisory practices during the pre-application process. They should also in turn help an insurance or reinsurance undertaking to develop its internal model framework and thereby prepare to submit an application to use an internal model under Solvency II. They also extend the pre-application process for an undertaking aiming at submitting an application for decision on the use of an internal model from the first day on which Solvency II is applicable.
- 1.10. In the case of pre-application process for groups, there should be appropriate level of communication between national competent authorities within the colleges, in particular between the national competent authorities involved.
- 1.11. Communication between national competent authorities and the insurance or reinsurance undertaking should continue throughout the pre-application and the future assessment of the application the undertaking may submit under Solvency II, and after the internal model is approved through the supervisory review process.
- 1.12. More provisions on the pre-application process are contained in CEIOPS' Level 3 Guidance on Pre-Application process for internal models (former CEIOPS Consultation Paper 80)<sup>3</sup>.
- 1.13. National competent authorities are expected to ensure that these Guidelines are applied in a manner which is proportionate to the nature, scale and complexity inherent in the risks and business of the insurance

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<sup>3</sup> [https://eiopa.europa.eu/fileadmin/tx\\_dam/files/consultations/consultationpapers/CP80/CEIOPS-DOC-76-10-Guidance-pre-application-internal-models.pdf](https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP80/CEIOPS-DOC-76-10-Guidance-pre-application-internal-models.pdf)

and reinsurance undertaking. The Guidelines already reflect the application of the principles of proportionality by having the principle embedded and also by introducing specific measures in certain areas.

1.14. All the Guidelines apply, unless otherwise explicitly stated, to the pre-application process for:

- An internal model, full or partial, that would be submitted for decision to use for the calculation of the Solvency Capital Requirement of an insurance or reinsurance undertaking under Solvency II.
- An internal model for a group, full or partial, as defined below, which would be submitted for this decision.

1.15. For the purpose of the Guidelines of Section II the following definitions apply:

- “*Internal model(s) for a group (or for groups)*” should be understood as both an internal model that would be used under Solvency II for the calculation only of the consolidated group Solvency Capital Requirement (under Article 230 of Solvency II) and an internal model that would be used under Solvency II for the calculation of the consolidated group Solvency Capital Requirement as well as the Solvency Capital Requirement of at least one related undertaking included in the scope of this internal model for the calculation of the consolidated group Solvency Capital Requirement (group internal model under Article 231 of Solvency II).
- “*The national competent authorities concerned*” should be understood as the national competent authorities of all the Member States in which the head offices of each related insurance and reinsurance undertakings included in the scope of a group internal model as referred to above (Article 231 of Solvency II) and for which the Solvency Capital Requirement would be calculated by the group internal model, are situated.
- “*The national competent authorities involved*” should be understood as the national competent authorities of all the Member States in which the head offices of related undertakings included in the scope of an internal model for a group (both under Article 230 and Article 231 of Solvency II) are situated.

The *national competent authorities concerned* in the case of a group internal model under Article 231 of Solvency II are part of these *national competent authorities involved*.

- “*Expert judgment*” should be understood as the expertise of individual persons or committees with relevant knowledge,

experience and understanding of the risks inherent in the insurance or reinsurance business.

- The concept of "*richness of the probability distribution forecast*" is determined mainly in two dimensions: the undertaking's extent of knowledge about the risk profile as reflected in the set of events underlying the probability distribution forecast and the capability of the calculation method chosen to transform this information into a distribution of monetary values that relate to changes in basic own funds. The concept of richness should not be reduced to the granularity of the representation of the probability distribution forecast because even a forecast in form of a continuous function might be of low richness.
- The "*reference risk measure*" should be understood as the Value-at-Risk of the basic own funds subject to a confidence level of 99,5% over a one-year period as set out in Article 101(3) of Solvency II.
- "*Analytical closed formulae*" should be understood as direct mathematical formulae that link the risk measure chosen by the undertaking to the reference one as defined above.
- "*t=0*" should be understood as the date of which the Solvency Capital Requirement computation will be made by the undertaking according to its internal model.
- "*t=1*" should be understood as one year after the date of which the Solvency Capital Requirement computation will be made by the undertaking according to its internal model.
- A quantitative or qualitative aspect of an internal model should be considered as "*material*" when a change or an error of this aspect could generate an impact on the outputs of this internal model, which could influence the decision-making or the judgement of the users of that information, including the national competent authorities.

1.16. These Guidelines shall apply from 1 January 2014.

## **Section I: General Provisions for Guidelines**

### **Guideline 1 - General provisions for Guidelines**

- 1.17. National competent authorities should take the appropriate steps in order to put in place from 1 January 2014 the present Guidelines on Pre-application for Internal Models.
- 1.18. During the pre-application process, national competent authorities should take the appropriate steps in order to form a view on how prepared an insurance or reinsurance undertaking engaged in a pre-application process is to submit an application for the use of an internal model for the calculation of the Solvency Capital Requirement under Solvency II and to meet the internal models requirements set out in Directive 2009/138/EC, in particular in Articles 112, 113, 115, 116, 120 to 126 and 231.
- 1.19. During the pre-application process, national competent authorities should form a view on how the insurance or reinsurance undertaking engaged in the pre-application process takes the appropriate steps to:
  - (a) build its internal model framework in a way that enables it to be prepared to use the internal model for both, risk management and decision-making purposes and the calculation of the Solvency Capital Requirement; and
  - (b) prepare for the eventuality that its internal model may not be approved and set up processes to calculate the standard formula Solvency Capital Requirement as well as to consider the capital planning implications.

### **Guideline 2 – Progress report to EIOPA**

- 1.20. National competent authorities should send to EIOPA, a progress report on the application of these Guidelines by the end of February following each relevant year, the first being by 28 February 2015 based on the period 1 January 2014 to 31 December 2014.

## **Section II: Pre-application for internal models**

### **Chapter 1: General Guidelines**

#### **Guideline 3 - National competent authorities' review**

- 1.21. During the pre-application process, when defining and considering the extent of the reviews they carry out for the purposes of this process, national competent authorities should take into account at least:
  - (a) the specificities of the undertaking engaged in the pre-application process, and of its internal model;

- (b) the relation between the aspect of the internal model being reviewed and other parts of the internal model; and
  - (c) the proportionality principle as set out in Article 29(3) of Solvency II bearing in mind that proportionality principle should not, however, be understood as waving or lowering any of the internal models requirements set out in Solvency II. In particular, national competent authorities should take into account the proportionality principle by considering:
    - (i) the nature, scale and complexity of the risks to which an insurance or reinsurance undertaking is exposed; and
    - (ii) the design, scope and qualitative aspects of the internal model of this undertaking.
- 1.22. National competent authorities should provide on-going feedback to the undertaking on the reviews they carry out on the internal model for the purposes of pre-application.
- 1.23. National competent authorities should ensure during the pre-application process that the undertaking submits to them the standard formula Solvency Capital Requirement. The information to be submitted should cover the overall Solvency Capital Requirement and the following risk categories for the risks within the scope of the internal model:
- (a) Market risk
  - (b) Counterparty default risk
  - (c) Life underwriting risk
  - (d) Health underwriting risk
  - (e) Non life underwriting risk
  - (f) Non - life catastrophe risk
  - (g) Operational risks
- 1.24. The information to be submitted should be agreed by national competent authorities to the most granular level when they deem appropriate, and take account of the items as defined in Technical Annex I and the detail described in Technical Annex II of the "Guidelines on submission of information to national competent authorities". This submission of this information should follow the reference dates and deadlines to be agreed by the national competent authorities with the undertaking during the pre-application process.

#### **Guideline 4 - Changes to the internal model during pre-application**

- 1.25. National competent authorities should monitor and, where appropriate, review changes that the insurance or reinsurance undertaking makes to its internal model after some reviews have been completed during the pre-application process.
- 1.26. To this end, national competent authorities should ensure that the insurance or reinsurance undertaking notifies to them any changes to the internal model or plan of changes the undertaking considers relevant.
- 1.27. National competent authorities should, in relation to the changes the insurance or reinsurance undertaking makes to its internal model during the pre-application process, form a view on, at least:
  - (a) the governance the undertaking puts in place in relation to these changes, including the internal approval of changes, the internal communication, the documentation and the validation of the changes; and
  - (b) the classification of changes the undertaking establishes.

### **Chapter 2: Model changes**

#### **Guideline 5 - Scope of the policy for model changes**

- 1.28. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, when establishing the policy for changing the model, covers all relevant sources of change that would impact its Solvency Capital Requirement, and at least the changes:
  - (a) in the system of governance of the undertaking;
  - (b) in the undertaking's compliance with the requirements to use the internal model;
  - (c) in the appropriateness of the technical specifications of the undertaking's internal model; and
  - (d) in the risk profile of the undertaking.

#### **Guideline 6 - Definition of a major change**

- 1.29. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking develops and uses a number of key qualitative or quantitative indicators to define a major change, and whether the insurance or reinsurance undertaking sets out an objective approach for classifying changes as major.



- 1.30. Whilst the quantitative impact of a model change on the Solvency Capital Requirement or on individual components of the Solvency Capital Requirement may be one of the indicators an insurance or reinsurance undertaking plans to use to identify major changes, national competent authorities should form a view on how the undertaking ensures that other qualitative and quantitative indicators are also used.
- 1.31. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the indicators it develops take into account the specificities of the undertaking itself and of its internal model.

### **Guideline 7 - Combination of several changes**

- 1.32. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking plans to evaluate the effect of each change in isolation and the effect of all changes combined on the Solvency Capital Requirement or its individual components.
- 1.33. National competent authorities should form a view on how the insurance or reinsurance undertaking plans to evaluate such effects in order to prevent individual impacts that offset one another and the combined impact of multiple changes from being overlooked.

### **Guideline 8 – Group internal model change policy (under Article 231 of Solvency II)**

- 1.34. Through the pre-application process, in the case of a group internal model, the national competent authorities involved should form a view on how the insurance or reinsurance undertaking develops one model change policy.
- 1.35. The national competent authorities involved should form a view on how the insurance or reinsurance undertaking ensures that the model change policy includes a specification of major and minor changes with regard to the group, as well as each of the related undertakings which would use the group internal model to calculate their individual Solvency Capital Requirement.
- 1.36. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that any change that is major at an individual undertaking is classified as a major change within the policy.

## **Chapter 3: Use test**

### **Guideline 9 – Assessment of compliance**

- 1.37. Through the pre-application process national competent authorities should form a view on the insurance or reinsurance undertaking's compliance with the use test as set out in Article 120 of Solvency II, and in particular in relation to, at least:

- (a) the different uses of the model;
- (b) how the model fits to the business;
- (c) how the model is understood;
- (d) how the model supports the decision-making; and
- (e) how the model is integrated with the risk management system.

1.38. National competent authorities should form this view taking into account that no complete and detailed list of specific uses should be prescribed to the insurance or reinsurance undertaking.

#### **Guideline 10 – Incentive to improve the quality of the internal model**

1.39. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the internal model is used in its risk-management system and decision-making processes in a way that creates incentives to improve the quality of the internal model itself.

#### **Guideline 11 – Fit to the business**

1.40. Through the pre-application process national competent authorities should, in forming a view on how the insurance or reinsurance undertaking ensures that the level of detail to which the internal model fits its business is appropriate, consider at least the following factors:

- (a) whether the uses of the internal model by the insurance or reinsurance undertaking in its decision-making process covers key business decisions, including strategic decisions, and any other relevant decisions;
- (b) the insurance or reinsurance undertaking's risk management system and how granular this is;
- (c) the granularity required for the decision-making process of the insurance or reinsurance undertaking;
- (d) the decision-making structure in the insurance or reinsurance undertaking; and
- (e) the internal record by the insurance or reinsurance undertaking related to the design of the output from the internal model.

#### **Guideline 12 – Understanding of the internal model**

1.41. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures understanding of the internal model by the administrative, management

or supervisory body and relevant users of the internal model for decision-making.

- 1.42. With the aim of forming a view on their understanding of the internal model national competent authorities should consider using interviews of persons from the administrative, management or supervisory body and persons who effectively run the insurance or reinsurance undertaking.
- 1.43. National competent authorities should also consider reviewing the documentation of the minutes of the board meetings or appropriate decision-making bodies to form a view on how ready is the insurance or reinsurance undertaking to comply with the use test requirements.

### **Guideline 13 – Support of decision-making**

- 1.44. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures and is able to demonstrate that the internal model is used in decision-making.

### **Guideline 14 – Support of decision-making**

- 1.45. Through the pre-application process, national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the internal stakeholders of the undertaking, in particular its administrative, management and supervisory bodies, receive regular internal model results that relate to the relevant business decisions.

### **Guideline 15 – Support of decision-making**

- 1.46. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the internal model is at a minimum able to measure the economic capital and to identify the impact on the risk profile of potential decisions for which the model is used.
- 1.47. National competent authorities should form a view on how the insurance or reinsurance undertaking also understands the effect such decisions will have on the Solvency Capital Requirement.

### **Guideline 16 – Frequency of calculation**

- 1.48. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking develops a process to monitor its risk profile and how a significant change of the risk profile triggers a recalculation of the Solvency Capital Requirement.

### **Guideline 17 – Group specificities**

- 1.49. Through the pre-application process, in case of a group internal model, the national competent authorities involved should form a view on how the participating undertaking and the related undertakings which would use the group internal model to calculate their individual Solvency Capital

Requirement cooperate to ensure that the design of the internal model is aligned with their business.

- 1.50. The national competent authorities involved should form a view on the evidence provided by the participating undertaking and related undertakings that, at least:
- (a) their individual Solvency Capital Requirement would be calculated with the frequency required by Article 102 of Solvency II and whenever it is needed in the decision-making process;
  - (b) they can propose changes to the group internal model, especially for components that are material to them or following a change in their risk profile and taking into account the environment in which the undertaking is operating; and
  - (c) the related undertakings possess the adequate understanding of the internal model for the parts of the internal model which cover the risks of that undertaking.
- 1.51. The national competent authorities involved should form a view on how insurance or reinsurance undertakings that would use a group internal model to calculate their Solvency Capital Requirement, ensure that the design of the internal model is aligned with their business and their risk-management system, including the production of outputs, at group level and at related undertaking level, that are granular enough to allow the group internal model to play a sufficient role in their decision-making processes.

## **Chapter 4: Assumption setting and expert judgement**

### **Guideline 18 – Assumptions setting**

- 1.52. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking sets assumptions and uses expert judgment in particular, taking into account the materiality of the impact of the use of assumptions with respect to the following Guidelines on assumption setting and expert judgement.
- 1.53. National competent authorities should form a view on how the undertaking assesses materiality taking into account both quantitative and qualitative indicators and taking into consideration extreme losses conditions.
- 1.54. National competent authorities should form a view on how the insurance or reinsurance undertaking overall evaluates the indicators considered.

### **Guideline 19– Governance**

- 1.55. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that

all assumption setting, and the use of expert judgement in particular, follows a validated and documented process.

- 1.56. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the assumptions are derived and used consistently over time and across the insurance or reinsurance undertaking and that they are fit for their intended use.
- 1.57. National competent authorities should form a view on how the insurance or reinsurance undertaking signs off the assumptions at levels of sufficient seniority according to their materiality, for most material assumptions up to and including the administrative, management or supervisory body.

### **Guideline 20 - Communication and uncertainty**

- 1.58. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the processes around assumptions, and in particular around the use of expert judgement in choosing those assumptions, specifically attempt to mitigate the risk of misunderstanding or miscommunication between all different roles related to such assumptions.
- 1.59. National competent authorities should form a view on how the insurance or reinsurance undertaking establishes a formal and documented feedback process between the providers and the users of material expert judgement and of the resulting assumptions.
- 1.60. National competent authorities should form a view on how the insurance or reinsurance undertaking makes transparent the uncertainty of the assumptions as well as the associated variation in final results.

### **Guideline 21 - Documentation**

- 1.61. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking documents the assumption setting process, and in particular the use of expert judgement, in such a manner that the process is transparent.
- 1.62. National competent authorities should form a view on how the insurance or reinsurance undertaking includes in the documentation the resulting assumptions and their materiality, the experts involved, the intended use and the period of validity.
- 1.63. National competent authorities should form a view on how the insurance or reinsurance undertaking includes the rationale for the opinion, including the information basis used, with the level of detail necessary to make transparent both the assumptions and the process and decision-making criteria used for the selection of the assumptions and disregarding other alternatives.
- 1.64. National competent authorities should form a view on how the insurance or reinsurance undertaking makes sure that users of material assumptions receive clear and comprehensive written information about those assumptions.

## **Guideline 22 - Validation**

- 1.65. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the process for choosing assumptions and using expert judgement is being validated.
- 1.66. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the process and the tools for validating the assumptions and in particular the use of expert judgement are being documented.
- 1.67. National competent authorities should form a view on how the insurance or reinsurance undertaking tracks the changes of material assumptions in response to new information and analyses and explains those changes as well as deviations of realizations from material assumptions.
- 1.68. National competent authorities should form a view on how the insurance or reinsurance undertaking, where feasible and appropriate, uses other validation tools such as stress testing or sensitivity testing.
- 1.69. National competent authorities should form a view on how the insurance or reinsurance undertaking reviews the assumptions chosen, relying on independent internal or external expertise.
- 1.70. National competent authorities should form a view on how the insurance or reinsurance undertaking detects the occurrence of circumstances under which the assumptions would be considered false.

## **Chapter 5: Methodological consistency**

### **Guideline 23 - Consistency check points**

- 1.71. Through the pre-application process, national competent authorities should form a view on how the insurance or reinsurance undertaking ensures consistency between the methods used to calculate the probability distribution forecast and the methods used for the valuation of assets and liabilities in the balance sheet for solvency purposes.
- 1.72. In particular national competent authorities should form a view on how the insurance or reinsurance undertaking checks consistency at the following steps of the calculation of the probability distribution forecast, in case that they are relevant to the model part under consideration:
  - (a) the consistency of the transition from the valuation of assets and liabilities in the balance sheet for solvency purposes to the internal model for the purpose of Solvency Capital Requirements calculations;
  - (b) the consistency of the valuation of assets and liabilities in the internal model at the valuation date with the valuation of assets and liabilities in the balance sheet for solvency purposes;

- (c) the consistency of the projection of risk factors and their impact on the forecast monetary values with the assumptions on those risk factors used for the valuation of assets and liabilities in the balance sheet for solvency purposes; and
- (d) the consistency of the re-valuation of assets and liabilities at the end of the period with the valuation of assets and liabilities in the balance sheet for solvency purposes.

#### **Guideline 24 - Aspects of consistency**

1.73. Through the pre-application process, national competent authorities should form a view on how the insurance or reinsurance undertaking, when assessing consistency, takes at least the following aspects into account:

- (a) the consistency of the calculation methods applied in the valuation of assets and liabilities in the balance sheet for solvency purposes, and in the calculation of the probability distribution forecast;
- (b) the consistency of data and parameters that are used as input for the respective calculations; and
- (c) the consistency of the assumptions underlying the respective calculations, in particular assumptions on contractual options and financial guarantees, on future management actions and on expected future discretionary benefits.

#### **Guideline 25 - Consistency assessment**

1.74. Through the pre-application process, national competent authorities should form a view on how the insurance or reinsurance undertaking conducts regular consistency assessments as part of its internal model validation process as set out in Article 124 of Solvency II.

1.75. National competent authorities should form a view on how the insurance or reinsurance undertaking conducts the consistency assessment on a quantitative basis whenever possible and proportionate.

1.76. National competent authorities should form a view on how the insurance or reinsurance undertaking, in its consistency assessment,:

- (a) identifies and documents any deviation between the calculation of the probability distribution forecast and the valuation of assets and liabilities in the balance sheet for solvency purposes;
- (b) assesses the impact of the deviations, both in isolation and in combination; and
- (c) justifies that the deviations do not result in an inconsistency between the calculation of the probability distribution forecast and

the valuation of assets and liabilities in the balance sheet for solvency purposes.

## **Chapter 6: Probability distribution forecast**

### **Guideline 26 - Knowledge of the risk profile**

- 1.77. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the set of events of the probability distribution forecast underlying the internal model is exhaustive.
- 1.78. National competent authorities should form a view on the processes that are put in place by the insurance or reinsurance undertaking in order to maintain sufficient and current knowledge of its risk profile.
- 1.79. In particular, national competent authorities should form a view on how the insurance or reinsurance undertaking aims to maintain the knowledge of risk drivers and other factors which explain the behaviour of the variable underlying the probability distribution forecast, so that the probability distribution forecast can reflect all relevant characteristics of its risk profile.

### **Guideline 27 - Probability distribution forecast richness**

- 1.80. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking assesses the appropriateness of the actuarial and statistical techniques used to calculate the probability distribution forecast, and on how it considers the capability of the techniques to process the knowledge of the risk profile as an important criterion.
- 1.81. National competent authorities should form a view on how the insurance or reinsurance undertaking chooses techniques that generate a probability distribution forecast that is rich enough to capture all relevant characteristics of its risk profile and to support decision-making.
- 1.82. National competent authorities should also form a view on how the insurance or reinsurance undertaking as part of this methodological assessment considers the reliability of adverse quantiles estimated based on the probability distribution forecast.
- 1.83. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the effort to generate rich probability distribution forecast does not impair the reliability of the estimate of adverse quantiles.

### **Guideline 28 – Assessment of richness of the probability distribution forecast**

- 1.84. Through the pre-application process, to form a view according to Guideline 28, and with a view to ensure a harmonised approach for the pre-



application and model changes, national competent authorities should take into account at least:

- (a) the risk profile of the undertaking and to what extent it is reflected by the probability distribution forecast;
- (b) the current progress in actuarial science and the generally accepted market practice;
- (c) with respect to the level of probability distribution forecast richness, any measures that the insurance or reinsurance undertaking puts in place to ensure compliance with internal model test and each of the standards set out in Articles 120 to 126 of Solvency II;
- (d) for a particular risk under consideration, the way in which the techniques chosen and the probability distribution forecast obtained by the insurance or reinsurance undertaking interact with other risks in the scope of the internal model as regards the level of richness of the probability distribution forecast; and
- (e) the nature, scale and complexity of the risk under consideration as set out in Article 29(3) of Solvency II.

#### **Guideline 29 – Probability distribution forecast enrichment**

1.85. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking takes care not to introduce into the probability distribution forecast unfounded richness which does not reflect the original knowledge of its risk profile [cf. Guideline 26].

1.86. National competent authorities should form a view on how the methodology followed by the insurance or reinsurance undertaking to enrich the probability distribution forecast complies with the Statistical Quality Standards regarding methods, assumptions and data. Where these techniques involve the use of expert judgement the relevant Guidelines on assumptions setting and expert judgement should apply.

### **Chapter 7: Calibration - approximations**

#### **Guideline 30 - Knowledge of approximations**

1.87. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking demonstrates a detailed understanding of the approximations allowed by Article 122(3) of Solvency II that it makes.

1.88. In particular, national competent authorities should form a view on how the undertaking at least:

- (a) considers the error that is introduced by the approximations in the Solvency Capital Requirement;
- (b) demonstrates that the approximations it makes do not result in a Solvency Capital Requirement that is materially underestimated compared to the result of the calculation with the reference risk measure, in order to ensure that policyholders are provided with a level of protection equivalent to that provided in Article 101(3) of Solvency II; and
- (c) challenges and justifies the stability of the output of approximations over time, and under extreme loss conditions, according to its risk profile.

1.89. National competent authorities should make clear to the insurance or reinsurance undertaking that material uncertainty around approximations to recalibrate the Solvency Capital Requirement is not allowed if this uncertainty leads to an underestimation of the Solvency Capital Requirement.

**Guideline 31 - Reference risk measure as an intermediate result**

1.90. When the insurance or reinsurance undertaking can derive the reference risk measure as an intermediate result of the economic capital calculation process, through the pre-application process national competent authorities should form a view on how the undertaking is able to demonstrate that this result also reflects appropriately its risk profile.

**Guideline 32 - Use of another underlying variable**

1.91. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, if it uses for the calculation of the Solvency Capital Requirement the variation of an underlying variable different from the basic own funds, demonstrates:

- (a) either that the difference between the basic own funds and the underlying variable is not material at  $t=0$  and in any foreseeable situation up to and including  $t=1$ ; or
- (b) in case of this difference being material, that there cannot be any significant variation of it over the next period,, especially under extreme losses conditions, according to the undertaking risk profile.

1.92. National competent authorities should form a view on how the insurance or reinsurance undertaking, if it uses the variation of an underlying variable different from the basic own funds to derive the value of basic own funds, demonstrates that:

- (a) it is able to reconcile the difference between the basic own funds and the underlying variable at  $t=0$ ; and
- (b) it understands the difference between the basic own funds and the underlying variable in any situation up to and including  $t=1$ .

1.93. National competent authorities should form a view on how the balance sheet for solvency purposes that is run by the insurance or reinsurance undertaking enables such undertaking to determine the amount of eligible own funds available to cover the Solvency Capital Requirement, irrespectively of the calculation method used to calculate this Solvency Capital Requirement.

### **Guideline 33 - Use of analytical closed formulae**

1.94. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, where it uses analytical closed formulae to recalibrate its capital requirement from the internal risk measure to the reference one, demonstrates that the assumptions underlying the formulae are realistic and are also valid under extreme losses conditions, according to the insurance or reinsurance undertaking's risk profile.

### **Guideline 34 - Management actions**

1.95. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, where it chooses in its internal model a time period longer than one year, takes into account management actions in the context of the Solvency Capital Requirement calculation, and ensures that such management actions are modelled in a realistic and reasonable way and have effects on the balance sheet for solvency purposes between  $t=0$  and  $t=1$ .

1.96. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the general principles about the valuation of assets and liabilities hold at  $t=1$  when considering management actions effects on the balance sheet for solvency purposes for the purpose of this Guideline.

### **Guideline 35 - Multiple approximations**

1.97. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, where it has to make several approximations, assesses whether there are any interactions between these approximations that need to be allowed for explicitly.

## **Chapter 8: Profit and loss attribution**

### **Guideline 36 – Definition of profit and loss**

- 1.98. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking considers profit and loss as changes over the relevant period, in:
- (a) basic own funds; or
  - (b) other monetary amounts used in the internal model to determine changes in basic own funds, such as the actual change in economic capital resources.
- 1.99. To this end the profit and loss attribution should exclude movements attributable to the raising of additional own funds, the repayment or redemption of those funds and the distribution of own funds.
- 1.100. When an undertaking uses a variable other than the basic own funds in its internal model, national competent authorities should form a view on how the insurance or reinsurance undertaking uses this variable for the purposes of profit and loss attribution.
- 1.101. National competent authorities should form a view on how, through the profit and loss attribution, the undertaking identifies how changes in the risk drivers relate with the movement in the variable underlying the probability distribution forecast.

### **Guideline 37 – Application of profit and loss attribution**

- 1.102. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the profit and loss attribution is consistent with the intended applications of the profit and loss attribution in the use test and in the validation process.

### **Guideline 38 – Application of profit and loss attribution and validation**

- 1.103. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that information relating to how the model has performed in the past provided by the profit and loss attribution feeds into the undertaking's regular validation cycle.

## **Chapter 9: Validation**

### **Guideline 39 – Validation policy and validation report**

- 1.104. Through the pre-application process, national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the validation policy it establishes sets out at least:
- (a) the processes, methods and tools used to validate the internal model and their purposes;

- (b) the frequency of regular validation for each part of the internal model and the circumstances that trigger additional validation;
- (c) the persons who are responsible for each validation task; and
- (d) the procedure to be followed in the event that the model validation process identifies problems with the reliability of the internal model and the decision-making process to address those concerns.

1.105. National competent authorities should form a view on how the insurance or reinsurance undertaking documents in a validation report the results of the validation as well as the resulting conclusions and consequences from the analysis of the validation.

1.106. National competent authorities should form a view on how the insurance or reinsurance undertaking includes in this report a reference to the validation data sets as mentioned in Guideline 50 as well as the sign-off from the main participants in the process.

#### **Guideline 40 – Scope and purpose of the validation process**

1.107. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, when specifying the purpose and scope of the validation, clearly sets out the specific purpose of the validation for each part of the internal model.

1.108. National competent authorities should form a view on how the insurance or reinsurance undertaking covers both qualitative and quantitative aspects of the internal model within the scope of the validation.

1.109. National competent authorities should form a view on how the insurance or reinsurance undertaking, when considering the scope of the validation, in addition to considering the validation of the various parts of the internal model, considers the validation in its entirety and in particular the appropriateness of the calculated probability distribution forecast to ensure that the level of regulatory capital will not be materially misstated.

#### **Guideline 41 - Materiality**

1.110. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking considers the materiality of the part of the internal model being validated, not only in isolation but also in combination, when using materiality to decide on the intensity of the validation activities.

1.111. When the insurance or reinsurance undertaking does not validate specific individual parts of the internal model with a high level of accuracy because of their lack of materiality, national competent authorities should form a view on how the insurance or reinsurance undertaking nevertheless takes into consideration that those parts in combination may be material when it decides how they should be validated appropriately.

1.112. National competent authorities should form a view on how the undertaking considers sensitivity testing when determining materiality in the context of validation.

#### **Guideline 42 – Quality of the validation process**

1.113. Through the pre-application process, national competent authorities should form a view on how the insurance or reinsurance undertaking sets out all the known limitations of the current validation process.

1.114. Where there are limitations to the validation of parts which are covered by the validation process, national competent authorities should form a view on how the insurance or reinsurance undertaking is aware of them and documents these limitations.

1.115. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the assessment of the quality of the validation process explicitly states the circumstances under which the validation is ineffective.

#### **Guideline 43 – Governance of validation process**

1.116. Through the pre-application process national competent authorities should form a view on the governance the insurance or reinsurance undertaking puts in place around the communication of the results of the validation it carries out.

1.117. National competent authorities should form a view on how the insurance or reinsurance undertaking forms and communicates internally an overall opinion based on the findings of the validation process.

1.118. National competent authorities should form a view on how the insurance or reinsurance undertaking puts in place pre-defined criteria in order to determine whether the results, or part of the results, of the validation, are required to be escalated within this undertaking.

1.119. National competent authorities should form a view on whether the insurance or reinsurance undertaking specifies under which conditions the results of the validation process should be escalated; and on how the insurance or reinsurance undertaking clearly defines and sets the escalation path in such a way as to maintain the independence of the validation process.

1.120. National competent authorities should form a view on how the validation policy the insurance or reinsurance undertaking establishes sets out how the results of the different validation tools are reported, for both regular validation as well as additional validation triggered by specific circumstances, and how they are used if the tests show that the internal model does not perform as intended.

#### **Guideline 44 – Roles in validation process**

1.121. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, if parties

other than the risk-management function contribute to specific tasks in the validation process, ensures that the risk-management function fulfils its overall responsibility as set out in Article 44 of Solvency II, including the responsibility to ensure the completion of the various tasks within the validation process.

- 1.122. National competent authorities should form a view on how the insurance or reinsurance undertaking formally explains the role of each party in the validation process defined.
- 1.123. National competent authorities should form a view on whether the allocation of tasks for the entire validation process is covered by the undertaking in the validation policy it establishes.

#### **Guideline 45 – Independence of the validation process**

- 1.124. Through the pre-application process national competent authorities should form a view on how the risk-management function of the insurance or reinsurance undertaking, in order to provide an objective challenge to the internal model, ensures that the validation process is done independently from the development and operation of the model and that the tasks set out in the validation policy it establishes create and maintain the independence of the validation process.
- 1.125. National competent authorities should form a view on how the insurance or reinsurance undertaking, when deciding the parties which contribute to the tasks related to the validation process, takes into account the nature, scale and complexity of the risks that this undertaking faces, the function and the skills of people to be involved, the internal organisation of the undertaking and its governance system.

#### **Guideline 46 – Specificities for group internal models**

- 1.126. Through the pre-application process for a group internal model the national competent authorities should form a view on how the insurance or reinsurance undertaking considers the validation of the internal model in the context of the calculation of both the consolidated group Solvency Capital Requirement and the Solvency Capital Requirement of related undertakings which would be calculated with the group internal model; and on how the insurance or reinsurance undertaking explicitly sets out this consideration in the validation policy it establishes for the group internal model.
- 1.127. National competent authorities should form a view on how the participating undertaking and the related undertakings for which the Solvency Capital Requirement would be calculated with the internal model, establish a single validation policy to cover the validation process both at group and individual level.

## **Guideline 47 – Universe of tools**

- 1.128. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the qualitative or quantitative validation tools it uses are appropriate and reliable to validate the internal model for internal use of the internal model as well as for the Solvency Capital Requirement calculation.
- 1.129. National competent authorities should form a view on how the insurance or reinsurance undertaking understands the validation tools it uses and acknowledges that different tools have different characteristics and limitations.
- 1.130. National competent authorities should form a view on whether the insurance or reinsurance undertaking considers which validation tools or combination thereof are the most appropriate to meet the purpose and scope of the validation, as set out in the validation policy it establishes.
- 1.131. National competent authorities should form a view on how the insurance or reinsurance undertaking puts a process in place to choose the appropriate set of validation tools in order to ensure a robust validation process. National competent authorities should form a view on how the insurance or reinsurance undertaking documents this process and whether it considers at least the following characteristics when selecting the validation tools:
- (a) level of complexity: validation tools ranging from simplified techniques to sophisticated methods;
  - (b) nature: validation tools being qualitative, quantitative or a combination of both;
  - (c) knowledge required: the extent of knowledge required by the persons performing the validation;
  - (d) independence: the level of independence required by the person performing the validation;
  - (e) information required: potential restrictions to the amount or the type of information available for external versus internal validation; and
  - (f) cycle of validation: validation tools relevant to cover every key assumption made at different stages of the internal model from development, to implementation and to operation.

## **Guideline 48 – Stress tests and scenario analysis**

- 1.132. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking uses stress tests and scenario analysis as part of the validation of the internal model.



1.133. In particular national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the stress tests and scenario analysis it uses cover the relevant risks and are monitored over time.

#### **Guideline 49 – Application of the tools**

1.134. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking is able to explain which parts of the internal model are being validated by each of the validation tools used and why these validation tools are appropriate for the particular purpose by describing at least:

- (a) the materiality of the part of the model being validated;
- (b) the level at which the tool will be applied from individual risks, modelling blocks, portfolio, business unit to aggregated results;
- (c) the purpose of this validation task; and
- (d) the expected outcome from the validation.

#### **Guideline 50 – Validation data sets**

1.135. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the selected data and expert judgement used in the validation process effectively allow it to validate the internal model under a wide range of circumstances that have occurred in the past or could potentially occur in the future.

### **Chapter 10: Documentation**

#### **Guideline 51 - Control procedures**

1.136. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that the documentation of the internal model is kept up to date and regularly reviewed.

1.137. In particular, national competent authorities should form a view on how the insurance or reinsurance undertaking puts in place at least:

- (a) an effective control procedure for internal model documentation;
- (b) a version control procedures for internal model documentation; and
- (c) a clear referencing system for internal model documentation which should be used in a documentation inventory.

## **Guideline 52 - Documentation of methodologies**

1.138. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking produces documentation which is detailed enough to evidence detailed understanding of the methodologies and techniques used in the internal model, including at least:

- (a) the underlying assumptions;
- (b) the applicability of such assumptions given the undertaking's risk profile; and
- (c) any shortcomings of the methodology or of the technique.

1.139. This should also apply in case a methodology or any other technique used by the insurance or reinsurance undertaking in the internal model is documented by an external party.

1.140. National competent authorities should form a view on how the insurance or reinsurance undertaking, when documenting the theory, assumptions and mathematical and empirical basis underlying any methodology used in the internal model, in accordance with Article 125(3) of Solvency II, includes, if available, the material steps of the development of the methodology, as well as any other methodologies which were considered but not subsequently used by the insurance or reinsurance undertaking.

## **Guideline 53 - Circumstances under which the internal model does not work effectively**

1.141. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking includes in its documentation an overall summary of the material shortcomings of the internal model, consolidated in a single document, containing at least the following aspects:

- (a) the risks which are not covered by the internal model;
- (b) the limitations in risk modelling used in the internal model;
- (c) the nature, degree and sources of uncertainty connected with the results of the internal model including the sensitivity of the results for the key assumptions underlying the internal model;
- (d) the deficiencies in data used in the internal model and the lack of data for the calculation of the internal model;
- (e) the risks arising out of the use of external models and external data in the internal model;

- (f) the limitations of information technology used in the internal model; and
- (g) the limitations of internal model governance, and
- (h) the work done to identify these shortcomings and any plans for model improvements.

#### **Guideline 54 - Appropriateness to addressees**

1.142. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking considers having documentation of the internal model that consists of more than one level of documentation for the internal model, commensurate with the different uses and target audiences.

#### **Guideline 55 - User manuals or process descriptions**

1.143. Through the pre-application process national competent authorities should form a view on how, as part of its documentation of the internal model, the insurance or reinsurance undertaking puts in place user manuals or process descriptions for operation of the internal model which should be sufficiently detailed to allow an independent knowledgeable third party to operate and run the internal model.

#### **Guideline 56 - Documentation of model output**

1.144. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking documents and retains, not necessarily in a single document, the outputs of the model that are relevant to satisfy the requirements of Article 120 of Solvency II.

#### **Guideline 57 - Software and modelling platforms**

1.145. National competent authorities should form a view on how the undertaking, in its documentation, provides information about the software, modelling platforms and hardware systems used in the internal model.

1.146. National competent authorities should form a view on how the undertaking, where using software, modelling platforms and hardware systems, provides in the documentation sufficient information to be able to assess and justify their use, and enable national competent authorities to assess their appropriateness.

## **Chapter 11: External models and data**

### **Guideline 58 – External data**

1.147. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking, given the nature of external data, demonstrates an appropriate level of understanding of the specificities of external data used in the internal model including any material transformation, rescaling, seasonality and any other processing inherent in the external data.

1.148. In particular, national competent authorities should form a view on how the insurance or reinsurance undertaking at least:

- (a) understands the attributes and limitations or other peculiarities of the external data;
- (b) develops processes for identifying any missing external data and other limitations;
- (c) understands the approximations and processing made for missing or unreliable external data; and
- (d) develops processes to run timely consistency checks including comparisons with other relevant sources to the extent that data are reasonably available.

### **Guideline 59 – Understanding of the external model**

1.149. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking demonstrates that all parties involved in the use of the external model have a sufficiently detailed understanding of parts of the external model relevant to them including assumptions, technical and operational aspects.

1.150. National competent authorities should form a view on how the insurance or reinsurance undertaking gives particular attention to the aspects of the external model that are more relevant to its risk profile.

### **Guideline 60 – Reviewing the choice of external model and data**

1.151. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking periodically reviews its justification for selecting a particular external model or set of external data.

1.152. National competent authorities should form a view on whether the insurance or reinsurance undertaking is not overly reliant on one provider and on how the undertaking puts in place plans to mitigate the impact of any failures of the provider.

1.153. National competent authorities should form a view on how the insurance or reinsurance undertaking pays attention to any updates of the external model or of the data that allows the undertaking to better assess its risks.

### **Guideline 61 – Integration within the internal model framework**

1.154. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking demonstrates that the approach for incorporating the external model into the internal model framework is appropriate; including the techniques, data, parameters, assumptions selected by the undertaking, and the external model output or outputs.

### **Guideline 62 – Validation**

1.155. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking performs its own validation of the material assumptions of the external model that are relevant to its risk profile and of the process for incorporating the external model and data within its own processes and internal model.

1.156. National competent authorities should form a view on how the insurance or reinsurance undertaking assesses the appropriateness of the selection or the non-selection of features or options which are available for the external model.

1.157. National competent authorities should form a view on how, as part of its own validation, the insurance or reinsurance undertaking considers appropriate information and in particular the analysis performed by the vendor or other third party, and, when doing so, on how the insurance or reinsurance undertaking ensures at least that:

- (a) the independence of the validation process from the development and operation of the internal model is not compromised;
- (b) it is consistent with the validation process the insurance or reinsurance undertaking sets out and is clearly laid out in the validation policy; and
- (c) any implicit or explicit bias in the analysis performed by the vendor or other third party is taken into account.

### **Guideline 63 - Documentation**

1.158. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking demonstrates that the documentation of external models and data meet the documentation standards.

1.159. National competent authorities should form a view on how the insurance or reinsurance undertaking produces documentation on at least the following:

- (a) the aspects of the external model and external data that are relevant for its risk profile;
- (b) the integration of the external model or external data within its own processes and internal model;
- (c) the integration of data, in particular inputs, for the external model, or outputs from the external model, within its own processes and internal model; and
- (d) the external data used in the internal model and its source and use.

1.160. If, as part of its own documentation, the insurance or reinsurance undertaking leverages on the documentation produced by the vendors and service providers, national competent authorities should form a view on how the insurance or reinsurance undertaking ensures that its ability to meet the documentation standards is not compromised.

**Guideline 64 - National competent authorities' relationship with vendors of external models**

- 1.161. Through the pre-application process national competent authorities should form a view on how the insurance or reinsurance undertaking keeps its responsibility for discharging its obligations related to its internal model and for the role of external model or data in the internal model and any other requirements.
- 1.162. National competent authorities should make clear to the insurance or reinsurance undertaking that any contact between national competent authorities and the vendors of an external model to inform national competent authorities' reviews of such model should not exempt the insurance or reinsurance undertaking from demonstrating that the external model fulfils the internal model requirements.
- 1.163. National competent authorities should form a view on the use of an external model entirely for each individual pre-application process.
- 1.164. National competent authorities should make clear to the insurance or reinsurance undertaking that they will reject any application for using an external model if the insurance or reinsurance undertaking fails to provide the specific information required in order for an assessment of the application to be carried out by national competent authorities.

**Guideline 65 - Role of service providers when using external models and data**

- 1.165. Through the pre-application process national competent authorities should form a view on whether the insurance or reinsurance undertaking uses an outsourcing agreement when it chooses not to operate the external model directly.

- 1.166. Similarly, national competent authorities should form a view on whether the insurance or reinsurance undertaking, through an outsourcing agreement, mandates a service provider to perform some tasks related to the external data.
- 1.167. National competent authorities should make clear to the insurance or reinsurance undertaking that it should not consider such outsourcing agreements to be a justification for exemption from demonstrating that the internal model fulfils the requirements.
- 1.168. National competent authorities should form a view on how the insurance or reinsurance undertaking ensures that any outsourcing agreement regarding the operation of an internal model or the performance of tasks related to the external data, in application of the requirements set out in Article 49 of Solvency II, defines the duties of the parties.
- 1.169. National competent authorities should form a view on how the insurance or reinsurance undertaking, irrespective of which party actually performs the tasks associated with the service provided, retains overall responsibility.

## **Chapter 12: Functioning of colleges during the pre-application process for internal models for groups**

### **Guideline 66 - Forming a view about the scope of the internal model during the pre-application process for internal models for groups**

- 1.170. During the pre-application process for an internal model for a group, when forming a view about the appropriateness of the scope of the internal model, the group supervisor, the other national competent authorities involved and other national competent authorities identified by the college should consider at least:
- (a) the significance of related undertakings within the group with respect to the risk profile of the group;
  - (b) the risk profile of related undertakings within the group compared to the overall group risk profile;
  - (c) if applicable, a transitional plan by the group to extend the scope of the model at a later stage and the timeframe to do so;
  - (d) the appropriateness of the standard formula or another internal model under pre-application that would be used for the calculation of the Solvency Capital Requirement of any related insurance or reinsurance undertaking included in the scope of the internal model; and
  - (e) the appropriateness of the standard formula or another internal model under pre-application that would be used for the calculation of the Solvency Capital Requirement of any related insurance or

reinsurance undertaking within the group but not included in the scope of the internal model for the group.

1.171. When forming a view about the appropriateness of the exclusion of related undertakings within the group from the scope of the internal model, the group supervisor and the other national competent authorities involved, should assess whether the exclusion of the undertakings could lead to:

- (a) an improper allocation of own funds based on individual undertaking Solvency Capital Requirements rather than on its contribution to the risk profile of the group;
- (b) inconsistencies that would derive from the use of the internal model to calculate the group solvency capital requirement and the use of the standard formula or a different internal model under pre-application by any related undertaking within the group to calculate its Solvency Capital Requirement;
- (c) weaknesses in risk management of the group and related undertakings within the group resulting from the limited scope of the internal model; or
- (d) an inadequate group Solvency Capital Requirement in relation to the risk profile of the group.

**Guideline 67 - Tasks of the group supervisor and the other national competent authorities involved and participating in the pre-application process for internal models for groups**

1.172. During the pre-application process for an internal model for a group, the group supervisor and the other national competent authorities involved should agree on the most efficient and effective allocation of tasks among the different national competent authorities involved.

1.173. The group supervisor, in consultation with the other national competent authorities involved, should record the agreed allocation of tasks and set up a work plan and the communication rules to follow among them.

1.174. In the case of a group internal model under Article 231, the group supervisor and the other national competent authorities concerned should consider including in the work plan specific provisions which set up the allocation of tasks and communication rules between them.

1.175. When appropriate, the group supervisor, in consultation with the other national competent authorities involved, should update the work plan.

1.176. The group supervisor should ensure that the work plan covers the timeline, main steps and deliverables for the pre-application process.

1.177. The group supervisor should ensure that the work plan, at least:



- (a) establishes when and how to consult and involve in the pre-application process the other national competent authorities involved;
- (b) establishes when and how to allow the other national competent authorities within the college of supervisors to participate in the pre-application process, bearing in mind that their participation would be limited to identifying and preventing circumstances where the exclusion of parts of the business from the scope of the internal model could lead to a material underestimation of the risks of the group, or where the internal model could conflict with another internal model under pre-application that would be used for the calculation of the Solvency Capital Requirement of any of the insurance or reinsurance undertakings in the group; and
- (c) identifies the priorities for the assessment, taking into account the scope of the internal model, the specificities of each related undertaking within the group, the risk profile of the group and related undertakings within the group and the available and relevant information about the internal model.

1.178. Whenever a national competent authority involved identifies a substantial point of concern regarding the pre-application process, it should share its concern with the group supervisor and the other involved authorities as soon as feasible.

**Guideline 68 - Joint on-site examinations carried out during the pre-application process for internal models for groups**

1.179. During the pre-application process for an internal model for a group, the group supervisor and the other national competent authorities involved should propose and discuss when and how to organize joint on-site examinations to verify any information concerning the pre-application process, with the aim of ensuring the effectiveness of this process.

1.180. The national competent authorities proposing a joint on-site examination should inform the group supervisor by indicating the scope and purpose of this examination, taking into account the objectives of joint on-site examinations in relation to the pre-application process as defined by the national competent authorities involved.

1.181. The group supervisor should then notify the other national competent authorities involved in the pre-application process, EIOPA, and, where relevant, other national competent authorities within the college, the national competent authorities responsible for the supervision of significant branches as referred to in Article 248(3) of Solvency II, and the national competent authorities responsible for the supervision of other branches.

- 1.182. Once the national competent authorities participating in the joint on-site examination have been identified, they should discuss and agree the final scope, purpose, structure and allocation of tasks of the examination.
- 1.183. The national competent authority organising the on-site examination, if other than the group supervisor, should provide the relevant documentation to the group supervisor.
- 1.184. The group supervisor should make the relevant documentation available to the national competent authorities involved in the pre-application process, to the other national competent authorities participating in the joint on-site examination and to EIOPA. The group supervisor should provide the rest of college members and participants with a list of the relevant documentation received and provide them with the relevant documentation upon specific request.
- 1.185. On the basis of a report stating the main findings of the joint on-site examination, the national competent authority organising the on-site examination should discuss with the national competent authorities involved the outcome of the joint on-site examination and the actions to be taken.
- 1.186. The group supervisor should notify the rest of college members about the outcome and actions as part of the agreed communication within the college.

**Guideline 69 – Off-site activities on internal models during the pre-application process for internal models for groups**

- 1.187. During the pre-application process for an internal model for a group, national competent authorities involved should share and discuss the main findings of their off-site activities with the group supervisor and the other national competent authorities involved.
- 1.188. The national competent authorities involved should share the approach they are following in the review of the elements of the internal model with the group supervisor and the other national competent authorities involved.
- 1.189. If, as a result of this sharing, the national competent authorities involved identify substantial differences in the approaches followed, they should discuss and they should agree on a process to develop consistent approaches when they consider appropriate to have this alignment.
- 1.190. When they deem appropriate, the national competent authorities involved should consider sharing the tools and techniques they are using for the review of the elements of the internal model with the other national competent authorities involved.

## **Guideline 70 - Involvement of third country national competent authorities during the pre-application process for internal models for groups**

- 1.191. During the pre-application process for an internal model for a group, the group supervisor and the other national competent authorities involved should form a view on whether and which third country national competent authorities should be consulted.
- 1.192. Before consulting the third country national competent authority, the group supervisor, with the support of the national competent authorities involved, should take appropriate steps to ensure that the legislative provisions on the confidentiality of information of the jurisdiction where the third country national competent authority is situated are equivalent to the professional secrecy requirements resulting from Solvency II, other EU Directives and national legislation applicable to the involved national competent authorities.

## **Compliance and Reporting Rules**

- 1.193. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, Competent Authorities shall make every effort to comply with Guidelines and recommendations.
- 1.194. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.195. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the publication.
- 1.196. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting.

## **Final Provision on Review**

- 1.197. These Guidelines shall be subject to a review by EIOPA.