FINAL REPORT

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on the revised Opinion on the supervisory assessment of internal models including a dynamic volatility adjustment

EIOPA-BoS-25/526
5 December 2025

European Insurance and Occupational Pensions Authority

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EXECUTIVE SUMMARY

1.1. INTRODUCTION

On 3 April 2025, EIOPA launched a public consultation on the revised Opinion on the supervisory assessment of internal models including a dynamic volatility adjustment (DVA). This final report sets out the final text of the revised Opinion, explanatory text and a feedback statement on the public consultation.

1.2. CONTENT

The Opinion on the supervisory assessment of internal models including a dynamic volatility adjustment was published in 2017 and is updated following the review of the volatility adjustment framework in Solvency II[2]. The Solvency II Directive has been amended, modifying the methodology for calculating the volatility adjustment and introducing a broader prudency principle for the DVA in the legislation. The Opinion has been updated to reflect the revised prudency principle and to add further clarifications.

1.3. PUBLIC CONSULTATION

EIOPA conducted a public consultation on the revised Opinion between 3 April and 26 June 2025. A stakeholder event was held on 16 May 2025 to discuss the consultation paper. Five stakeholders provided feedback on the consultation paper. Based on the stakeholder feedback, the drafting of the Opinion was slightly refined.

1.4. NEXT STEPS

A consolidated version of the Opinion will be published on EIOPA's website. It will become applicable on 30 January 2027.

[2] Directive (EU) 2025/2 of the European Parliament and of the Council of 27 November 2024 amending Directive 2009/138/EC as regards proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks and group and cross-border supervision, and amending Directives 2002/87/EC and 2013/34/EU

REVISED OPINION ON THE SUPERVISORY ASSESSMENT OF INTERNAL MODELS INCLUDING A DYNAMIC VOLATILITY ADJUSTMENT

1. LEGAL BASIS

1. The European Insurance and Occupational Pensions Authority (EIOPA) issues this Opinion on the basis of Article 29(1)(a) of Regulation (EU) No 1094/2010[1]. This Article mandates EIOPA to play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union.

2. This Opinion is based on Directive 2009/138/EC (Solvency II Directive)[2], Commission Delegated Regulation (EU) 2015/35 (Delegated Regulation)[3] and EIOPA's guidelines and other relevant instruments.

3. This Opinion is addressed to the competent authorities, as defined in Article 4(2) of Regulation (EU) No 1094/2010.

4. The Board of Supervisors has adopted this Opinion in accordance with Article 2(8) of its Rules of Procedure[4].

2. CONTEXT AND OBJECTIVE

5. EIOPA is attentive to the convergence of supervisory practices on internal models and undertakings' compliance with the relevant requirements set out in the Solvency II Directive, further developed in the Delegated Regulation and supplemented in EIOPA's guidelines.

6. The volatility adjustment (VA) is one of the measures introduced in the so called LTG package concerning Solvency II valuation of insurance contracts with long-term guarantees. It aims at stabilising the Solvency II balance sheet during short periods of high market volatility by adding an extra spread component to the discount rate used for the calculation of technical provisions.

[1] Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

[2] Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1–155)

[3] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12, 17.01.2015, p. 1)

[4] Decision adopting the Rules of Procedure of EIOPA's Board of Supervisors, available on: bos-rules_of_procedure.pdf.

7. Concerning internal models, there are currently dynamic volatility adjustment (DVA) approaches that take the VA into account in the Solvency Capital Requirement (SCR) by allowing the VA to move in line with the modelled credit spreads during the 1-year forecast of basic own funds. In the standard formula or constant VA approaches the VA is kept constant in the SCR calculation.

8. EIOPA has identified the DVA modelling as an area where supervisory convergence needs to be reinforced.

9. This Opinion does not concern the requirements applicable to the constant VA, such as the demonstration of the ability of the undertaking to earn the VA (recoverability test). However, these requirements are setting the frame and referred to as assumptions underlying the VA. These requirements have to be taken into account in the DVA context, e.g. assessed under the stressed scenarios relevant for the modelling approach.

3. MODELLING

10. All material quantifiable risks should be modelled in Pillar 1 and all non-quantifiable risks should be dealt with in Pillar 2 when applying a DVA in the internal model.

11. When challenging the model, competent authorities should consider *inter alia* all elements of the EIOPA VA methodology[5] (e.g. choice of the reference portfolio, the risk correction) and the variation of those elements over the forecasting period; sensitivity to the parameters and the undertaking's risk profile, including the assumptions underlying the VA and any deviations from that in the undertaking's risk profile; the principles of materiality and proportionality.

12. Furthermore, when challenging the model, competent authorities should assess the consistency of the DVA modelling with the approach to other aspects of the internal model, especially the approach to credit spreads, any potential interrelations to the approach to interest rates and the coverage of all material risks.

4. RISK MANAGEMENT

13. A holistic view should be taken in the supervisory assessment of modelling and risk-management aspects. This means on the one hand that all tests and standards on internal models apply and on the other hand that no undesirable risk management incentives should be allowed. In this context, deviation from close modelling or replication of EIOPA VA Methodology may be used if the requirements of Article 122(5) of the Solvency II Directive are satisfied and the approach is supported by appropriate non-model and Pillar 2 actions.

14. In the application of the above principle, when challenging the model, competent authorities should consider *inter alia* that:

a. No undesirable risk management incentives should be allowed. This includes such cases where undertakings would move their asset allocation towards the EIOPA VA reference portfolio with the sole purpose of lowering the SCR while increasing actual risk. This also includes

[5] The EIOPA VA methodology is published on the EIOPA website.

putting in place investment strategies that could trigger pro-cyclical behaviour in a stressed situation.

b. The undesirable incentives can be reduced or removed using a method that deviates from closely modelling the EIOPA VA Methodology, as long as the form of the deviation corresponds to the undesirable risk management incentives that should be resolved, and the revised model complies with the requirements of Article 122(5) of the Solvency II Directive.

c. In addition, non-model and Pillar 2 actions by the undertaking play an essential role:

   i. the use of DVA should be analysed regarding the requirements of the prudent person principle and risk management;

   ii. the validation and documentation of the DVA should justify the underlying reasons of each deviation and analyse the impact of each deviation.

d. A refusal to approve the use of the VA (in Member States where the competent authority has this power) and the possible application of a capital add-on in line with Article 278 of the Delegated Regulation are other ways to prevent or mitigate undesirable incentives.

5. PUBLIC DISCLOSURE

15. A specific requirement in the Solvency and Financial Condition Report as defined in Article 296(2)(e) of the Delegated Regulation is to disclose the impact of a change to zero of the VA on the undertaking's financial position. This should be performed as if the regulatory concept of the VA would not exist at all. No compensation should be included in this specific calculation, e.g. via switching off other model components, such as the modelling of sovereign risk.

16. EIOPA considers it necessary for undertakings to provide the explanation of DVA methodology in the Solvency and Financial Condition Report in order to fulfil the disclosure requirements defined in Article 297(4)(e) of the Delegated Regulation.

Done at Frankfurt am Main, on DayMonthYear.

[signed]

For the Board of Supervisors

Petra Hielkema

Chairperson

EXPLANATION OF THE MAIN CHANGES

This section sets out and explains the main revisions introduced in the Opinion.

AMENDED: Modelling – paragraph 9

~~9~~ **10.** All **material** quantifiable risks should be modelled in Pillar 1 and all non-quantifiable risks should be dealt with in Pillar 2 when ~~forecasting the VA~~ **applying a DVA in an internal model**. ~~Any deviations from the VA methodology as described in the Solvency II Directive, the Delegated Regulation and EIOPA VA Methodology[4] should be addressed in a way that the internal model produces an SCR guarantying a level of policyholder protection that is at least as high as if replicating the EIOPA VA Methodology. Concretely, this means that the undertaking shall demonstrate that its SCR is at least as high as if replicating the EIOPA VA Methodology (prudency principle).~~

Explanation of the changes:

The Solvency II Directive has been amended to introduce a broader prudency principle directly in Article 122(5) of the Solvency II Directive. To avoid redundancy with that Article, the reference to the prudency principle has been deleted in paragraph 9.

Furthermore, the text "... when forecasting the VA" is replaced by "... when applying a DVA in the internal model" as the Opinion covers also holistic DVA approaches that do not forecast the VA.

In addition, it has been clarified that **material** quantifiable risks should be modelled in Pillar 1. This clarification is in line with Article 121(4) of the Solvency II Directive and supports the objective of reducing regulatory burden.

AMENDED: Modelling – paragraph 10

~~10~~ **11**. ~~In the application of the above principle,~~ When challenging the model, competent authorities should consider inter alia all elements of the EIOPA VA Methodology[5] (e.g. choice of the reference portfolio, ~~the fundamental spread~~ **the risk correction**) and the variation of those elements over the forecasting period; sensitivity to the parameters and the undertaking's risk profile, including the assumptions underlying the VA and any deviations from that in the undertaking's risk profile; the principles of materiality and proportionality. **Furthermore, when challenging the model, competent authorities should assess the consistency of the DVA modelling with the approach to other aspects of the internal model, especially the approach to credit spreads, any potential interrelations to the approach to interest rates and the coverage of all material risks.**

Explanation of the changes:

The term "fundamental spread" has been replaced by "risk correction" to align the wording with the new approach to the volatility adjustment set out in Article 77d of the Solvency II Directive.

In order to enhance supervisory convergence, paragraph 10 has been amended to provide a non-exhaustive list of aspects that should be assessed by competent authorities when challenging a model in the amended (D)VA framework.

As mentioned in the footnote that was added to this paragraph, the EIOPA VA methodology will be published on the EIOPA website in time before the entry into application of the amended Directive.

AMENDED: RISK MANAGEMENT – paragraphs 11 and 12

"~~11~~ **12**. A holistic view should be taken in the supervisory assessment of modelling and risk-management aspects. This means on the one hand that all tests and standards on internal models apply and on the other hand that no undesirable risk management incentives should be allowed. In this context, deviation from close modelling or replication of EIOPA VA Methodology may be used ~~in certain circumstances and under the prudency principle mentioned above~~ **if the requirements of Article 122 (5) of the Solvency II Directive are satisfied and the approach is** supported by appropriate non-model and Pillar 2 actions."

"~~12~~ **13**. […] b. The undesirable incentives can be reduced or removed using a method that deviates from closely modelling the EIOPA VA Methodology, as long as the form of the deviation corresponds to the undesirable risk management incentives that should be resolved, and the revised model passes the ~~prudency principle introduced above~~ **requirements of Article 122 (5) of the Solvency II Directive.**"

Explanation of the changes:

The reference to the "prudency principle" has been replaced by a reference to Article 122(5) of the Solvency II Directive.

ANNEX: FEEDBACK STATEMENT

This feedback statement set out a high-level summary of the consultation comments received and EIOPA's assessment of them. The full list of all the non-confidential comments and their resolutions can be found on EIOPA's website.

EIOPA received comments from its Insurance and Reinsurance Stakeholder Group (IRSG) and from four other stakeholders from the insurance industry, actuarial associations and academia.

As part of the consultation, EIOPA held a workshop with stakeholders to discuss the revised Opinion on 16 May 2025.

EIOPA would like to express its appreciation for the feedback of the stakeholders during the preparation of the revised Opinion.

PROPORTIONALITY

Stakeholder comments

The insurance industry stakeholders emphasise the need for proportionality and avoiding undue operational burden in the use of the DVA, calling for supervisory expectations to be implemented in a manner that avoids excessive complexity and duplication of work.

Assessment

EIOPA believes that the specifications set out in the Opinion are proportionate to the nature, scale, and complexity of the risks modelled within internal models using a DVA, as well as the corresponding risk reduction reflected in the model through the use of a DVA.

SCOPE OF MODELLING

Stakeholder comments

Stakeholders support EIOPA's proposal to clarify that all quantifiable risks should be captured under Pillar 1 and non-quantifiable risks under Pillar 2 when applying a DVA in internal models. However, they suggest refining the wording of paragraph 10 to reflect this by limiting the requirement to "material, quantifiable risks" to avoid unnecessary complexity and ensure proportionality.

Assessment

Paragraph 10 has been amended to reflect the proposed clarification: "All quantifiable risks" has been replaced by "All material quantifiable risks".

MODELING OF NEW VA DESIGN

Stakeholder comments

The IRSG commented that the revised Opinion does not provide any details regarding a possible DVA approach where an undertaking-specific adjustment of the risk-corrected spread is applied in the base case and would welcome a clearer specification to further reinforce the convergence of this instrument in Europe.

Assessment

No details on the modelling of the undertaking-specific adjustment of the risk-corrected spread in the DVA were added to the revised Opinion. In accordance with Article 121(4) of the Solvency II Directive, the DVA component of internal models is not subject to a prescribed methodology, but any modelling approach used must comply with the principles and criteria outlined in paragraphs 2 to 9 of that Article.