

## **EIOPA Opinion on the preparation for Internal Model applications**

### **Legal Basis**

1. This opinion is issued under the provisions of Article 29(1)(a) of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 (hereafter the 'Regulation')<sup>1</sup>. As established in Article 29(1)(a) of the Regulation, EIOPA shall 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. To this end, EIOPA has provided this opinion concerning the preparation to the application to use an Internal Model (IM) for the calculation of the Solvency Capital Requirement (SCR). The opinion consists of the following parts:
  - the modelling of Sovereign Exposures
  - the practical preparation of the application in the absence of some related formal decisions
  - the use of comparative studies as a complementary tool in the analysis of internal models.
3. This opinion is addressed to the National Competent Authorities (NCAs) represented in EIOPA's Board of Supervisors.

### **Context and scope**

4. EIOPA is attentive to the convergence of practices concerning the approval of internal models. As part of the application process, undertakings which wish to apply for the approval of their internal model for the calculation of the SCR need to provide to their NCA the evidence necessary to show compliance with the relevant requirements set out in Directive 2009/138/EC ("Solvency II Directive")<sup>2</sup> and further developed in the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014<sup>3</sup> and supplemented in the Guidelines.

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

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

<sup>3</sup> OJ L 12, 17.01.2015

5. EIOPA has identified three areas where the existing different approaches would lead to inconsistent modelling of some risks and could jeopardise the joint-decision making processes for group internal models. This would harm convergence across Member States and could create confusion in the insurance market.
6. EIOPA has developed an opinion recommending to NCAs the preferred options in dealing with these areas.

### **(1) The modelling of Sovereign Exposures**

7. NCAs should require that the risks related to Sovereign Exposures are appropriately taken into account in internal models. In order to monitor consistency and convergence of supervisory practices, EIOPA will collect data and carry out a follow up study to assess the treatment of Sovereign Exposures in Internal Models in Member States and decide if further guidance or actions will be needed.

### **(2) The practical preparation of the application in the absence of some related formal decisions**

#### *Delay in the implementation of the risk-free interest rate term structure*

8. The Commission is required by Article 86 of Solvency II Directive to adopt delegated acts determining the risk-free interest rate term structure, the specifications with respect to matching adjustment and fundamental spread, and the methods and assumptions for the calculation of volatility adjustment.

If the risk-free rates have not been available early enough in advance of the date on which undertakings make an application to use an IM, NCAs should nonetheless accept and assess the IM application on a "best endeavours basis", e.g. the NCAs could assess an IM application in which a credible approximation of the risk free interest rate term structure has been used. If an approximation of the yield curve has been used on a "best endeavours basis", then where practicable, regard should be given to the impact of approximation error and possible restatements.

#### *Third country equivalence and the scope of the IM*

9. According to Article 227 of Solvency II Directive, the Commission may adopt delegated acts determining that supervisory regimes of third countries are equivalent (amongst others under Article 227(4) and (5) of Solvency II Directive). Where no delegated act has been adopted by the Commission, the verification of whether a third country regime is equivalent shall be carried out by the group supervisor at the request of the participating undertaking or on its own initiative (Article 227(2)). Equivalence decisions taken in the form of

delegated acts by the Commission are subject to Council and European Parliament scrutiny, and come into force after the scrutiny period is over (maximum 6 months). The Commission has an indicative timetable for the publication of its decisions on third country equivalence throughout 2015.

10. In general, where no delegated act of the Commission deeming a third country to be equivalent has been published at the time of the submission of an IM application of a given scope, supervisory authorities should not make presumptions upon the Commission's decisions on granting equivalence, with the following exception. In cases where the formal delegated act has not yet been adopted by the co-legislators, it is not unreasonable for supervisors to presume that the final delegated act will be consistent with the equivalence conclusion proposed by the Commission. However, it must be accepted that the undertaking may have to submit a new IM application (with appropriate IM scope) if the formal decision on third country equivalence is not in line with the Commission proposed delegated acts.

**(3) The use of comparative studies as a complementary tool in the analysis of an internal model**

11. It is considered good practice that NCAs gain insights from the comparison of different internal models. To this end, NCAs should carry out comparative studies on the NCA level and contribute to and make use of corresponding studies on the EU level coordinated by EIOPA.

12. This opinion will be published on EIOPA's website.

Done at Frankfurt am Main, 14 April 2015

[SIGNED]

Gabriel Bernardino

Chairperson

For the Board of Supervisors