

November 2014

**EIOPA**  
**Common Application Package**  
**For**  
**Internal Models:**  
**Explanatory Note**

## 1. Introduction

- 1.1. EIOPA has published an Opinion<sup>1</sup> stating that “National Competent Authorities (“NCAs”) should recommend undertakings to use the common application package to organise the documentation needed to prove compliance with the requirements relevant to the use of internal models”.
- 1.2. The objectives of this template are to enhance convergence across Member States, and ease the application process for both National Competent Authorities and undertakings, especially for international groups.
- 1.3. This note is expected to be used by groups or solo undertakings together with the Common Application Package (MS Excel) in order to organise the documentation required for the submission of a complete application for approval of an internal model by the National Competent Authorities.
- 1.4. The template is based on the documentation required by the Implementing Technical Standards on internal models approval processes<sup>2</sup> (“ITS”), and by Articles 343 and 347 of the Delegated Acts.
- 1.5. NCAs may translate the Common Application Package if they deem necessary.
- 1.6. The completed template should be readable and easy to navigate. Therefore, undertakings have the flexibility to adapt the template in agreement with their NCA when the structure of the model is particularly complex.

## 2. Group specificities

- 2.1. Groups are expected to submit only one template, containing both solo and group information.
- 2.2. When there is no distinction made between solo and group entities, the instructions in this note are applicable to both. Groups must satisfy the group requirements in addition to the solo requirements. For an application under Article 231 of the Solvency II Directive, the same information will need to be provided for each undertaking that plans to use the group model to calculate its Solvency Capital Requirement (“SCR”), as long as it does not duplicate the information provided by the group.
- 2.3. When the application is composed of a large number of documents due to the structure of the group, this can impair the readability of the template. In such case, and with agreement of the NCA, the group can adapt the template in the following ways:

---

<sup>1</sup> [Opinion on the use of a Common Application Package for Internal Models](#)

<sup>2</sup> [CP-14/005 Consultation Paper on the proposal for its on internal models approval processes](#)

- Refer to document types instead of listing every single document (e.g. if validation reports are written with a similar format for each risk in each entity of the group, it can be referred to all report with one single reference)
- Link the Self-assessment template to a group of documents instead of listing all related documents
- Link to other cells
- Merging cells
- Other methods when more appropriate

### **3. General instructions**

- 3.1. Within the application package, the number of documents deemed necessary to evidence each requirement is left to the undertaking's own judgment.
- 3.2. If the existing internal documentation is sufficient to prove compliance and is sufficiently well organised and catalogued so as to be easily referenced, the undertaking is not expected to create new documents solely for the purpose of the Application Package.
- 3.3. The documentation supporting the application package are expected to be available at the start of the application phase to show compliance with the Solvency II requirements; however, if necessary, National Competent Authorities could ask for additional information.
- 3.4. During the application phase, if new documents are sent upon request of National Competent Authorities, the application Package is expected to be updated with information related to the documents exchanged during the period of assessment.
- 3.5. In the self-assessment template ("S.A.T."), references can be made to documents which are not included in the application package, as long as at least one other document is already provided to evidence the compliance with the related requirement. The dedicated column "Documents that are related to this requirement - not included within the submission" can be used in this case. If relevant, competent authorities may require the undertaking to provide this information.
- 3.6. In addition to the self-assessment template, National Competent Authorities can require that the undertaking provides evidence of its compliance with other requirements. In this case, the undertaking is expected to fill the corresponding rows in the worksheet "Background Information".
- 3.7. As specified by article 2 (1) of the ITS (for solo applications) and by articles 343 (1) and 347 (2) of the Delegated Acts, it is expected that submissions are made in writing in one of the official languages of the Member State in

which the undertaking has its head office, or in another language for which the competent authorities gave pre-approval.

## 4. Structure of the template

- 4.1. The Excel template contains a worksheet "Instructions" which explains how the different sections of the template should be filled.
- 4.2. The main sections in the template are:
  - Application package: set of worksheets (tabs with blue colour) where the undertaking is expected to list the evidence showing its compliance with each requirement,
  - S.A.T.: the worksheet where the undertaking is expected to map and justify how the evidence provided in the previous 'application package' shows compliance with the relevant requirements,
  - Background Information: this worksheet contains a list of additional requirements, not directly related to internal models, which should be filled when required by your NCA.
- 4.3. Note that the options selected on the "Cover" worksheet will automatically customize the remaining part of the template. Therefore, depending on whether the undertaking is a group or a solo and whether the template is filled for pre-application or for formal application, certain lines and columns will be automatically hidden.

## 5. Specific requirements

- 5.1. For each internal model requirement of the article 2(3) of the ITS and of articles 343 and 347 of the Delegated Acts, the undertaking is expected to provide specific documentation within the application. Further guidance is provided below regarding some of these requirements. The headings below indicates the related paragraph of the ITS.

### Cover letter - Article 2(3)(a)

- 5.2. As specified by the ITS (article 2 (3)(a), paragraph *i* ), the cover letter includes a statement that the undertaking is requesting approval to use an internal model to calculate the SCR. The start date for using the internal model is also specified. Although no specific size is required for the cover letter, it would be appropriate to keep it concise, but complete. The undertaking needs to keep in mind that the detailed documentation of the model will be provided in specific documents. It is also expected that the size of the cover letter will vary depending on the complexity of the model and of its scope.

- 5.3. The same paragraph of the ITS specifies that the cover letter includes a general explanation of the internal model. A way of doing this could be to use a graphical representation of the internal model, showing the major components of the internal model with a brief description of each, and describing the platform supporting each component.
- 5.4. The undertaking also provides in the cover letter a description of the scope of the internal model. This could be done for instance through a list or a table detailing: (i) the business units included; (ii) the lines of business included; and (iii) the risks modelled in the internal model. An appropriate measure of materiality for each item on the list/table may be useful. It can be useful also to identify on the list/table the risks and business units excluded from the model, with the same measure of materiality.

#### *Group specificities*

- 5.5. For an application under Article 230 of the Solvency II Directive, groups provide the additional information specified in article 343 of the Delegated Acts.
- 5.6. For an application under Article 231 of the Solvency II Directive, groups provide the additional information specified in article 347 of the Delegated Acts. In particular, the following is considered good practice: each undertaking intending to use the group internal model for the calculation of its SCR confirms that all clarifications and supporting documentation has been provided and that no material facts relevant to the approval have been omitted.

Where the development, implementation or validation of the group internal model components which are necessary for the calculation of the Solvency Capital Requirement of the related undertaking, are performed by another related undertaking, it is a good practice to include an explanation of how the tasks are allocated within the group.

#### **Risks covered - Article 2(3)(b)**

- 5.7. As specified by article 2 (3)(b) of the ITS, the undertaking explains how the internal model covers all material and quantifiable risks. In doing this, it would be appropriate to take into account the qualitative and quantitative indicators specified in the Article 233 of the Delegated Acts.
- 5.8. For partial internal models, the undertaking refers to Article 113 of the Solvency II Directive and provides the additional information required. In particular, undertakings explain why the use of the standard formula was chosen for the coverage of other business units/risks.

#### **Integration with risk management - Article 2(3)(c)**

- 5.9. To satisfy this requirement, the undertaking could provide information that:

- Demonstrates how the internal model is integrated into the risk management system.
- Demonstrates the extent to which the risk management function has been and continues to cover the design, implementation, test, analysis of performance, validation and documentation of the internal model.
- Evidences the role played by the internal model in the different risk management tasks, for example the Own Risk & Solvency Assessment (Article 45 of the Solvency II Directive), the risk appetite, and in the identification, measurement, monitoring, managing and reporting of risks. These evidences are provided together with the relevant extracts of the risk management policy.
- Explains the reporting and escalation processes including any risk committee structure and responsibilities.
- Evidences the understanding of the nature of the risks it has identified, their origin, the possibility or need to control them and the effects that could arise, both in terms of losses and opportunities.

### **Self-assessment, model strengths, weaknesses and transitional plan - Article 2(3)(d)**

- 5.10. As specified by article 2 (3)(d) of the ITS, the undertaking is expected to perform a self-assessment of its compliance with the relevant internal model requirements.
- 5.11. The undertaking is also expected to provide a separate, overall assessment of the material strengths and weaknesses of the internal model, together with a plan for future improvements addressing the weaknesses, limitations and shortcomings of the model. It would be appropriate to define a measure of complexity, and a timescale for correcting them. The undertaking may include a short description of how difficult it is to fix each issue.

#### *Use of the S.A.T. during the pre-application*

- 5.12. To satisfy the requirement stated in paragraph (m) of article 2(3), the undertaking fills the self-assessment worksheet (S.A.T.) and explains how it complies with each listed requirements. When possible, the undertaking refers to the evidence supplied in the application package (using the appropriate reference name).
- 5.13. In the S.A.T., the column "*Firm's own compliance assessment with this requirement*" contains a drop-down list which should be used by the undertaking under pre-application, to indicate whether it complies with each one of the requirements. When presenting a final application, an undertaking is expected to comply with all requirements listed in the S.A.T.

and therefore, this column is not needed (the column is hidden automatically when selecting "Final application" in the "Cover" tab).

- 5.14. In the case when the Application Package is used during the pre-application period, some requirements will not yet be complied with. For a group for which some entities comply with a requirement but other entities don't, the Firm should select "Partial compliance". More details about the compliance for each entity are then expected in the column "*Firm's justification of its compliance assessment with this requirement*".

#### *Group specificities*

- 5.15. As specified by article 2 (3)(d) of the ITS in the case of an application for a group model; when the plan for future improvements includes extending the scope of the model, the assessment is expected to mention which, and when, business units will be added to the scope of the model.

### **Technical specifications - Article 2(3)(f)**

- 5.16. As specified by article 2 (3)(f) of the ITS, the undertaking is expected to provide the technical specifications of the internal model. A list of possible examples is given below:
- A detailed description of the structure of the internal model through explanatory texts alongside a diagram showing the key steps of significant calculations.
  - Details of management and policyholder actions assumed to occur and evidence of their appropriateness.
  - Modelling details of the risk mitigating techniques applied by the firm, impact on the SCR of these techniques and evidence of their effectiveness.
  - List of material assumptions underlying the internal model, describing how they are derived and providing a justification for the approach used.
  - In the case of an application for a group: details of the treatment of intragroup transactions and, where relevant, the list of parameters within the internal model that may be set differently to calculate the group SCR and the solo SCR.
  - The documentation regarding the aggregation, dependencies and diversification components applied in the internal model. In the case of a partial internal model, the documentation includes justifications for the feasibility and appropriateness of the aggregation techniques applied.
  - The documentation on calibration standards, especially in the case where the risk measure differs from that set out in Article 101(3) of the Solvency II Directive, or where the SCR cannot be calculated directly from the probability distribution forecast.

5.17. The undertaking is expected to keep available promptly upon request the parts of the technical specifications which were not included in the application (for instance the less material assumptions).

### **Adequacy of controls - Article 2(3)(g)**

5.18. The undertaking is expected to explain its approach to internal control, detailing internal reporting, the escalation process, and the approval of changes. In particular, the undertaking demonstrates the appropriateness of the controls around the internal model and shows how they are proportionate to the size and operational characteristics of the undertaking and to the nature and complexity of its risks.

5.19. The undertaking may consider referring to Article 116 and the last paragraph of Article 120 of the Solvency II Directive when providing the relevant information.

5.20. It is seen as good practice to provide information on backup processes, business continuity planning and disaster recovery plans as appropriate.

### **Resources - Article 2(3)(h)**

5.21. To satisfy the requirement stated in paragraph (h) of article 2(3), the undertaking can provide for instance:

- a list of staff (including external consultants) involved in the development and validation of the model and their responsibilities; and
- information on the adequacy of the skills, qualifications, knowledge and experience of staff listed with responsibilities regarding the model.

5.22. The undertaking is expected to set out the reporting structure relating to the development and validation processes of the internal model.

### **Validation report - Article 2(3)(m)**

5.23. To satisfy the requirement stated in paragraph (m) of article 2(3), the undertaking provides a report on the most recent validation of the internal model. This validation report results from the process described in the validation policy and details the results of the validation exercise that demonstrates that the internal model meets all relevant requirements, together with actions taken and/or escalated to address the identified weaknesses.

5.24. The undertaking is expected to demonstrate how the process of validation is independent from the development and operation of the internal model and how the administrative, management or supervisory bodies are involved in the process. Where the undertaking identifies conflicts of interests, it explains the plans set up to mitigate these conflicts of interest. This might have been provided already under the section "Resources – Article 2(3)(h)".

5.25. The validation is expected to be performed at the level of each component of the internal model, as well as overall.

### **Inventory of the documentation - Article 2(3)(n)**

5.26. In line with the requirement of Article 244 (a) of the Delegated Acts, the undertaking is expected to provide an inventory of its internal model documentation. A reference to the inventory can be included in the "Additional information" worksheet of the application package. The whole documentation on internal model is expected to be promptly available during the application phase.

### **External model and Data - Article 2(3)(o)**

5.27. If the undertaking is using a model or data obtained from a third party, it is expected to explain:

- The role of the external model or data in its internal model and provide a justification of this preference over its own internal model or data.
- How the external model or data meet Article 126 of the Solvency II Directive and Article 247 of the Delegated Acts.
- The role and materiality of external model or data in each instance where it is used, and how this external model or data is integrated into the undertaking's overall internal model.

5.28. The undertaking is expected to list the alternative options considered to the use of the external models or data.

### **Partial internal model integration technique - Article 2(3)(r)**

5.29. Where the undertaking uses a partial internal model, it explains how the partial internal model results will be fully integrated with the standard formula in order to calculate the final SCR, as per requirements of Article 113(1) of the Directive. The explanation includes justifications for the feasibility and appropriateness of the aggregation techniques applied.

5.30. To satisfy this requirement, the undertaking also considers Article 239 of the Delegated Acts.