Press Release

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EIOPA CALLS FOR CONSISTENT SUPERVISORY PRACTICES ON INTERNAL MODELS

- *EIOPA expresses its prudential expectations on internal models making use of a dynamic volatility adjustment (DVA)*
- *Undertakings shall demonstrate that by using a DVA its Solvency Capital Requirement (SCR) is at least as high as if replicating the "EIOPA VA Methodology"*
- *Supervisors should ensure that all tests and standards on internal models are applied and no undesirable risk management incentives are allowed*
- *EIOPA reminds undertakings to fulfil the Solvency II disclosure requirements and provide the explanation of the DVA methodology in their Solvency and Financial Condition Report*

Frankfurt, 20 December 2017 – Today, the European Insurance and Occupational Pensions Authority (EIOPA) issued an Opinion on the supervisory assessment of internal models including a dynamic volatility adjustment (DVA).

The Opinion is addressed to national supervisory authorities and stresses the importance of common supervisory practices and approaches throughout the European Union as regards the use of internal models.

The volatility adjustment (VA) is one of the measures of the "Long-Term Guarantee Package" linked with the 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.

This Opinion considers internal models making use of a DVA by allowing the VA to move in line with the modelled credit spreads during the 1-year forecast of basic own

funds.

According to EIOPA’s assessment, the DVA modelling is an area where supervisory convergence needs to be reinforced.

When using the DVA, undertakings should ensure a prudency principle, meaning that the internal model should produce an SCR guarantying a level of policyholder protection that is at least as high as if replicating the “EIOPA VA Methodology”.

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.

Undertakings have to provide the explanation of the DVA methodology in the Solvency and Financial Condition Report in order to fulfil the Solvency II disclosure requirements.

Gabriel Bernardino, Chairman of EIOPA said: *“This Opinion in another step towards achieving common supervisory practices. It addresses the key principles for modelling, risk assessment and disclosure and will improve the prudency and consistency in the modelling of the dynamic volatility adjustment. EIOPA will monitor the developments and assess the implementation of this Opinion in the course of 2019.”*

The Opinion is available on EIOPA’s website.

Notes for the Editors:

The **European Insurance and Occupational Pensions Authority** (EIOPA) was established on 1 January 2011 as a result of the reforms to the structure of supervision of the financial sector in the European Union. EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities, the National Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union. EIOPA’s core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

“EIOPA Volatility Adjustment (VA) Methodology” (prudency principle)
Following Article 77 of Solvency II Directive (2009/138/EC) and Articles 43-54 of the Delegated Regulation, EIOPA published a Technical Document (EIOPA-BoS-15/035, 20 December 2017), where all the assumptions and methodologies of Risk-free interest rates including the VA are documented.

"Long-Term Guarantee Package"

The **long-term guarantees (LTG) measures** were introduced in the Solvency II Directive to ensure an appropriate treatment of insurance products that include long-term guarantees. The long-term guarantees measures are the following:

- The extrapolation of risk-free interest rates
- The matching adjustment
- The volatility adjustment
- The extension recovery period in case of non-compliance with the Solvency Capital Requirement
- The transitional measure on the risk-free interest rates
- The transitional measure on technical provisions