ECO-SLV-09-237

Comments on Consultation 37-09 Draft advice on the procedure to be followed for the approval of an internal model	
Name company: CEA	
Reference	**Comment**
Introductory remarks	The CEA welcomes the opportunity to comment on the Consultation Paper (CP) No. 37 on level 2 measures for "The procedure to be followed for the approval of an internal model: General provisions and some specificities related to partial internal model". It should be noted that the comments in this document should be considered in the context of other publications by the CEA. Also, the comments in this document should be considered as a whole, i.e. they constitute a coherent package and as such, the rejection of elements of our positions may affect the remainder of our comments. These are CEA's views at the current stage of the project. As our work develops, these views may evolve depending in particular, on other elements of the framework which are not yet fixed.
Key comments	**The harmonisation of supervisory processes should be achieved without the use of prescriptive requirements** The approval process needs to be harmonised leading to a common standard of protection for all consumers in Europe regardless of the insurers' legal form, size or location. At the same time these processes should be as flexible as possible in order to correspond to companies' specific needs and the inherent dynamic nature of model development. CP 37 will be supplemented by further work within Level 3 standards and guidance on internal and partial internal models. We strongly encourage CEIOPS to seek a balance between flexibility and harmonisation in this respect. The approval of internal models requires flexibility as internal models are by definition very specific and tailored to the individual needs of insurance companies, and because models are intrinsically dynamic. On the other hand it is important – both for the implementation of a level playing field within Europe and for the practical handling of multi-national groups – to find a harmonised set of standards and guidelines for internal and partial internal models. We agree that transparency and standardisation of processes will help to ensure supervisory convergence. In this regard, it is essential that supervisors commit to report overall statistics, minor and major changes rules during the year, best practices, approval time periods. However, we feel that additional mechanisms should also be considered as ways to increase the degree of harmonisation of

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	supervisory practices. These may include: • peer reviews and/or a mediation role for CEIOPS, e.g. in case of limited approvals or rejections • expert exchange with the industry and other independent third-parties, e.g. consultants, auditors and scientific institutions These tools may be of particular importance in ensuring a level playing field across solo entities not being part of groups and which therefore do not benefit from the harmonising role of the college of supervisors. **Guidance on reasonable timeframes for each key phase of the approval process should be provided in Level 2** We are concerned that in some cases the approval of internal models may take too long. The Level 1 text defines the overall timeframe for the approval process in Article 110 (4): "*supervisory authorities shall decide on the application within six months from the receipt of the complete application*". We note that the proposed Level 2 text does not define further timelines. In particular, we believe that the options *"stop the clock"* and *"restart the clock"* for modifications done during the approval phase are not in line with the Level 1 text as they may unduly delay the process if no guidance on time limits is provided. It would help if supervisors could commit to reasonable timeframes for at least the following phases of the approval process: • pre-application phase • transitional plan following a limited approval • transitional plan following a partial internal model approval • prior model usage (3.22) • decision upon the formal completeness of the application (3.28) • approval of changes to an approved model change policy (3.66) • approval of major changes (3.73) • implementation deadline and approval of minor modifications (3.95) • later date to be set out in the permission document (3.164) • minimum waiting period after rejection (3.172) **The approval of internal models for groups have to involve all relevant authorities under the coordination and leadership of the Group supervisor**

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	We understand that this CP deals with the model approval process for solo companies and that specificities related to the approval of group internal models as set out in Article 229 of the Level 1 text will be provided in an addendum to CP37. We would like to point out that in this context it is not only relevant how the overall group model will be approved by the lead supervisor, but also in which way model of individual legal entities belonging to the group will be treated and how the collaboration between potentially various supervisors will be managed eg. how the approved group Internal Model will be used to calculate the solo SCRs. For groups it essential that the responsibilities between supervisors for the approval of an internal model are clearly defined.
General comments	We are aware that there are further CPs to follow on related topics, e.g. the approval of group internal models (Art. 229) and standards required for the approval of internal models (Art. 118 – 124) and that on some issues this paper only gives initial thoughts. As our work develops, our views may evolve depending in particular on these elements of the level 2 text which are yet to be discussed. In particular, we think that the approval process cannot be fully assessed without knowing the criteria and model standards that will be discussed as part of the CP on Art. 118 – 124.
General comment on Para 3.1	**Pre-application phase** We welcome the introduction of a pre-application phase and agree that it can benefit both undertakings and insurance supervisors (as stated in 3.11) to the extent that a successful pre-application phase establishes a close dialogue between company and supervisor(s). Indeed, we expect that this phase and the self-assessment of internal model readiness will provide enhanced preparation for the next steps and minimise the chances of requests for modifications, limited approvals and model rejections. CEA recommends that during the pre-application phase • the proportionality principle applies, i.e. intensity of this phase should be aligned to the risk profile of the company in order not to make it an exercise overly onerous for small and medium sized entities • there should be a clear timeframe in line with our overall comments • and there should be clear objectives, steps and a defined minimum output
Para 3.8.	**The proportionality principle should apply to standard formats which should be used in the "Initiation of discussion" phase**

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	CEIOPS states that "the initial discussion" shall at least include: a) intention to apply b) scope of the internal model c) self-assessment of internal model readiness d) plan for meeting the internal model requirements e) any information the (re)insurance undertaking deems necessary and relevant f) access to any draft documentation" We believe that topic b) shall also embrace the objectives of the firm for going down the internal model route. We also believe that standard formats for applications should be developed. These standards should be aligned with the principle of proportionality. In practice this means that supervisors would have to develop particular standards formats being valid for specific types of companies yet should allow for a certain extent of judgement for the individual companies reflecting their specific situation.
Para 3.12 - 3.14	**The pre-application phase should be optional and be used for the identification of specific concerns that would need to be factored into the process** The industry understands that the supervisors will need to understand the extent and nature of the intended use, scope of application and coverage of the internal model. It is also very desirable that there is early identification and communication of any specific concerns or issues that need to be factored into the process. We recommend that pre-application should end with the view of the supervisor, as mentioned in 3.14, expressed in a written Statement of Preparedness. As part of Level 3 guidance we suggest defining how results of the pre-application are shared with the insurance undertaking and what the Statement of Preparedness will have to include.
General comment on Para 3.2	**Application phase** CEA believes that the documents necessary for an application to be deemed complete seem reasonable, under the caveat that this cannot be fully assessed without concrete definition of the contents of these documents.

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	Since these provisions will have a strong impact on internal model practices and the level of harmonisation we would also encourage the EC to define the contents of the documents as level 2 legislation (instead of level 3 only), i.e. to include 3.22 in CEIOPS' Advice (in 3.30). The application process will need to be managed in a sensible way and the standards applied in a reasonable and proportionate manner to avoid becoming an unduly cumbersome and bureaucratic exercise which is not in the interests of anyone. There should be clear explanations from supervisors where they refuse to assess an application. Finally, we believe that the mapping between the tests defined in the Level 1 text (Art. 118 – 122) and the particular documents mentioned in 3.30 should be clarified.
Para 3.17	The official language of documentation should not impose additional burden on cross-border operating undertakings. It is stated that "*all information shall be provided in an official language of the Member State, except if the supervisory authority agrees that information is provided in another language*". For insurance companies operating across different countries or using specialised software documented in another language this might impose unnecessary translation work. The official language should either be that of the member State or English.
Para 3.22 a)	It would be helpful if CEIOPS could clarify what is deemed to be a 'reasonable period'. Indeed, there is no mention of what a reasonable time period is, which may lead to inconsistent application amongst regulators across Europe. The CEA suggests that the time period should be specified in the Level 2 implementing measures.
Para 3.22 d), 3.30 d)	**It is difficult to assess whether the ORSA should be part of the documentation or not as there is little insight yet as to how the ORSA itself should be documented** It is stated that the latest ORSA should be part of the minimum documentation required. The CEA would like to point out that at the time of the application (especially in the early phase of Solvency II) ORSA might not have been submitted officially to the supervisor yet. This would seem particularly challenging in the absence of final details on what the ORSA should cover.
Para 3.28	**There should be a maximum timeframe for the supervisory authority to determine whether they have received a**

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	complete application or not. The pre-application phase should result in a "statement of completeness" issued by the supervisor. It is unclear when the 6 months approval period will start as the pre-requisites on the completeness of an application ("*relevant supervisory authorities' satisfaction*") are unclear. The CEA recommends defining appropriate level 2 measures to clarify this. We suggest a time limit of 8 working days between the official reception of an application and a decision from the supervisor on its completeness.
Para 3.29	**Clearer indication of the necessary steps to complete the application should be provided** CEIOPS advises that the reasons for a rejection of an incomplete application "*may include*" an indication of the necessary steps towards completing the application. We recommend replacing "*may include*" by "*should include*" to provide more certainty with respect to the required steps the undertaking will have to take to achieve a complete application. The CEA considers that the motivations for rejecting an application "should", rather than "may", include the necessary steps for the undertaking to achieve a complete application. This would provide more certainty with respect to the required steps the undertaking will have to take to achieve a complete application and assist companies in better understanding the weaknesses.
Para 3.32	**We agree that the definition of document contents should be further detailed in Level 3, but we believe more insight should be provided as part of Level 2** CEA appreciates the basic definition of the minimum documentation contents and structures in 3.22 and agrees to further elaborate these as part of Level 3 guidance and standards as indicated in 3.32. However, we believe that a basic definition of contents and structures is essential to understand the role of each one of the documents and therefore recommend including these in level 2. The basic definitions included 3.22 may for that purpose be included by CEIOPS in its advice in 3.30.
General comment on Para 3.3	**Model Change Policy** Model development is a key element of model usage within companies, and thus models are inevitably dynamic. So the model change policy should be as flexible as possible in order to allow for these dynamics. This can be facilitated by implementing clear model change process including change requests, sign-offs of intended change and validation of implemented changes as readily indicated in the CP.

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	Trust and interaction between the firm and the supervisors will however be of great importance in order to make this step workable. As firms will be responsible for the model change policy, they will need to consider carefully how they distinguish major and minor changes. Underatkings should therefore be allowed to propose to supervisors what should be considered as a minor or major model change. Supervisors, on the other hand, will need to apply a reasonable timeframe for the approval of changes. As major changes will have to be agreed in advance, it would be very impractical if they were both frequent and very long to get approval on. Typically, it is essential that the necessary annual updates of parametric assumptions (and even quarterly for financial assumptions) do not count as major changes to the model requiring pre-approval. We suggest that these are explicitly considered as minor changes in level 2. Both undertakings and supervisors will need to be very transparent throughout this process.
Para 3.35, 3.72	**Guidance on a reasonable timeframe for the "approval of the model change phase" should be provided** We agree that major changes and changes which are not covered by the scope of the change policy should be approved by the supervisors. In order to allow for a smooth and continuous development process we would argue to include – as it is done for the whole model approval process – a timeframe for the approval of this kind of changes. In addition CEA recommends foreseeing a "transition procedure". The existing approved version of the model should be seen as appropriate during the implementation of changes, i.e. between the points in time when model changes are deemed necessary and when changes are implemented. When changes have been implemented, the updated model should prevail until its official approval by the supervisor for a transitional period of time. In the event of a major modification, if a company is forced to use a previously approved model until the changes are approved, it could lead to the model not being used internally which contradicts the use test requirement.
Para 3.43, 3.62, 3.63	**The scope of model change policy needs to be focused on changes directly related to the model. The CEA opposes the maximum scope option.** The minimum scope would imply that changes to the model are addressed by the change policy provided they solely refer to the calculation kernel. We understand that there are many other areas that influence the model of an insurance company, e.g. processes linking the model with data inflows and decision processes of the company. These areas are well beyond the calculation kernel and are covered by Art. 110 – 124 of the Level 1 text.

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	The maximum scope alternative on the other hand would be very burdensome for both insurance undertakings and supervisors as each and every change in the company (even if the model is only marginally concerned) would potentially be subject to the model change policy and possibly to supervisory approval. In our opinion it is unclear what is meant by asking to include the system of governance as defined in Chapter IV, Section 2 as an "area of relevance" for the model change policy in addition to Art. 110 - 124. Clarification is need on the scope of the model change policy, in particular the notion "area of relevance".
Para 3.49. Para 3.64	**The differentiation between minor / major changes needs to be benchmarked** The CEA supports the differentiation of changes into two categories, i.e. minor and major changes. We agree that the differentiation should be done according to individual criteria defined in the model change policy. We would encourage to initiate a discussion on a benchmarking of minor vs. major changes and appreciate that CEIOPS has defined a starting point in the appendix to the CP.
Para 3.65	**Subcategories of model changes are welcomed but should not be more granular** CEIOPS suggests a further breakdown of change categories. We agree that the given list is feasible, we would however like to emphasize that any further classification of changes is dependent on the individual needs and risks of the insurance company and should therefore be assessed on case by case basis.
Para 3.57, 3.71, 3.75, 3.78	**Undertakings should not be required to systematically report all changes made to the model** We do not believe that the quarterly reporting by default of all minor changes is appropriate considering the possibilities the authorities will have to monitor and follow-up these minor changes. We believe it may be more appropriate to require companies to record these changes which should then be available upon supervisor's request. Whilst we can understand the concerns from the regulatory perspective, the supervisory intervention in the change process may become unduly burdensome where changes need to be made in response to a changing risk environment. This is likely to

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	lead to insurers devoting a disproportionate amount of effort in designing a change policy which minimises regulatory intervention rather than a change policy which makes sense for the effective management of risks in the firm. The sections on change policy also fail to recognise the difficulty of envisaging all circumstances in which it might be necessary to make amendments to the internal model (however defined) and of allowing firms the ability for develop their models in line with their understanding and emerging practices. It is unclear why changes (minor and major) could not be reviewed by the regulator post-change and with less frequency (perhaps annually)
Para 3.76	**The model change policy should be flexible enough to allow for un-anticipated changes and minor changes should not be subject to pre-approval by supervisors** There will always be cases where changes may not be anticipated. In this case an amendment of the model change policy should be possible in a flexible way. The model change policy should not be expected to deliver a restrictive list of model changes and should be flexible enough to allow models to be changed in due time. Minor changes should in general not be subject to pre-approval by the supervisor.
General comment on Para 3.4	**Assessment phase** CEA agrees with the general procedure and objectives for the assessment phase of internal and partial internal models. However, the industry is strongly concerned with the management of the modifications within the assessment process as we believe it is not in line with the general timeline of six months defined in the Level 1 text. Furthermore we note that in practice there will be cases where it will be difficult to agree whether a model should be seen as an internal or a partial internal model. We expect that this differentiation will be subject to a CP still to come.
Para 3.88, 3.89	**There should be no presumptions on the motivation for partial internal models** CEA agrees that there should be no cherry picking. We assume that the limited scope may be motivated along the lines given in 3.89. However the industry believes that there might also be other reasons for not going down the path of a full internal model implementation, i.e. the list in 3.89 should not be seen as being exhaustive. In general, it should be assumed that the reasons for developing full and partial internal models are that they will allow a

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	more accurate assessment and quantification of a company's risk exposure as they will be tailored to and designed for the specific needs of the company. To this extent, we believe that undertakings should not be obliged to develop a full model in the future simply as a result of having developed a partial internal model. Indeed, it may be that for certain risk modules the standard formula can be proportionate and therefore appropriate to the scale, nature and complexity of the risks taken by the undertaking.
Para 3.95	**The CEA does not endorse the introduction of minor / major modification loops into the assessment process** CEIOPS states that model assessment needs to be an iterative process. We agree that the dialogue with the supervisor must be iterative as is the model development process itself. However, the pre-approval phase should take the major part of iterations out of the formal assessment process. Indeed, the approval process already provides for a sufficiently large spectrum of possible outcomes: • Approval • Approval with terms and conditions • Limited approval • Limited approval with a realistic transitional plan • Withdrawal or rejection of the application • Withdrawal or rejection of the application with a waiting period In particular, we do not see any differences between the prescription of major modifications and a rejection, since the six-months period begins to run anew and as the "rules for re-applying" (as stated in 3.95) will apply for major modifications anyway. Likewise, we believe that minor modifications could equally be included in the conditions part of an approval with terms and conditions. CEA does therefore not endorse the introduction of minor / major modification loops into the assessment process. Instead, we recommend removing these loops from CEIOPS' advice, in particular because these provisions might – in addition to the issues listed above – tend to make the assessment process overly complex and delay the approval period beyond the 6months foreseen in the Level 1 text (Art. 110 (4)).

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General comment on Para 3.5	**Decision making process** **Approval, rejection, limited approval, disclosure** CEA agrees on the overall spectrum of possible outcomes of the process. As mentioned before, we expect however that rejections and limited approvals are an absolute exception – also based on the assumption that a pre-approval phase has been successfully undergone by the undertaking. We believe that any rejection or limited approval of an internal model is potentially detrimental to the commercial interest of the firm. Only the approval of internal models should be disclosed. We do not see any merit in the disclosure of model rejections.
Para 3.114, 3.167	**The "approval subject to terms and conditions" and "plan for necessary steps" need a timeframe** We understand that terms and conditions could include "a plan indicating the necessary steps". The supervisor should also define a time horizon for the submission of such a plan, and we would also encourage CEIOPS to consider a procedure for when a company fails to submit a feasible plan.
Para 3.115	**It is unclear what the "right of withdrawal" will be used for. In case the undertaking disagrees with the supervisor's decision it should have the right to appeal – a peer review or a mediation role for CEIOPS should be envisaged in this case.** It is unclear what is meant by the "undertaking shall be given the possibility to withdraw the application". We would interpret this as a move implying that the undertaking will return to the calculation of the standard formula, and would assume that this also means that the results of the approval / decision process will not be subject to disclosure. In case of rejection of the application, we believe that in cases where companies strongly disagree there should be some opportunity for appealing the decision and for asking for a peer review by a fully independent third party. Considerations on how this could be implemented are needed. One general consideration could be that such appeals and peer reviews may be handled on a European level by CEIOPS. We believe this may also be beneficial for the convergence of supervisory approval practises.

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Para 3.125	**Limited approvals / approvals with terms and conditions should be used instead of requests for major modifications during the approval phase.** We understand that a limited approval may be accompanied with an obligation of the company to submit a realistic transitional plan. This possibility (i.e. to require a transitional plan) is close to the alternative to – within the approval process – require major modifications to the model and re-start the approval process. However the practical implications of these two alternatives are fundamentally different (stepwise approval of an internal model vs. full approval by repeating the approval phase). Indeed, major modifications imply a prolongation of the approval phase with the insurance company not being able to use its internal models until it is formally approved.
Para 3.128	**The review report should in all cases be communicated to the undertaking** We understand from the advice that supervisors will have the discretion over whether they communicate a review report indicating the result of the approval process to the company or not. Supervisors are (by 3.172) only required to give reasons for the rejection of a model. In our opinion the supervisory authorities should also in the case of approvals send a review report to the undertaking.
Para 3.137-3.139	**We agree** Care is needed to ensure that commercially sensitive information that could be used to detriment of companies and their policyholders are not disclosed.
Para 3.145 (footnote)	**Approval process in case of Art. 117 (requirement to use an internal model)needs to be defined** We understand that Art. 117 of the Level 1 text is not within the scope of this CP. We would however like to emphasize that it seems important to discuss the approval process of an internal model in the case it has been required by a supervisor based on Art. 117, i.e. in cases there are significant deviations from the assumptions underlying the standard formula.
Para 3.164	**We do not see any reason why there is an "approval with later date" option for supervisors.** Internal models will allow a more accurate assessment and quantification of a company's risk exposure and in the interest of

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	all they should be used as soon as they are approved.
Para 3.172	We expect that in these cases a "waiting period" will only be enforced in exceptional circumstances: "… may enforce **in exceptional circumstances** ,..."
Para 3.179-3.181	**Companies should be informed in advance of any disclosure and should have a right to oppose the disclosure of commercially sensitive information** CEA agrees that commercial sensitive information regarding companies is never disclosed. It should not however only be up to the company to justify why information is inappropriate or unnecessary to disclose. Limited approvals or model rejections should not be subject to disclosure in any case. We do not see any merit in the disclosure of model rejections. Restricting disclosure to approval decisions could on the contrary create a more positive discrimination toward firms trying to model.