



The Actuarial Profession

making financial sense of the future

Life Conference and Exhibition 2012
Tim Ford & Brian Edey, Ernst and Young

International experience of internal model approval

November 2012

How are the regulatory teams performing?

Agenda

- Introduction
- Emerging themes
- Country by country view
- Groups / Colleges of supervisors
- Outlook

Introduction

One year ago

- Questioned whether there was “a level playing field”?
- Observed mixed early experiences across regulators
- Generally lots of “teething problems” for colleges
- Level 2 text just issued: article 203 covering IMAP
- Implementation date of 1 January 2014 expected

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Where we are today

- Implementation date of 1 January 2014 now **not** expected
- Uncertainty on timeline / local regulatory responses to this
- “Levelling up” of progress made by regulators
- Varying transparency of process in each country
- “Teething problems” for colleges still apparent
- Continued attrition of firms included / scope of IMAP

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Alignment of regulators

Areas of consistency:

- Generally thematic interaction approach
- Large degree of alignment with Level 2 reference point
- Some similarity on focus areas

Areas of difference:

- Some differences in interpretation
 - Technical issues
 - *how much is enough?*... justification / validation
- No direct equivalent of FSA's 'new' SAQ / SAT

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Increasing public and private roles for EIOPA

Opinion on external models and data (May 2012):

- Reinforces the need to meet internal model tests and standards
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- The Opinion states that the national supervisory authorities (NSAs) may request any additional information from insurance companies using external models/data in order to assess that requirements are met
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- **Emerging themes**
- Country by country view
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Emerging themes

- Data requirements
- Use test
- Expert judgements

Emerging themes: Data requirements

The Netherlands

- Links to Dutch requirement for internal audit sign-off on entire IMAP application
- Guidance published around internal audit's ability to rely on data that has been subject to financial statements audits
 - Past audits cannot automatically and solely be used to determine the accuracy of data eg existing data used for new purposes, new data items and different metrics (where historic offsets may not apply)
 - Risk analysis will have to be performed for each type of data and an approach will have to be determined on that basis
 - Materiality of inaccuracies in terms of SCR impact, potential for independent third party view on impact of deficiencies
 - No “tool” provided nor explicit mention of EUCs

Emerging themes: Use test – Ireland

April 2012

Support for decision making

- Requirement is **not** to be met by presentations - back up material (board minutes etc) required

Board understanding

- CBI may interview Board as a whole but concerned if reliant on a few members for understanding
- Covers overall structure of model, main risks and limitations...

Senior management understanding

- More detailed level of understanding required than of the Board. Individual interview of at least CEO/CFO/CRO (without technical experts!)

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March 2012

Example questionnaire issued to all firms, to be assessed through on-site visits:

- Scope of model & justification
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Emerging themes: Use test

Who has to meet it ?

- L1 / L2 refers to 'administrative, supervisory or management body'
- Unitary boards - seems accepted that the Board is the body to comply
- 2 tier Boards (Supervisory / Executive) – common practice for executive board to be expected to meet the use test and have understanding of model
- Not directly equivalent to financial statements where supervisory board would sign off on the Balance sheet, P&L account and issues / judgements and also receive the auditors' report

Emerging themes: Expert judgement

- Key issue in most risk and dependency modelling
- Documentation required for explaining, challenging and justifying the judgement...not just recording it:
 - transparent process to set assumptions
 - evidence of the materiality and sensitivity of judgements
 - alternatives considered and their impact
 - circumstances when the expert judgement should be considered false
 - how the expert judgement was arrived at
 - how the expert judgement was challenged
 - process and tools for validating the assumptions derived from expert judgement

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- **Country by country view**
- Experiences for groups
- Outlook

Country status: Belgium (NBB)

- Encouraging model use by largest companies. Adopting an “apply when you’re ready” approach
- No revised SAT format issued yet
- Some significant technical challenges raised eg Full PDF, standard formula appropriateness / completeness
- Data quality / controls also raised
- Variable meeting durations (few hours – several days)



Country status: France (ACP)

- Large teams put in place by ACP so able to cope with demands
- Focus areas:
 - Governance/process (Documentation quality has improved as a result)
 - Justification of all components required
 - Whole PDF needs to be produced
 - Evidence of testing being sought



Country status: Germany (BaFin)

- Regulator meets frequently with companies, typically quarterly
- Technical challenges by specific teams from BaFin
- Feedback provided orally through presentation; written feedback follows many months later
- Each company has a tailored approach; lack of commonality given small number of firms in first wave
- No consistent audit plan



Country status: Ireland (CBI)

- Number of applications reduced
- Regular communication with industry
- Conducting walkthrough of models with companies as part of the pre-application
- Local vs group a major issue (calibration justification / materiality / validation)
- VA expertise – examples of regulatory cooperation within colleges



Country status: Italy (ISVAP)

- Agreed schedule of meetings
- Focus on governance, expert judgement and auditability
- Some technical challenges
 - Full PDF
 - Consistency of risk measurement ($t=0$ / $t=1$)
- Written feedback provided 6-8 weeks after the meeting. Verbal feedback earlier.



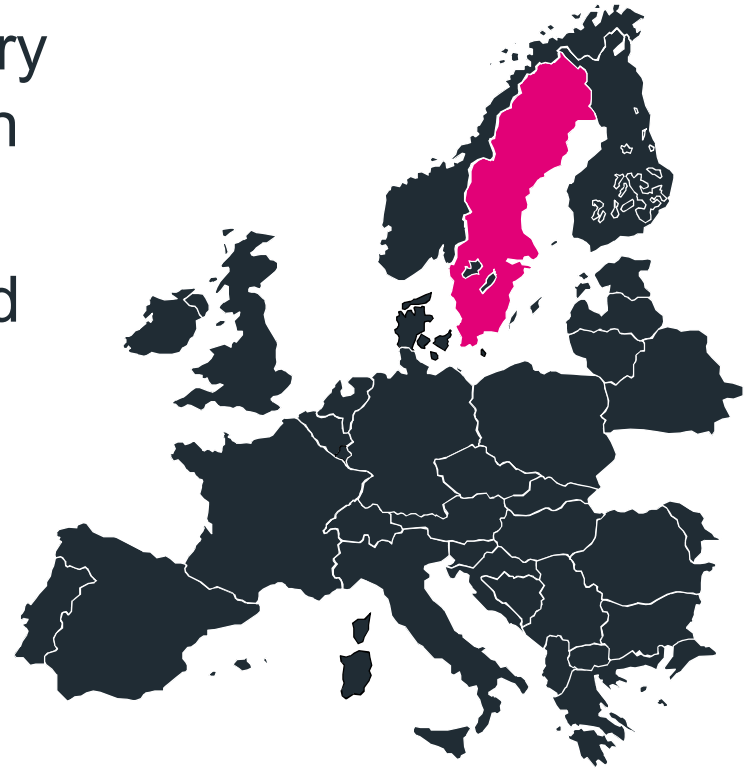
Country status: Poland (KNF)

- Very active in the IMAP process
- Visits devoted to specific topics
- KNF specialists very well prepared for meetings
- Significant emphasis on statistical quality of the internal model approach rather than consideration of material impacts to the SCR
- Formal inspections under Polish law also a possible tool



Country status: Sweden (FI)

- (Bi)monthly seminars with industry and identities of applicant firms in public domain
- Individual meeting schedules and dates agreed with firms around standard list of topics
- FI has become more technical in its approach (previously governance focus)
- Significant focus on data
- Issues logs maintained by FI and shared with firms



Equivalence

Country status: Switzerland (FINMA)

- Strong encouragement and incentive for application – over 100 models in the process
- Process has been running for 4 years; a handful of models approved, more conditionally approved.
- Submissions focused on detailed methodology description
- Limited requirements for companies to perform own validation
- Significant regulatory resource constraints – delays in reviews



Equivalence

Country status: Bermuda (BMA)

- 3 stages: Triage / Pre-App / Application
- Triage – ‘soft’ process to identify any blockers / focus areas
- Pre-App – Affirmation statements required (eg ‘*The ICM is relied upon for key management and tactical operating decisions*’) and SAT template per FSA
- Affirmation statements cover: controls / documentation use test / statistical / calibration / validation / governance
- Application – consultant supported review on specific scorecards
- Pre-App commencing 1 April 2013

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- **Groups / Colleges of supervisors**
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Colleges: Common client experiences

- Practice not in line with theory
- Frustrations over duplication of effort
- Supervisors have different interpretations, particularly timing, amount and format of the supporting documentation
- Limited coordination although “improving over time”
- Not much evidence of one regulator being prepared to place reliance on another
- More erratic and less predictable regulatory approaches noted (impact of financial crisis?)

Colleges: An industry view

- Large college – over 10 different supervisors
- “1000 man days” of regulatory scrutiny in 2011
- Limited coordination between supervisors with respect to pre-application process
- Different regulator **styles**: “final examiner” vs. “working with insurer”, **focus**: process vs. technical, and **interpretation**
- Implications of long pre-application:
 - Additional quantitative impact studies not aligned with the upcoming EIOPA impact assessment
 - Requirement for local cover letters and local IMAP submissions
 - Indications regarding potential capital add-ons for initial model approval

Colleges: EIOPA's view

Progress made but greater convergence needed:

- **Speed of process** – needs to increase..but depends on firm
- **Emphasis of reviews** – likely to be a timing difference
- Different **interpretation of requirements** or set out **different requirements** for the same issues – improve wording and when necessary clarify guidelines and standards + intensify activity on other initiatives
- **College coordination** considered a priority

“Internal Model Application Process in Europe: risk modelling, calibration and validation” Paolo Cadoni, EIOPA Internal Models Committee Chair, London, 10 October 2012

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- Country
- Groups / Colleges
- **Outlook**

Outlook

- Unclear response to delays in the Solvency II timeline
- Expect more prescription from EIOPA
 - Level 3 as a more robust reference point
 - Finalising ITS/RTS included in the EIOPA 2013 workplan
 - Potentially more opinions ? (public)
 - Q&A material (private)
- Colleges
 - EIOPA Medium term workplan includes: “*Enhance functioning of colleges by collecting, defining and disseminating best practices regarding e.g. internal model pre-application assessment process...*”
 - ...but challenging in absence of enabling legislation

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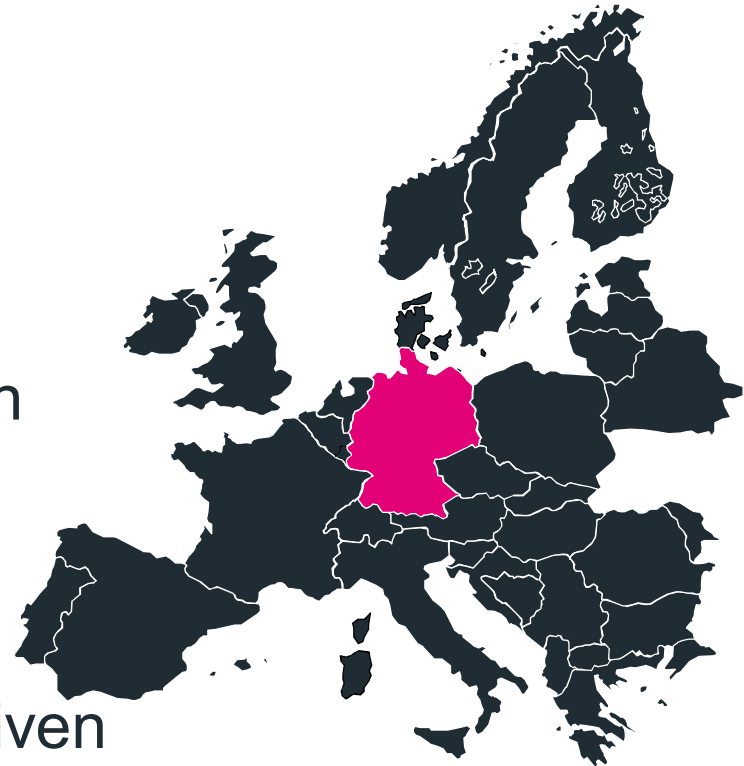
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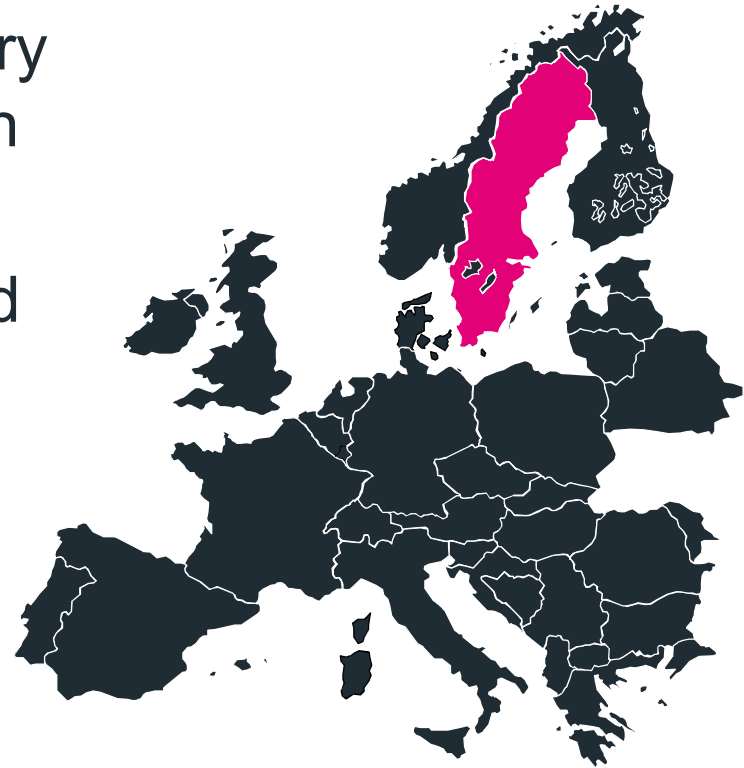
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