Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Guidance on Major Changes to Internal Models – 2018

1. Background

1.1 This Information Note is relevant to insurance and reinsurance undertakings (hereafter referred to as "undertakings") with an internal model approval under Solvency II, whether full or partial internal models. It may also be of interest to Solvency II undertakings seeking approval to use an internal model in the future and to Irish Solvency II undertakings with a group internal model.

1.2 This note sets out the Central Bank of Ireland's (hereafter referred to as Central Bank's) expectations in respect of undertakings applying for approval for a major change to their approved internal models (possibly an accumulation of minor changes) or an extension of scope to an approved internal model (e.g. to cover new risks or new business units). Given that a change to the model change policy constitutes a major change, this note also applies to changing the model change policy.

1.3 Where the undertaking is part of a group, the college of supervisors may need to co-ordinate and agree the overall process for approving a major change application, which may differ to that set out in this Information Note.

2. Introduction

2.1 The Central Bank's approach to reviewing model change applications will have similarities to the internal model approval process (IMAP), including the proportional use of the informal pre-application phase whenever possible.

2.2 The Central Bank will adopt the same supervisory approval process for model change applications for any of the following:

- Major model changes;
- Major changes triggered by an accumulation of minor changes;
- Extensions of the scope of the internal model (e.g. to cover new risks or business units); and
- Applications to alter the internal model change policy.

3. Interaction with the Central Bank before a Model Change Application

3.1 The Central Bank expects undertakings to engage as early as possible with their supervision contacts about planned changes and developments to their internal models. This should include any model changes that may arise from expected future changes in the undertaking's risk profile; for example resulting from a potential business transaction. In particular, the Central Bank expects undertakings to give notice of their proposed model change application(s) as soon as they consider an application likely.

3.2 When giving notice of a model change application, the Central Bank expects undertakings to provide:

- A summary of their planned model change(s);
- The reasons for the change(s);
- The potential impact (both qualitative and quantitative);
- The impact that the approval would have, if granted, on the accumulation of minor changes; and
- The intended timescales for implementation.

3.3 The Central Bank expects undertakings to discuss the scope of their model change application with their usual supervisory contact. The Central Bank expects model change applications to address past Central Bank feedback (possibly including on-site inspections), past data audits, limitations of the model, improvements driven by ongoing use of the model, validation findings, and/or findings arising from the Central Bank's supervisory review process. In addition, the Central Bank expects undertakings to articulate clearly how they have identified and prioritised the model change(s) included in their application as opposed to other model improvements in their model development plan.

3.4 If undertakings choose to make use of a pre-application period, the Central Bank would provide feedback during this process; however, this is not a substitute for the undertaking's own internal governance or validation process. The length of any pre-application will also be subject to discussion with the Central Bank and will reflect the extent of review work considered necessary.

3.5 The Central Bank expects undertakings to submit no more than one model change application per year. This application may comprise several individual major changes (and include any extensions of scope of the internal model), which will be reviewed together under the same process. This will help to ensure that undertakings are able to provide robust governance over model changes and that the Central Bank is able to commit appropriate resources to the review of the application. However, the Central Bank understands that business or market conditions may, in some circumstances, lead to more than one model change application in a year.

3.6 In the event of a planned transaction (for example an acquisition or investment in a new asset class) or other event that leads to a change in the undertaking's risk profile, the undertaking may instigate a model change application. In such situations, undertakings should consider whether the Central Bank could realistically approve the model change application by the time the transaction takes place. If approval of the model change application is not expected to be obtained in time, undertakings should discuss with the Central Bank how they will calculate revised capital requirements and remain adequately capitalised immediately after the transaction or event takes place.

3.7 Where an event occurs which causes a undertaking to consider whether changes might be required to its internal model, the Central Bank recognises that it might take some time for the undertaking to determine what changes are required and for any changes to be implemented within the model in a way that meets the Solvency II requirements. In such circumstances, the Central Bank expects undertakings to discuss with the Central Bank what other steps might be taken in the interim until a model change application can be made and a decision can be taken.

4. Interaction with the Central Bank during a Model Change Application

4.1 Following the submission of a model change application, an undertaking should continue to use its existing approved internal model when determining its SCR for formal Solvency II reporting purposes. The undertaking should use the version of the model that has been approved on or before the last day of the reporting period for the purposes of Solvency II reporting at that date. However, the undertaking can include minor changes implemented within the existing approved internal model as long as these fall below the undertaking's threshold in respect of accumulating minor changes.

4.2 The Central Bank expects undertakings to have regard to the possibility that a model change application is not approved. This should include having contingency plans, where appropriate, and sharing these plans with the Central Bank.

4.3 While the Central Bank does not formally approve minor model changes, it will regularly review undertakings reporting of minor changes and may challenge any that it considers should be classified as a major model change. In addition, minor changes may be subject to review by the Central Bank at any time as part of the Central Bank's ongoing supervisory review process. If a minor change causes the model to no longer meet the Solvency II tests and standards, undertakings must address this issue.

4.4 Undertakings are reminded that they should remain adequately capitalised at all times, including the period when a model change application is being reviewed by the Central Bank. The Central Bank may consider use of supervisory tools (including as a temporary measure) to ensure that any risks are adequately mitigated.

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