

Any views provided in this presentation are tentative views at working group level and should not be understood as EIOPA positions.

# Dynamic Volatility adjustment (DVA) within the Solvency II Review 2020

DVA-WS  
Stakeholder Meeting  
Frankfurt, 5 June 2019

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1. DVA scope of activities
2. Questions to Stakeholders

EIOPA's current activities cover especially

- **DVA opinion:** Monitor developments and assess the implementation of the **EIOPA opinion on the DVA** (EIOPA-BoS-17/366)
- **CfI:** COM's **Call for Information** on long term guarantee measures (Ref. Ares(2018)2252352 - 27/04/2018)
- **CfA:** COM's **Call for technical Advice** on the review of the Solvency II directive (Ref. Ares(2019)782244 - 11/02/2019)

A **holistic view** should be taken in 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.

In this context **deviation from close modelling or replication of EIOPA VA Methodology** may be used in certain circumstances and **under the prudency principle** [...], supported by appropriate non-model and Pillar 2 actions.

Undesirable risk management incentives include cases where undertakings would move their asset allocation towards the EIOPA VA reference portfolio with the sole purpose of lowering the SCR while increasing actual risk. This also includes putting in place investment strategies that could trigger pro-cyclical behaviour in a stressed situation.

- 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”**.
- [...] When challenging the model, competent authorities should consider inter alia **all elements** of the EIOPA VA Methodology (e.g. choice of the reference portfolio, the fundamental spread) and their **variation over the forecasting period**.

- 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.
- A specific requirement in the SFCR [...] is to **disclose the impact of a change to zero of the VA** on the undertaking's financial position. This should be performed **as if the regulatory concept of the VA would not exist at all. No compensation** should be included in this specific calculation, e.g. **via switching off other model components**, such as the modelling of sovereign risk.

## **3.3 Information on long-term guarantee measures**

With regards to the VA, EIOPA is asked to provide the following information:

- [...]
- The potential effect of this measure on the Solvency Capital Requirement in various economic environments, and in particular the impact of EIOPA's opinion related to this measure.

## 3.6 Dynamic modelling of the Volatility adjustment

EIOPA is asked to assess whether the modelling of the dynamic volatility adjustment by internal model users sets **disincentives** for insurance and reinsurance undertakings' **investment and risk management strategies**, and whether the existence of diverging practices in this regard can be detrimental to the **level playing field**. In this context, EIOPA is asked to assess the **appropriateness of this dynamic modelling** in internal models in **light of the assumptions underlying the volatility adjustment**.

**In case** that EIOPA advises to **maintain** this dynamic modelling in internal models, it should also advise on **criteria to improve harmonisation** of the modelling.

- Request to undertakings
  - o covers **solos & groups**
  - o has a **quantitative and qualitative part**
- Quantitative part covers three economic/**spread scenarios**:
  - o Base case: YE 2018 EUR-VA: 24 bps
  - o Widening: +100 bps → EUR-VA: 71 bps (+47 bps)
  - o Tightening: -50 bps → EUR-VA: 2 bps (-22 bps)

## Scenarios

- o impact corporate and sovereign portfolio
- o Don't differentiate along rating / CQS or maturity

- Quantitative Information:
  - o Base case and scenarios each with and without DVA:
    - SCR, SCR components: market & credit risk, spread risk
    - Own Funds, assets and technical provisions
  - o Base case: Constant VA figures and impact from 'sovereign risk'
- Qualitative information:
  - o Risk & investment management:
    - Impacts from DVA on risk appetite, decisions, allocations, ...
    - Potential disincentives, considerations on SCR minimal positions, ...
    - Risk management requirements incl. ORSA
  - o Risk profile ('scenario relevant for the SCR' with/without)

- Assess implementation of **DVA opinion**:
  - Modelling and SCR ('prudency principle' compared to replication of EIOPA VA methodology)
  - Risk and investment management
  - Disclosure to supervisors and public
- Answer to **Call for Information** (04/2018)
  - Potential SCR impact in various economic environments
- Answer to **Call for Advice** (02/2019)
  - Disincentives for investment and risk management strategies
  - Existence of diverging practices detrimental to level-playing field
  - If to maintain and if yes: advise on harmonisation of modelling.

1. DVA scope of activities
- 2. Questions to Stakeholders**

- Would you have additional questions?
- What are your views on topics addressed in CfI and CfA?
- What are your experiences with risk & investment management incentives from the DVA?
- Do you see any specific potential disincentives from the DVA beyond an amplification of VA implications?