Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Guidance on Applications for Approval of the Volatility Adjustment – 2018

1. Overview

1.1 "Solvency II Information Note 1 – Applications for approval of certain items specified in Article 308a of the Solvency II Directive", "Solvency II Information Note 3 – Applications for approval of certain items specified in Article 308a of the Solvency II Directive" and "Solvency II Information Note 4 – Applications for approval of certain items specified in Article 308a of the Solvency II Directive – Undertaking Specific Parameters" have been replaced by the following:

- Guidance on Applications for Approval of Ancillary Own Funds;
- Guidance on Applications for Approval of Basic Own Funds & Capital Contributions;
- Guidance on Applications for Approval of the Matching Adjustment;
- Guidance on Applications for Approval of the Volatility Adjustment;
- Guidance on Applications for Approval of Transitional Risk Free Interest Rates;
- Guidance on Applications for Approval of Transitional Technical Provisions;
- Guidance on Applications for Approval of Undertaking Specific Parameters.

1.2 Regulation 88 of the European Union (Insurance and Reinsurance) Regulations 2015 (S.I. 485 of 2015) permits (re)insurance undertakings to apply a volatility adjustment, subject to prior approval by the Central Bank of Ireland (hereafter 'Central Bank').

2. Approvals Process for Applications

2.1 This document provides guidance in relation to the Central Bank's requirements for applying to use volatility adjustment items outlined in Regulation 88. In order to ensure an efficient application process and avoid unnecessary delays in the review of those applications it is vital that undertakings submit applications which include all relevant information necessary for the assessment and decision by the Central Bank. The complete application should be submitted in electronic format to your usual supervisory contact.

3. Volatility Adjustment

3.1 Regulation 88 (1) requires that (re)insurance undertakings obtain prior approval from the Central Bank in order to apply a volatility adjustment. Undertakings wishing to use the volatility adjustment can submit applications to the Central Bank for assessment.

3.2 A checklist is provided in Appendix 1 to assist in making an application. Failure to provide all of the necessary evidence will result in the application being deemed incomplete.

Appendix 1 - Volatility Adjustment Application Checklist

- Complete all sections of this checklist.
- Insert the relevant section or page number from your application in the column marked 'Applicant'.
- The application should include the following:

	Applicant
1. Documentary evidence of approval of the application by the Board of the insurance or reinsurance undertaking.	
2. Details of the criteria for the application of the volatility adjustment, specifically the written policy required by Regulation 46 (10) covering:	
• All currencies to which the volatility adjustment will be applied [for clarity, the volatility adjustment must be applied to all liabilities in one currency, except those liabilities which will be used in the matching adjustment]	
• Details of the product types to which the volatility adjustment is being applied.	
• Details on the volatility and illiquidity of the liabilities. Details on whether these liabilities could be subject to sudden changes in claims patterns (including surrenders or reported claims) or claims settlements.	
• Details on the historical claims experience and surrender rates for these liabilities, with particular emphasis on claims volatility, particularly in periods of market stress.	
• Where there is claims volatility, the justification for the use of a volatility adjustment.	
• Details of the assets backing the liabilities impacted by the volatility adjustment, highlighting if the currency of the assets is different to that of the liabilities.	
• Details on how the asset mix compares to the reference portfolio used by EIOPA in determining the volatility adjustment.	

• Details on how the volatility adjustment adheres to the undertaking's investment strategy/asset-liability matching policy, and whether the approval or refusal of the volatility adjustment would impact such policies.	
• Information on whether the investment policy includes restrictions or penalties on the disposal of the assets. Should such restrictions or penalties apply, details on the governance and controls to enforce same.	
• Details of the IFRS classification of the assets ('Available for Sale', 'Held to Maturity').	
• Details of the history of portfolio rebalancing to counter falling/ rising assets prices, if any.	
• Details of any dominant asset classes in the asset mix.	
3. Details from the risk management team of the controls on the use of the volatility adjustment should be provided, including:	
• The liquidity plan showing incoming and outgoing cash flows subject to the volatility adjustment (required by Regulation 46 (6)). The liquidity plan should include: o Details of any guarantees or options on these liability cash flows o Details of any callable bonds in the asset cash flows and what assumptions have been made in relation to same. o Details on the effect on the cash flows in the event of policyholder surrenders or changes in claims settlement patterns. Details on whether this could cause a forced sale of assets. Please demonstrate that sufficient liquidity exists to meet the possible volatility of the outflows. o Details of the processes and controls to manage surrender and claims settlement, and to identify if additional liquidity is needed. o Details of the historic surrender experience. o Details of the impact of increase/decrease in surrenders on cash flow matching.	

• A demonstration that there is sufficient liquidity in stressed market conditions to ensure that there would be no forced sale of the assets that justify the use of the volatility adjustment. This demonstration should allow for any illiquidity in other assets being held.	
• The sensitivity of the technical provisions and eligible own funds to assumptions underlying the calculation of the volatility adjustment (required by Regulation 46 (7)(c)(i)). This should include an assessment of the effect of a possible forced sale of assets on eligible own funds.	
• Where a reduction of the volatility adjustment to zero results in non-compliance with the Solvency Capital Requirement, an analysis of the measures available to re-establish compliance (either to re-establish the level of eligible own funds or to reduce its risk profile). A demonstration that these measures would be available in stressed market conditions or are within the control of the company.	
• How, within the ORSA, the Risk Management function will perform the assessment on an on-going basis of compliance with the capital requirements with and without taking into account the volatility adjustment, required by Regulation 47 (5).	
4. Detail and quantify the impact of a change to zero of the volatility adjustment on the undertaking's financial position, including on the amount of • technical provisions; • the Solvency Capital Requirement; • the Minimum Capital Requirement; • the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement This impact should consider the effects on the possible lack of transferability of any assets backing liabilities impacted by the volatility adjustment to cover other liabilities or capital requirements.	
5. If the undertaking is using an internal model, provide details of how the volatility adjustment is allowed for in the model.	

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