



Annex 1: Procedure - SST audit concept

In the following concept, the process for approving an Internal Model are broken down into sub-steps, and variations for a shorter procedure and the Standard Model are described.

Steps	Methodology / Content
Complete process for Internal Model	
1.: Preliminary consultation: Could the model be recognized in principle? (preliminary assessment, part of target-target comparison)	Meeting of supervisory authority with an insurance undertaking or an insurance group or conglomerate (abbreviation: IU), explanation of model and its environment by IU so that the supervisory authority can perform a preliminary assessment of whether the model/IU is ready to complete the full audit process.
2.: Application by IU: IU requests permission to use its Internal (partial) Model for calculating solvency requirements in the future.	<p>Formal application: Contains designation of legal entity/entities for which the application is submitted. Circumscribes modules/risk classes to which the model application refers.</p> <p>Standard documentation (at least the documentation of the Internal Model, pro forma calculation of TC and RBC, data corresponding to minimum requirements for Internal Models, portfolio analysis, ...) may be submitted already along with the application.</p>
3.: Informally: Determination of audit date with IU	Determination of availability of resources on both sides.
4.: Transmission of formal audit announcement to IU.	<p>Announces audit. The audit announcement contains notice that the FOPI audit concept will be used (risk-based system audit, samples, interview technique). Participants, modules and audit areas, start of audit, approximate audit duration, savings clause for expansion if necessary, as well as required documents for which the management vouches for completeness and correctness. Sample list of documents is included in the audit concept. Other documents and relevant contents will be communicated individually. The supervisory authority requires certain infrastructure on site (e.g. PCs with access to internal systems).</p> <p><i>Alternative: At the same time as the audit announcement, an audit mandate is sent to an external expert. The audit mandate refers to the FOPI audit concept and outlines audit areas and topics. The external expert is responsible for steps up to step 9, including obtaining of documentation. After discussing the report with the external expert, the supervi-</i></p>

	<i>sory authority takes over the rest of the process.</i>
5.: Submission of documentation by IU	IU makes requested documentation available (to supervisory authority and/or external experts)
6.: Evaluation of documentation prior to on-site audit	The goal of the evaluation is to carry out a target-target comparison and to determine detailed audit focuses for the on-site audit according to risk-oriented criteria, to organise the on-site audit in an efficient manner, and to process the information received prior to the on-site audit in order to structure the target-actual comparison on site as efficiently as possible.
7.: Actual on-site audit	Different channels for gathering information. 1.) Evaluation of additional documents 2.) Interviews with employees of the IU at different levels. Documentation of the discussions in the form of minutes. 3.) Sample audit of the received information on the basis of the IU's internal systems, tracing of workflows, test calculations, tracing of individual transactions.
8.: Discussion at the conclusion of the on-site audit, with the participation of responsible officers (general management, Chief Risk officer).	Preliminary presentation of the audit results, communication of critical points from the perspective of the supervisory authority. Clarification of misunderstandings, explanation of next steps.
9.: Preparation of audit report	Description of which audit activities were carried out with respect to which topics, the depth of the audit, which points were not audited. Draft description of the audited modules and audit areas from the perspective of the auditors. Inclusion of audit findings with reference to the legal foundations (ISA, SO, SST Directive) that were not fulfilled.
10.: Preparation/transmission of accompanying letter:	IU is requested to comment on important points/findings in the report.
11.: Response letter	IU responds. Elimination of last substantial misunderstandings. IU has the option of commenting on the data considered significant by the supervisory authority and on their importance.
12.: Evaluation of response letter	Evaluation of the IU's responses by the supervisory authority, possibly leading to reassessment of individual data.
13.a.: Preparation and service of official notification (as decree/letter)	Official notification describes content of IU's application, refers to audit report, accompanying letter, and response. Approval of model on the bases of the information received and with reference to legal foundations, conditions relating to remedy of significant weaknesses, as set out in the report and the accompanying letter. Conditional approval possible;

	<p>if necessary, capital surcharges or correction of RBC until deficits are remedied.</p>
13.b.: Rejection of Internal Model	<p>Supervisory authority refers to concluded audit process and submitted documentation disclosing deficiencies, such that the Internal Model is not suitable in accordance with the legal foundations of the supervisory authority.</p> <p>Supervisory authority demands time schedule for preparing a <i>suitable</i> Internal Model.</p> <p>Supervisory authority sets out interim procedure until suitable Internal Model is prepared. Supervisory authority sets out fallback procedure for determining RBC, e.g. Standard Model with suitable surcharges, the rejected Internal Model as starting point for TC estimate, or estimation of TC by supervisory authority.</p> <p>Supervisory authority takes preventive measures if the time schedule is not met through no third-party fault.</p>
14.: Annual/semi-annual SST consultation	<p>The SST report submitted by the IU is discussed. Any questions are clarified. In particular, it is clarified whether the model and/or the business, and thus the basis on which the approval was granted, have changed substantially.</p> <p>During this procedural step, information may arise that leads to a follow-up audit, if the risk landscape has changed substantially or significant cumulative changes to the model have been made. The consultation may lead to step 13.b. and the consequences thereof.</p>
15.: Certification of SST consultation	<p>The supervisory authority issues a certification to the IU that neither the consultation nor the SST report has given rise to indications that the calculation was not carried out in accordance with the approval.</p> <p>If substantial changes have taken place, the certification contains a notice that the calculation will be carried out in accordance with the approved approach until any follow-up audit is conducted.</p>
Comment on 7.:	<p>Actual on-site audit: There is a risk that the supervisory authority does not receive complete or accurate information or that it misses or misinterprets important facts. The supervisory authority thus depends on the cooperation of the IU to a certain degree. What reduces the risk for the supervisory authority is that, over the course of the audit, numerous persons are interviewed and documents and internal systems are reviewed. It is then relatively difficult for the IU to portray a consistent system that does not correspond to the actual approach taken. If cooperation is lacking (this may also be the cause of a slow audit procedure), the audit should be</p>

	extended accordingly and refocus on auditing the result. The audit should last as long as necessary to obtain a sufficiently consistent picture.
Comment on 8, 9, 11:	The supervisory authority internally documents the observed data in the audit database, in order to ensure uniform judgments. The database also serves to document the uniform approach vis-à-vis the Federal Administrative Court.
Comment on 11:	<p>The legal act of approving Internal Models can in principle not be based on "unambiguous criteria" such as calculation of the Solv-I parameter (which does not provide sufficient relevant information). The same is also true of qualitative audits as part of the SQA. The interaction between FOPI and the IU becomes more complex.</p> <p>When evaluating the appropriateness of procedures and processes, the supervisory authority must ensure that it uses the right measures in reaching its decisions. Decisions that are too harsh or too lenient give rise to the danger of IU's not being treated consistently, so that they may appeal the decision.</p> <p>As part of its own corporate governance, the supervisory authority ensures that it takes quality assurance measures both with respect to the general strictness of interpretation and with respect to the equal treatment of data among different IU's, also across divisions within the supervisory authority. One instrument for this purpose is the audit database, in which the data requested is recorded in the context of the IU in question, along with its evaluation.</p>
Abridged process for Internal Model	
1.: Preliminary assessment: Part of target-target comparison	<p>In most cases where the use of Internal Models is planned, this process step was carried out, in whole or in part, until mid 2008.</p> <p>Explanation of the construction and development of the model in <i>detailed</i> form, more detailed than in the preliminary consultation as part of the full process for Internal Models.</p> <p>If the model development has not yet been concluded, FOPI accompanies the development pursuant to SST requirements.</p>
2.: Application by FirmIU: IU requests permission to use its Internal (partial) Model for calculating solvency requirements in the future.	Formal application: Contains designation of legal entity/entities for which the application is submitted. Circumscribes modules/risk classes to which the model application refers. Describes from what time the Internal Model will be used for supervisory purposes.
3.: Evaluation of documenta-	Evaluations with the possible result of issuing preliminary

tion, taking account of preliminary assessment	approval on the basis of the documentation in connection with the results obtained in step 1, with the proviso of a more detailed audit and any necessary conditions.
4.: Preliminary approval	The supervisory authority explains its audit steps that have generated information on which the preliminary approval rests. It makes clear that this is an abridged process covering the target-target comparison, which will be supplemented as soon as possible by a more complete process in the form of a target-actual comparison.
5.: Annual/semi-annual SST consultation	The SST report submitted by the IU is discussed. Any questions are clarified. In particular, it is clarified whether the model and/or the business and thus the basis on which the approval was granted have changed substantially. The supervisory authority demands a recalculation or takes any necessary measures if the calculation was not carried out correctly.
Alternatives for standard approach (suitability)	
1.: Submission of standard template and SST report	The submission of the standard template along with the SST report is interpreted by the supervisory authority as meaning that the IU views the Standard Model as suitable for covering all relevant risks and thus for calculation of the SST.
2.: Audit of SST report and evaluation of standard template prior to SST consultation	The supervisory authority regularly reviews the submitted documentation and any other information available to the supervisory authority with respect to whether the Standard Model is appropriate for the IU. The supervisory authority reviews whether the adjustments of parameters in the Standard Model are commensurate to the IU's risks.
3.: SST consultation	During the consultation, the SST report and the standard template are reviewed with respect to whether the Standard Model is used completely and correctly.
4.: Certification of SST consultation	The supervisory authority issues a certification to the IU that neither the consultation nor the SST report has given rise to indications that the calculation was not carried out completely and correctly in accordance with the Standard Model. Certification that, at the time of calculation, the supervisory authority found no indications that the Standard Model is not appropriate for the IU. The supervisory authority notifies that it accepts the submitted solvency calculation.

Alternative for standard approach (when not appropriate)	
<p>Steps 1, 2 and 3 are identical with the variant for the standard approach (appropriate). In this alternative, the supervisory authority would determine at the end of step 3 that the Standard Model is <i>not</i> appropriate. If the supervisory authority already knows that the Standard Model is not appropriate, it continues with step 4.</p>	
4.: Request for comments	<p>The supervisory authority notifies the IU that it does not believe the Standard Model is appropriate. Evidence for this assessment is presented.</p>
5.: Comments	<p>The IU submits comments. Once it analyses the comments, the supervisory authority either shares the view of the IU, or the supervisory authority is unable to accept the justification of the IU's arguments.</p>
6.a.: Certification or	<p>The supervisory authority certifies that, at the present time, there is not sufficient evidence that the Standard Model is not appropriate.</p>
6.b.: Request to calculate SST according to Internal Model.	<p>The supervisory authority calls upon the IU to implement an Internal Model and to submit a time schedule for implementation. The supervisory authority sets out the interim procedure. This may, for instance, consist in a partial or complete calculation of the SST with the help of the Standard Model as well as fixing capital surcharges in addition to the result arising from the Standard Model.</p> <p>Capital surcharges and additional measures are to be determined individually depending on the quality of the information, preferably in separate letters with disclosure of the information on which the decision is based.</p>