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FMA CIRCULAR

CONCERNING
DETAILED
EXPLANATIONS OF
THE REQUIREMENTS
FOR THE INTERNAL
MODEL AND THE
INDEPENDENT EXPERT
PURSUANT TO
ARTICLE 18 PARA. 1A
VAG

Disclaimer: This circular does not constitute a legal regulation. It is intended to serve as guidance and reflects the FMA's legal interpretation. No rights and obligations extending over and above the provisions of the law can be derived from circulars.

The general legal framework for the supervision of state-sponsored retirement provision was defined as part of the 2003 amendment to the *Versicherungsaufsichtsgesetz* (VAG; Insurance Supervision Act), Federal Law Gazette I no. 33/2003. The corresponding changes have been in force since 1 July 2003.

In the opinion of the Financial Market Authority (FMA), the following requirements apply to the internal model specified in Article 18 para. 1a VAG, by means of which the risk of the investment is controlled and managed, as well as to the external expert opinion and the qualifications of the independent expert as specified in Article 18 para. 1a VAG:

The internal model should include a detailed explanation of the investment strategies used, both from a mathematical and an economic perspective. In assessing this internal model, an expert opinion must be obtained from an independent expert.

This external expert opinion pursuant to Article 18 para. 1a VAG should be submitted unless a 100% capital guarantee is given by a third party to cover the assets allocated to the retirement provision or at least the proportion of shares allocated to the retirement provision, i.e. unless the insurance undertaking retains the residual risk arising from the investment.

The opinion by the independent expert must be submitted once, upon introduction of the product, as well as any time the investment strategies are altered to the extent that the new strategies differ substantially from the strategies examined in the last expert opinion. The opinion of the independent expert should explain in detail all the investment strategies, as well as any possible cases where the investment strategies would be altered. It must specifically list all financial and actuarial considerations in detail as well as the parameters used, including the reasons for assuming that these parameters are appropriate for modelling. The use and appropriateness of the model must also be set forth.

Specifically, all safeguarding measures and transaction rules used to control and manage the investment risk must be described in detail, commenting on their usefulness and usability. For simulation calculations, both the simulation methods and the parameters used must be indicated and spelled out in mathematical detail, with the methods and parameters commented on and reasons provided for their use.

The expert opinion must also explain in detail the risks entailed in the model (including specifically the model risk, the liquidity risk, the transaction cost risk, etc.), as well as any scenarios where the undertaking could suffer losses on account of the state-sponsored retirement provision product and the worst-case scenario implicit in the model. In this context, adequate justification must be provided for assuming that particular case as the worst-case scenario, as well as an estimate provided of the probability of this scenario occurring. All measures to be taken in response to the worst-case scenario must be additionally listed, along with the resulting consequences for the insurance undertaking.

In addition, calculations must be performed, with the underlying reasoning provided, that reveal the probability of achieving the capital guarantee. All models, parameters and assumptions used in this regard must be explained in detail, both from a mathematical and an economic perspective.

Details must additionally be provided of the extent (as a percentage) to which current investments are deemed to be hedged, providing reasons for this assumption. If the Model Regulation specified in Article 26b of the *Bankwesengesetz* (BWG; Banking Act), Federal Law Gazette II no. 179/1997 as amended, is applied correspondingly, a value-at risk comparison between the hedged and the non-hedged investment share can be presented by way of justification.

Specific details must be provided in this regard on the level of hedging (as a percentage) in the event of any change in the investment strategy for which the internal model provides. Explanations should also be provided of any measures to be taken to maintain this level of hedging in the event of any restructuring of the portfolio.

Specific mention is made here of Article 129h para. 3 VAG, which stipulates that any documents – and specifically the expert opinions pursuant to Article 18 para. 1a VAG – pertaining to state-sponsored retirement provision products already being offered must be submitted to the FMA by no later than 30 September 2003.

In addition, the qualifications of the independent expert should be stated by referring to the explanations below.

The independent expert pursuant to Article 18 para. 1a VAG must not be exposed to any conflict of interest as a result of being financially dependent on the insurance undertaking or the provider of the investment product. The independent expert must in particular not be involved in developing the internal model specified in Article 18 para. 1a VAG.

The professional qualifications required of the independent expert presuppose one of the following conditions, in the opinion of the FMA:

1. Postdoctoral lecturing qualification (*Habilitation*) or holder of a chair, as well as specific practical experience, in one of the following areas:
 - Financial mathematics
 - Probability theory
 - Financial management
 - Business management

2. Several years of practical work experience in one of the following areas:
 - Financial mathematics
 - Financial management
 - Business management

The opinion should additionally include a statement by the independent expert to the effect that, on account of the expert's education and expert knowledge, he feels qualified to prepare the required opinion and to assess all potential risks.

In keeping with the intention of this document, the Financial Market Authority reserves the right, in an individual case, to request additional information on the submitted opinion from an independent expert or from the insurance undertaking.