



EIOPA-CP-14/058

27 November 2014

Consultation Paper
on
the proposal for draft
Implementing Technical Standards
on
the equity index for the symmetric
adjustment of the equity capital charge

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Responding to this paper

EIOPA welcomes comments on the draft Implementing Technical Standards on the equity index for the symmetric adjustment of the equity capital charge.

Comments are more helpful if they:

- contain a clear rationale; and
- describe any alternatives EIOPA should consider

Please send your comments to EIOPA in the provided Template for Comments, by email Consultation_Set2@eiopa.europa.eu by 2 March 2015.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents¹.

Contributions will be made available at the end of the public consultation period.

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

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¹ [Public Access to Documents](#)

Consultation Paper Overview & Next Steps

EIOPA carries out consultations in the case of drafting Technical Standards in accordance to Articles 10 and 15 of the EIOPA Regulation.

This Consultation Paper presents the draft Technical Standard (including a Technical Annex) and the analysis of the expected impact from the proposed policy, which is covered under Annex I Impact Assessment.

The draft Implementing Technical Standard refers in the Annex to several equity indices which are used by EIOPA under permission. All the indices are protected registered trademarks and/or copyrights. Specifically, EIOPA has been requested to include the following disclaimers:

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Next steps

EIOPA will consider the feedback received and expects to publish a Final Report on the consultation and to submit the Consultation Paper for adoption by the Board of Supervisors.

Draft Technical Standard

COMMISSION IMPLEMENTING REGULATION (EU) No .../... laying down the implementing technical standards with regards to the symmetric adjustment of the equity capital charge according to Article 109a(2)(b) of Directive 2009/138/EC of the European Parliament and of the Council

of []

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), and in particular Article 109a(2)(b) thereof,

Whereas:

- (1) This Regulation lays down the equity index for the calculation of the symmetric adjustment as referred to in Article 106(2) and Article 109a(2)(b) of Directive 2009/138/EC.
- (2) To ensure a consistent aggregation, the levels of equity indices have to be made comparable. For this reason the level of each equity index at the beginning of the 3 year period is normalised to 100%.
- (3) This Regulation is based on the draft regulatory technical standards submitted by the European Insurance and Occupational Pensions Authority to the Commission.
- (4) The European Insurance and Occupational Pensions Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Insurance and Reinsurance Stakeholder Group established by Article 37 of Regulation (EU) No 1094/2010.

HAS ADOPTED THIS REGULATION:

Article 1

Definitions

For the purpose of this Regulation the following definition shall apply:

- ‘closing level’ means the last level at which an equity index was quoted during a regular trading session.

Article 2

Calculation of the equity index

- (1) The level of the equity index referred to in Article 106(2) of Directive 2009/138/EC for a given day shall be calculated as the weighted average of the normalised levels of the equity indices, determined in accordance with paragraph 2, with the weights set out in the table in the Annex.
- (2) The normalised level of an equity index for a given day shall be the closing level on the day divided by the closing level at the beginning of the period set out in Article 172(1)(c) of the Implementing Measures.
- (3) The level of the equity index shall be calculated for each working day. Where, for a given day, the closing level of an equity index is not available, the most recent closing level shall be used instead.

Article 3

Final provisions

- (1) This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.
- (2) This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,
[For the Commission
The President]

[For the Commission
On behalf of the President]

Annex: Indices and Weights

Indices (Non-total return indices)	Weights
AEX®	14
CAC 40®	14
DAX®	14
FTSE® All-Share Index	14
FTSE® MIB Index	8
IBEX 35®	8
Nikkei 225 (© Nikkei Inc.)	2
OMX® Stockholm 30 Index	8
S&P 500®	8
SMI®	2
WIG30®	8

Annex I: Impact Assessment

Section 1: Procedural issues and consultation of interested parties

According to Article 15(1) of EIOPA Regulation, EIOPA shall analyse the potential related costs and benefits when drafting implementing technical standards. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

This ITS defines an equity index for the symmetric adjustment referred in Article 106 of Directive 2009/138/EC (also referred as "equity dampener adjustment").

For the purpose of calculating the equity dampener adjustment, EIOPA selected in 2012 a single equity index which was not freely publicly available and proprietary to a certain financial institution.

An informal pre-consultation was carried out with the main comment that a single European index does not appear to be, in all cases, appropriate to represent the average equity holding of European insurers and reinsurers. Stakeholders proposed the use of one index per currency, but recognised the increased volatility of such an alternative.

The European Commission legal services indicated that referencing a single and non-public proprietary index would not be admissible. The proposed approach takes this steer into account.

The draft ITS and its Impact Assessment are subject to public consultation.

Section 2: Problem definition

Recital 61 of Directive 2009/138/EC states that "in order to mitigate undue potential pro-cyclical effects of the financial system and avoid a situation in which insurance and reinsurance undertakings are unduly forced to raise additional capital or sell their investments as a result of unsustainable adverse movements in financial markets, the market risk module of the standard formula for the Solvency Capital Requirement should include a symmetric adjustment mechanism with respect to changes in the level of equity prices".

Directive 2009/138/EC sets out in Article 106 that the equity risk sub-module calculated in accordance with the standard formula shall include a symmetric adjustment to the equity capital charge applied to cover the risk arising from changes in the level of equity prices. This symmetric adjustment shall be based on a function of the current level of an appropriate equity index and a weighted average level of that index. The weighted average shall be calculated over an appropriate period of time, which shall be the same for all insurance and reinsurance undertakings.

The Implementing Measures set out requirements which the equity index has to meet.

Baseline

When analysing the impact of proposed policies, the Impact Assessment methodology foresees that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered. The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention.

The baseline scenario is based on the current situation of EU insurance and reinsurance markets, taking account of the progress towards the implementation of the Solvency II framework achieved at this stage by insurance and reinsurance undertakings and supervisory authorities.

In particular the baseline includes:

- The relevant content of Directive 2009/138/EC as amended by Directive 2014/51/EU.
- The relevant Implementing Measures.

According to Article 109a (2) (b) of Directive 2009/138/EC, this ITS has to define the equity index to be used for the adjustment mechanism.

Section 3: Objective pursued

The objective of this ITS is to define an equity index for the symmetric adjustment that meets the aim stated in Recital 61 of Directive 2009/138/EC and fulfils the requirements set out in Article 172 of the Implementing Measures:

- a) the equity index measures the market price of a diversified portfolio of equities which is representative of the nature of equities typically held by insurance and reinsurance undertakings;
- b) the level of the equity index is publicly available;
- c) the frequency of published levels of the equity index is sufficient to enable the current level of the index and its average value over the last 36 months to be determined.

EIOPA is responsible for calculating the equity index as well as the symmetric adjustment referred to in Article 106 and for publishing the results at least quarterly according to Article 109a(3) of Directive 2009/138/EC. A more frequent publication may be desirable to help insurance and reinsurance undertakings. Therefore the calculation of the index should be practicable for EIOPA in terms on efficiency, cost and timely publication.

Furthermore, the calculation of the equity index should be simple and undertakings should be able to carry out at least short-term projections of its value. To allow this, the equity index has to be defined in an unambiguous and comprehensive manner and

the values necessary to replicate the calculation of the equity index should ideally be publicly available for the undertakings free of any cost.

Finally, it is necessary to consider the impact of the EIOPA equity index, both as a reference for hedging equity risk and also its perception from a macroeconomic point of view (the index may likely be seen as representative for a desirable degree of geographical diversification for equity investments). Therefore, another objective is to avoid an index fostering the concentration of investments in certain markets or sectors.

The specific objectives of this ITS described above are consistent with the following objectives for Directive 2009/138/EC:

- improved risk management of EU undertakings,
- better allocation of capital resources, and
- harmonised risk sensitive and prospective solvency standards.

Section 4: Policy options

Policy issue 1: Inputs for the calculation of the equity index

Three alternative options were considered, of which one was discarded at the very initial stage:

Option 1.1 (Indices of EU equity markets):

To calculate the equity index based on well-known equity indices of the relevant EU equity markets. Under this option, the relevant ITS would mention the indices to use in the formula of the equity index. In this case, EIOPA does not need to publish the values of the components, but just the final value of the symmetric adjustment index (to be published on EIOPA's website).

Option 1.2 (List of individual companies):

To calculate the equity index based on a set of individual listed equities.

Option 1.3 (Direct external procurement):

To select a non-public equity index proprietary of a certain financial institution for calculating the equity index. Although this option was initially considered due to its simplicity, it was discarded because a reference to a proprietary index, not published free of charge, is problematic.

Policy issue 2: Exhaustive set or subset of relevant markets

Option 2.1 (Subset of national indices):

To use a subset of the relevant national indices.

Option 2.2 (Exhaustive set of national indices for all relevant markets):

To use one index for each relevant equity market.

Policy issue 3: Type of indices to use: gross total return indices or non-total return indices

Option 3.1 (Total return indices):

To use gross total return indices (i.e. indices that assume that all cash distributions and dividends are reinvested) to calculate the equity index.

Option 3.2 (Non-total return indices):

To use non-total return indices to calculate the equity index.

Policy issue 4: Calculation of the weights

Option 4.1 (Absolute economic amount approach):

The weights correspond to the relative shares of each national stock market (or national stock markets of a group of countries) in the aggregated equity portfolio of EU insurance and reinsurance undertakings, based on a survey EIOPA performed in the first quarter of 2013.

Each national stock market selected has been assigned to a representative national equity index.

The weight W_j of country (or group of countries) j is calculated as:

$$W_j = \frac{\sum_{i=1}^n AE_i^j}{\sum_{j=1}^m \sum_{i=1}^n AE_i^j}$$

} Total amount of equities from country j in the aggregated EU equity portfolio of insurance and reinsurance undertakings
} Total amount of equities in the aggregated equity portfolio of EU insurance and reinsurance undertakings

with "equities from country j " being the equities whose main stock exchange is located in country j , m the number of Member States taken into account in the equity index (i.e. the number of indices used in the calculation), n the number of Member States for which equity holdings were available and AE_i^j the amount of equities from country j held in total by (re)insurance undertakings in country i .

Option 4.2 (Average of national percentages approach):

The weight of one national stock market corresponds to the average of the relative shares of this stock market in the equity portfolios of the insurance and reinsurance undertakings of each Member State, based on a survey EIOPA performed in the first quarter of 2013.

Each national stock market selected has been assigned to a representative national equity index.

The weight W_j of country j is calculated as:

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$$W_j = \frac{1}{n} \sum_{i=a}^n \frac{AE_i^j}{\sum_{k=0}^z AE_i^k}$$

Share of equities from country j in the aggregated equity portfolio of country i 's insurance and reinsurance undertakings

with n the number of Member States taken into account in the equity index (i.e. the number of indices used in the calculation), z the number of countries that have stock exchanges in which some equities of the EU aggregated equity portfolio are mainly traded and AE_i^j the amount of country j equities in the aggregated equity portfolio of country i (re)insurance undertakings.

Option 4.3 (Combined approach):

This approach combines the weights that result from the two approaches described above.

Some equity markets are important both in terms of the relative share of each national stock market in the aggregated equity portfolio of European insurers and in terms of the average of national percentages (e.g. France and the United Kingdom). For other equity markets, there are marked differences. The Swedish and Polish equity markets are for example much more important when looking at averages of national percentages.

The combined approach chooses equity indices with a high weight based on one or both measures. It also takes into account that all geographic parts of Europe should be represented. An index might also be included where it can be seen as a good representative for other equity markets (e.g. Japan as proxy for the Asian markets).

The starting point is the relative shares of the equity markets in the aggregated equity portfolios of European insurers. But the weights of smaller markets are adjusted upwards if insurers from many European countries have a meaningful allocation to this market or the market can be seen as a proxy for other non-included equity markets.

The selected indices are allocated to three categories. Each member of a category has the same weight (14%, 8% or 2%). The weights for the equity markets of Poland, Sweden and Japan reflect also the fact that they can be seen as proxies for the Eastern European, Scandinavian and Asian markets.

Policy issue 5: Normalisation of equity indices (Article 2)

The equity index is a weighted average of different national indices. For those national indices to be consistently aggregated it is necessary to make them comparable by normalising them.

Option 5.1 (Values at a specific date):

To normalise all indices to a permanent base of 100 at a specific date based on their then current values.

Option 5.2 (Values at the beginning of the observation period):

To use a “rolling window base”, i.e. normalise the indices for each new calculation to a basis of 100 at the beginning of the observation period (36 months before) based on their then current value.

Section 5: Analysis of impacts

Policy issue 1: Inputs for the calculation of equity index

Option 1.1 (Indices of EU equity markets):

- Benefits:
 - From the point of view of (re)insurance undertakings, this option provides an index that they can replicate with limited effort for the purposes of risk management.
 - The use of a stable and limited list of well-known equity indices is preferable in terms of simplicity and transparency.

- Costs:
 - If (re)insurance undertakings want to replicate the equity index, they have to pay for acquiring the underlying individual indices.
 - EIOPA has to pay for acquiring values of equity indices for the relevant EU equity markets on an on-going basis.
 - EIOPA has to determine and update when necessary a set of indices/markets and implement them in the relevant processes. The total costs of this option do not seem to be material (including the allocation of EIOPA staff dedicated time, estimated in two hours per run/monthly).
 - Using indices of EU equity markets as building blocks restricts the flexibility in adjusting the equity index to the holdings of insurance undertakings (whose allocation to equities from a specific country might deviate from the composition of the country indices).

Option 1.2 (List of concrete equities):

- Benefits:
 - This approach allows creating an index that differs widely from established equity indices in case this should be necessary.

- Costs:
 - From the point of view of (re)insurance undertakings, this option makes it more difficult to replicate the index for the purposes of risk management.
 - For EIOPA, this option involves the complex tasks of managing a long list of companies that will likely change frequently. Furthermore, EIOPA would

have much higher implementation costs to design a mechanism for choosing companies so that the resulting portfolio is representative of a typical equity holding of undertakings. This mechanism would have to include a procedure for updating the list in case of de-listings, initial public offerings etc. The costs for acquiring prices of companies in the list would presumably be higher than in the first option. Finally the cost for executing, monitoring and controlling the process would be much higher under the policy option 2 (allocation of EIOPA staff dedicated time, estimated in perhaps more than one day per run/monthly).

Policy issue 2: Exhaustive set or subset of relevant markets

Option 2.1 (Subset of national indices):

- Benefits:
 - This option is easier to implement due to the reduced number of items involved in the calculation.

- Costs:
 - Where a national index is used as a proxy for a group of non-included indices based on geographical proximity and correlation, the non-perfect and changing correlations between the indices might result in over- or underestimating the symmetric adjustment of the equity capital charge.
 - It is necessary to monitor the correlations between the included and the non-included indices.
 - This approach makes it necessary to determine criteria for inclusion or exclusion.

Option 2.2 (Exhaustive set of national indices for all relevant markets):

- Benefits:
 - This option is more granular than Option 1. This allows potentially a better approximation of the equities held by insurers.
 - There is no need to monitor the correlations between included and non-included indices over time.

- Costs:
 - The higher number of indices results in a more complex calculation.
 - The procurement of additional indices produces higher costs.

Policy issue 3: Type of indices to use: gross total return indices or non-total return indices

Option 3.1 (Using gross total return national indexes to calculate the equity index):

- Benefits:
 - A gross-total return index avoids sudden drops resulting from dividend payments which do not correspond to actual losses as the dividends can be reinvested.

Option 3.2 (Using non-total return indexes to calculate the equity index):

- Benefits:
 - A non-total return index measures the actual market price of a portfolio of equities as required in Article 172 of the Implementing Measures.

Policy issue 4: Calculation of the weights

Option 4.1 (Absolute economic amount approach):

- Benefits:
 - The weight of a national stock market increases with the aggregate exposure of European insurers and reinsurers to this market.
 - No further adjustments to the data from the EIOPA survey are needed.
- Costs:
 - The weights reflect the portfolio composition of all European insurers and reinsurers (standard formula as well as internal model users). In case there will be meaningful differences between the two groups in the geographical allocation of equities, the equity index might not be representative for the holdings of standard formula insurers and reinsurers.
 - The approach produces high weights for national stock markets with high market capitalisation. As a result, the equity index could be not representative for the equity holdings of undertakings from smaller markets.

Option 4.2 (Average of national percentages approach):

- Benefits:
 - Only the mean percentage of equities from each country in the equity portfolio of a Member State country is taken into account. The size of national insurance and reinsurance equity portfolios is irrelevant. As a result each national insurance and reinsurance market is equally represented and small national insurance and reinsurance markets are not completely dominated by large ones.
 - No further adjustments to the data from the EIOPA survey are needed.
- Costs:
 - The weights reflect the portfolio composition of all European insurers and reinsurers (standard formula as well as internal model users). In case of meaningful differences between the two groups in the geographical allocation of equities the equity index might not be representative for the holdings of standard formula insurers and reinsurers.
 - Small equity markets are assigned a relatively high weight. As a result the behaviour of the equity index may deviate significantly from the overall equity portfolio of European insurers and reinsurers.

Option 4.3 (Combined approach):

- Benefits:
 - The approach takes into account both the relative importance and the average relative share of individual equity markets in the aggregated equity

portfolio of European insurers and in national insurance markets (i.e. all the information gathered in the EIOPA survey).

- While it is not possible to completely eliminate any distortions that are potentially introduced by the inclusion of internal model users in the EIOPA survey, the approach is more robust to them (one reason is that the selected equity indices are allocated to one of three categories with the same weights).
 - The approach ensures that equity markets of all areas are represented.
 - As other factors than market capitalisation are considered, there can be no disproportionately high weights for a single index that could distort the signals provided by the symmetric adjustment and create incentives for portfolios highly concentrated in equities from a single country.
- Costs:
 - There is no single method to take into account both the outputs based on market values and at the same time the outputs based on the average portfolio at national level.

Policy issue 5: Normalisation of equity indices

Option 5.1 (Values at a specific date):

- Benefits:
 - The implementation is very simple and there is no need to update on a regular basis.
- Costs:
 - It is necessary to determine the date at which the index is set to 100%.
 - The effective weights of the indices (i.e. weights multiplied by the value of their respective index) are not only determined by the weights that are derived from the equity portfolios of European insurers and the relative changes of the indices since the last three years, but also by the relative changes in the equity indices since the date chosen for normalisation.

Option 5.2 (Values at the beginning of the observation period):

- Benefits:
 - The actual weights of the individual national indices at the beginning of the observation period correspond always to the weights derived from the equity portfolios of European insurers and are constant over time and the relative changes of the indices since the last three years.
- Costs:

- This option requires an update of the base for the national indices used in the calculation for each calculation of the symmetric adjustment.

Section 6: Comparing the options

Policy issue 1: Inputs for the calculation of equity index

The objectives (b) and (c) listed in section 3 'Objectives pursued' can be achieved with both policy options. In theory, the objective of making the equity index "representative of the nature of equities typically held by insurance and reinsurance undertakings" could be better achieved by policy option 1.2. But even if the necessary information was available, there are a number of considerable drawbacks: the complexity and costs for both EIOPA as well as for insurers and reinsurers which want to replicate the index for risk management purposes is considerable compared with the marginal increase in precision. Moreover, policy option 1.2 could create incentives to invest in specific individual stocks.

The preferred choice is therefore **Option 1.1 (Indices of EU equity markets)**.

Policy issue 2: Exhaustive set or subset of relevant markets

With policy option 2.1, the objective (a) could potentially be better achieved. But with option 2.2, the most important indices (both in terms of their aggregated weight and the average of national percentages) are already included. Adding more indices would only have a meaningful impact on the value of the equity dampener if the corresponding weights were higher than warranted by the observed equity holdings of European insurers.

Moreover, from an implementation perspective, the costs of procuring the right to use each index of EEA stock markets for EIOPA may be material.

The preferred choice for this policy issue is therefore **Option 2.1 (Subset of national indices)**.

Policy issue 3: Type of indices to use: gross total return indices or non-total return indices

The Implementing Measures require that the equity index reflects the actual market price of an equity portfolio.

The preferred policy option for this policy issue is therefore **Option 3.2 (Non-total return indices)**.

Policy issue 4: Calculation of the weights

All three policy options fulfil the objectives (b) and (c) listed in section 3 'Objectives pursued'.

For all three options, the calculation of the index is practicable for EIOPA in terms of efficiency, cost and a timely publication.

All three options define the equity index in an unambiguous and comprehensive manner and the values underlying the calculation of the equity dampener index are publicly available for the undertakings (even if not necessarily free of any cost).

The equity index has to be “representative of the nature of equities typically held by insurance and reinsurance undertakings”. Of all the alternatives policy options policy option 4.3 meets this objective to the largest degree. With policy option 4.1, all but the largest markets in terms of market capitalisation (France, Germany, the Netherlands and the United Kingdom) are assigned a negligible weight. As a result, the equity nature of investments of Southern, Northern and Eastern Europe insurers is not really represented. On the contrary, policy option 4.2 gives very small equity markets a disproportionate weight.

As policy option 4.3 generates an equity index that is balanced across different markets and is therefore geographically diversified, it is preferable in terms of proper incentives for risk management.

While the weights of the national equity markets are fixed in the ITS, there will have to be at a later stage adjustments to reflect changes in the relevant factors. Policy option 4.3 moderates the impact of fluctuations in the capitalisation of individual markets. As a result, it produces more stable weights over time. This provides certainty for insurers and avoids incentives for equity portfolios that are concentrated in few countries or companies. This might help to avoid an uneven access to equity financing for the real economy across Europe.

With policy option 4.3 there are different possibilities to combine the relative weights based on the aggregated equity portfolio of European insurers and the average of national percentages. This can be justified as both metrics have their drawbacks and an adequate representative of all parts of Europe has to be ensured. This could not be achieved by mechanically combining the data underlying the first two policy options.

The preferred choice for this policy issue is therefore **Option 4.3 (Combined approach)**.

Policy issue 5: Normalisation of equity indices (Article 2)

With policy option 5.1, the effective weight of an equity index would depend on the relative performance of all selected indices between the date of normalisation and the start of the 36 months used for the calculation of the symmetric adjustment. As a result, the objective to develop an equity index “which is representative of the nature of equities typically held by insurance and reinsurance undertakings” would be met to a lesser degree.

The preferred choice is therefore **Option 5.2 (Values at the beginning of the observation period)**.