2020 review of Solvency II

Revision of specific pieces of advice in light of Covid-19

First batch

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

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Own funds buffer for compressed spreads

Current advice

The consultation paper did not include advice on the own funds buffer. The information request for the holistic impact assessment tested the maximum impact of such a buffer, for the specification see https://www.eiopa.europa.eu/solvency-ii-review-information-request-national-supervisory-authorities_en.

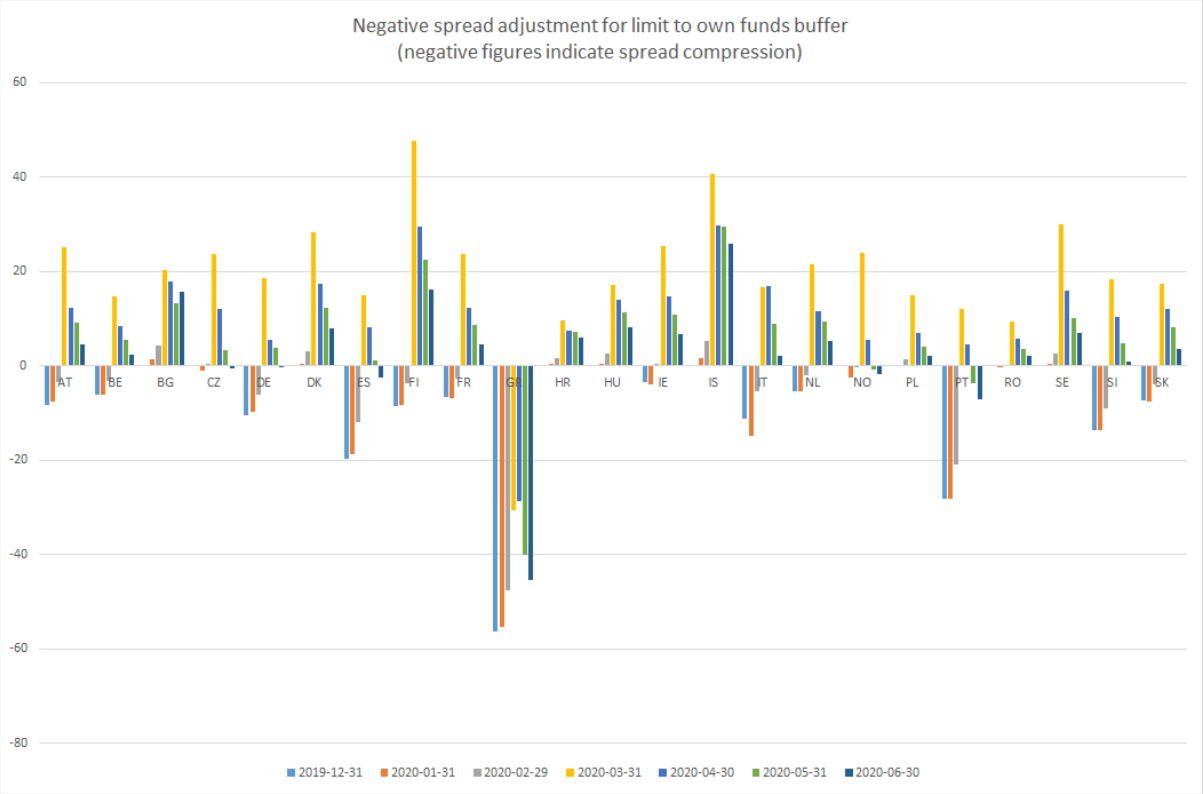
New evidence

Framework for the own funds buffer

Annex 1 sets out a framework for the own funds buffer for compressed spreads.

Performance of the maximum own funds buffer

The negative spread adjustment, which serves both as an indicator for spread compression and as a parameter to determine the maximum buffer that can be imposed, was calculated for December 2019 and the first six months of 2020, see following diagram.



Impact of the own funds buffer

The maximum impact of the own funds buffer was tested in the information request for the holistic impact assessment. On average the maximum size of the buffer would have been 3% of the eligible own funds to cover the SCR at the end

of 2019. More detailed results can be found in the note on the results of the information request.

Industry comments on the own funds buffer

Participants to the information request for the holistic impact assessment were invited to comment on the method to derive the maximum own funds buffer. Most participants just described the calculation they have carried out, stated that they had no comment or left the comment cell blank. Few participants did provide comments on the method. The comments are compiled in annex 2.

Sensitivity of the own funds buffer to the averaging period

The negative spread adjustment for the calculation of the maximum buffer is based on a comparison of the current spread and an average spread. The averaging period is seven years. The project group performed a sensitivity analysis of the negative spread adjustment in relation to the length of the averaging period.

Analysis of the evidence

Performance of the maximum own funds buffer

The negative spread adjustment developed in line with expectations. In December 2019, January and February 2020 the adjustment was negative, indication spread compression, in most countries. In March and April those adjustments turned positive, implying that no own funds buffer can be imposed anymore. The only exception is Greece where the spread adjustment is still negative in March and April 2020 because the current spreads for Greek government bonds are still significantly lower than those observed during the recent years.

This reveals the importance of the average period taken for the calculation, being possible different outcomes in function of the length of average period.

Impact of the own funds buffer

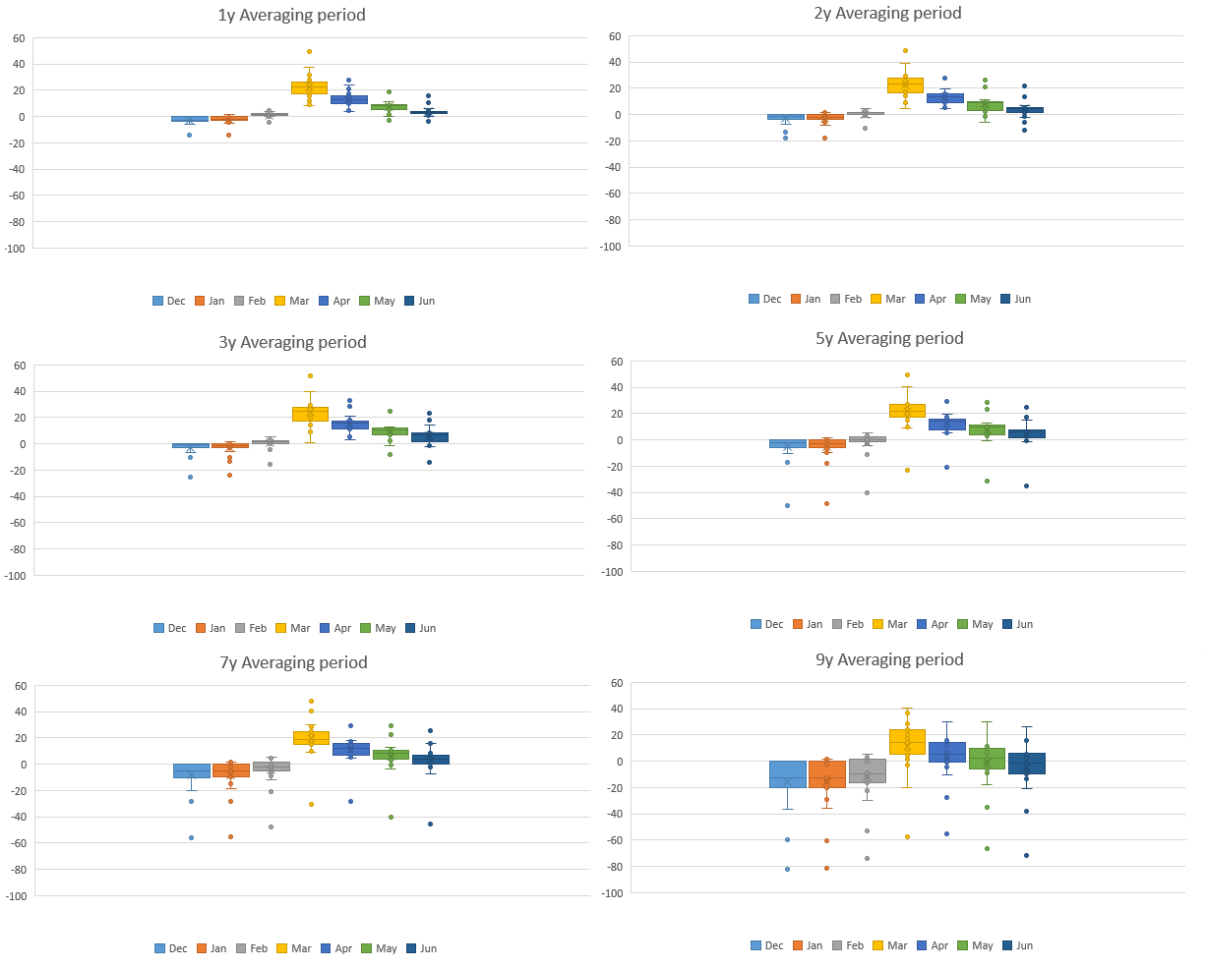
The impact measured in the information request is in line with expectations. If the maximum own funds buffers had been applied at the end of 2019, this would have led to a reduction in own funds by EUR 26.8 bn EUR. Releasing the buffers in March or April 2020 would have then led to a corresponding increase in own funds. The buffer serves the intent to stabilise the solvency position of undertakings. An analysis on the level of the volatility of the solvency position for individual undertakings could though not be performed.

Sensitivity of the own funds buffer to the averaging period

The averaging period is a key calibration parameter. Its length affects both the size and the sign of the adjustment. Too long periods used for the calculation of the average may give rise to undesired effects, in some cases failing to recognize the current stage of the cycle and potentially leading to pro-cyclical behaviour by insurers.

In order to assess the sensitivity of the own funds buffer with respect to the length of the averaging period, the following chart shows the distribution of the maximum

adjustment for EEA countries in each month from December 2019 to June 2020 for different lengths of the average.



It can be noted that:

- *Regardless of the length of the averaging period*, the spread adjustment develops in line with expectations, reflecting the fluctuations of the spread in the first half of 2020;
- The higher the length of the averaging period, the higher the mean and median size of the negative adjustment, as data from the financial crisis of the 2010s are included in the calculation;
- The higher the length of the averaging period, the higher the dispersion among EEA countries. The number of outliers increases, especially the ones with large negative values: in particular Greece, which represents the largest negative value in all the charts with an averaging period equal or greater than 3 years.

Data at country level show that in most cases the choice of the averaging period affects the sign of the adjustment only marginally (although the size is affected). There are however some exceptions:

- for almost all euro-area countries, in the case of shorter averaging periods (equal or less than 3 years) the adjustment turns positive already in

February, at the very beginning of the COVID-19 crisis, showing a prompter reaction to cycle inversions;

- for several euro-area countries, if the longer averaging period considered (9 years) would be used, adjustments would be mostly negative for the entire period (except in March), as data from the financial crisis would be taken into account in the calculations. This would be in contrast with the recent experience, which shows a great surge in credit spreads across Europe;
- for Greece, the use of averaging periods greater than 3 years fails to recognize the fluctuations of the cycle, as the adjustment would be negative for the entire period considered. Positive adjustments would be possible only for shorter periods of calculation. This is explained by the observation that longer averaging periods would fully incorporate the long government bond crisis experienced by the country that lasted until 2017.

Charts illustrating these results can be found in annex 3.

Options to change the current advice

Option 1: No change – Own funds buffers for compressed spreads are not introduced in Solvency II

Option 2: Own funds buffers for compressed spreads, as specified in the framework set out in annex 1, are introduced to Solvency II

Pros and cons of option 2 are set out in the following table:

Pros	Cons
• Reflects the risk that compressed spreads widen again • Contributes, together with the VA, to a symmetric treatment of spread compressions and spread exaggerations • Can mitigate procyclical behaviour	• It is not clear whether the buffer is needed, in addition to VA and MA, to mitigate procyclical effects. • Introduces level-playing field issues where no harmonized application by NSAs is achieved • Makes framework more complex, in particular, where national specificities need to be reflected, for example profit sharing, and thus maximum buffer cannot be plainly applied • Reduces comparability of solvency information across markets/undertakings Risk of increasing spreads already captured as part of the solvency capital requirement. Introduction of a buffer for compressed spreads may introduce double-counting of risks (in times of compressed spreads asset value is

	higher and therefore the spread capital charge increases).

SCR standard formula calibration for long-term equity investments

Current advice

In its advice, EIOPA assessed the current calibration of LTE based on data from 3 equity indices covering a period starting at 1970[1] to mid-April 2019.

The empirical analysis carried out by EIOPA resulted on a 62% stress for a 10 years time horizon when considering the MSCI Europe Total Return Index. It did not identify a clear decreasing trend in the risk with regard to extending the time horizon and, therefore, it did not corroborate the 22% capital charge.

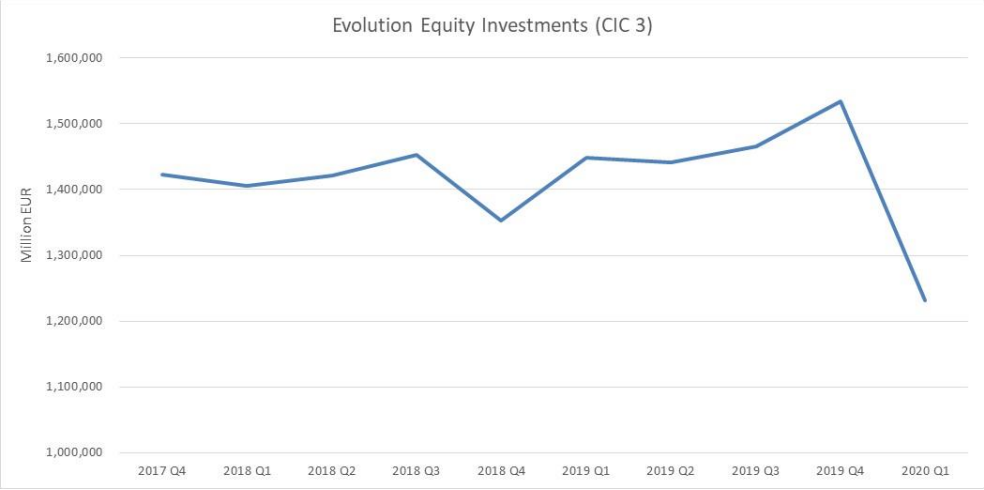
New evidence

New market observations are now available, which enabled to extend the time series included in the analysis, covering the period of significant market turbulence observed at the beginning of the COVID-19 crisis.

Analysis of the evidence

The period of historical data considered in the calibration was extended to include the period of market turbulence observed at the beginning of the COVID – 19 crisis and therefore reflect its impact to the equity market.

The graph below represents the evolution of equity investments over the last three years and demonstrates the drop in equity investment value during the beginning of the COVID – 19 crisis (first quarter of 2020[2]).



The updated analysis includes the following data (data source: Refinitiv):

Ticker	Description	First data point	Last data point

[1] For 2 of the 3 indices. For the third, observations started from 1998.

[2] The change in equity exposures may be driven by a number of different sources such as change in the market value, sales /purchases, substitutes, demographics and liquidity.

M2WO	MSCI World Total Return Index	31/12/1969	29/05/2020
M2AM	MSCI America Total Return Index	31/12/1998	29/05/2020
M2EU	MSCI Europe Total Return Index	30/01/1970	29/05/2020

The calibration methodology used is the same as the original analysis and the results are the empirical values at risk rather than the normalised values. As highlighted in the original analysis, there is a significant caveat in relation to the data, in particular at longer durations considering that the data only provides 5 complete and independent data series for MSCR Europe Total Return Index.

When considering the excess return over the 10 years risk free rate, the MSCI Europe data indicated empirical values at risk of between 67 and 38 percent for investment durations between 1 and 10 years. The results are in line with the calibration included in the Opinion and we note that the extension of the time horizon did not affect the overall results. Similar analysis was performed on the MSCI World Total Return index.

Based on the updated results, it is not possible to corroborate the assertion that investment for a longer duration justifies a lower capital charge.

Options to change the current advice

Considering these results the current opinion could be updated to reflect the most up to date analysis, however the current advice should remain unchanged.
Against this background, due to lack of empirical evidence the focus may continue to be on the criteria for LTE and not provide advice concerning the magnitude of the corresponding stress.

Symmetric adjustment to the equity capital charge

Current advice

The consultation paper proposed no changes to the symmetric adjustment to equity risk charge (SA). However, the issue investigated in the paper was the effect of a potential mismatch between the insurer's assets and the equity index composition used to calculate the SA (EIOPA's advice: no need to update the composition of the equity index for the SA).

New evidence

From the beginning of the year up to the end of April 2020 equity indices considered in the calculation of the SA lost about 18,63%, which translates into a raw SA (i.e. value of the adjustment before the application of the corridor of +/- 10%) of 10,40%. However, in March and April such a loss reached peaks of -35% (raw SA around 20%). Since 9 March, the SA has always been -10% (except on 29 April when it was -9.39%) because of the corridor (final shocks: equity type 1: 29%; equity type 2: 39%; qualifying infrastructure equity: 22.3%; qualifying infrastructure corporate equity: 26.8%).

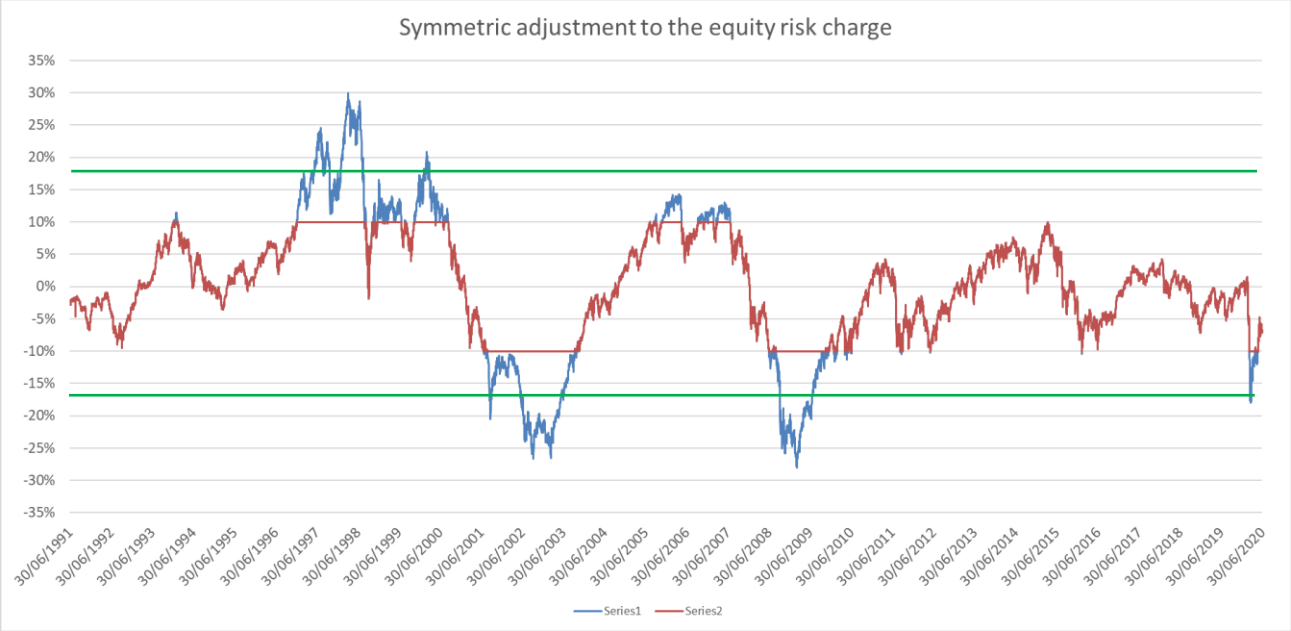
From 25th May on, SA never hit the lower boundary again: it has always been higher than -10%.

Analysis of the evidence

The objective of the measure is to dampen the volatility of own funds of (re)insurance undertakings resulting from changes in equity prices, thereby in particular reducing the risk of procyclical investment behaviour of the undertakings (fire sales). In a financial crisis, an increase of the amplitude of the SA would have the effect of reducing the equity risk module shock coefficients, which would lead to lower capital requirements. During periods of market exuberance the increase of the amplitude would result in higher capital requirements thus increasing the residence with regard to future downturns.

The following diagram shows the development of the SA since 1991. The green lines represent an alternative corridor (+/-17%). The corridor would have resulted in a higher SA during the period of increasing equity prices from 1996 to 2000 and in lower SA during the equity downturns 2001 to 2003 and 2009 to 2010. In those situations, the corridor would have limited the SA.

At the end of March and April 2020 the binding symmetric adjustment was at -10%, with the proposed wider corridor it would have been at -13.07% and -10.26% respectively. At the end of May, SA was at -8.45% and decreased further down to -6.72% at the end of June. In mid-July it reached -5.68%.



Annex 4 includes an assessment of the impact of the change to the solvency position of undertakings.

The project group analysed some specific cases of non-life undertakings with high share of equity investments where the SCR ratio improved during the downturn of equity markets in Q1 2020. The analysis could not confirm that the SA caused the improvement, at least not fully. At least partly, the improvements were due to changes in the investment or liability portfolio of the undertakings. Furthermore, it was noted that the capital surplus of all undertaking decreased during Q1 2020. Where undertakings have an SCR ratio significantly above 100%, a loss in equity value and the resulting decrease of the equity risk SCR can result in an increase of the SCR ratio, even without the application of the SA.

The analysis showed the need of additional transparency on the impact of the SA, at least for supervisors.

Options to change the current advice

Option 1: No change[3]

[3] The SA is a LTG measure operating as an increase/decrease on the risk charge for equity investments. It applies:

- in full to Type 1 and Type 2 equities, subject to a risk charge of 39% and 49% respectively (e.g. if the SA = - 4% then the risk charge will be 35% for Type 1 and 45% for Type 2);
- as a percentage to the value of (i) qualifying infrastructure equity and (ii) qualifying infrastructure corporate equities if they are not of a strategic nature or treated as long-term investments (cases in which 22% applies). In particular:
    - qualifying infrastructure equity: risk charge of 30% + 77% SA;
    - qualifying infrastructure corporate equity: risk charge of 36% + 92% SA.

Therefore, all equities subject, for any reason, to 22% (i.e. equity investments in related undertakings within the meaning of Article 212(1)(b) and 212(2) of Directive 2009/138/EC where these investments are of a strategic nature and strategic participations and equity investments that are treated as long-term equity investments in accordance with Article 171a) are explicitly excluded from the scope of the SA. The +/- 10% corridor provided by the Directive means implicitly that the minimum risk charge applicable to equities in the scope of SA is the 22.3%, referred to the qualifying infrastructure equity.

$$-10\% \leq \text{SA} = \frac{1}{2}\left(\frac{\text{CI}-\text{AI}}{\text{AI}} - 8\%\right) \leq +10\%,$$

CI denotes the current level of the equity index;

AI denotes the weighted average of the daily levels of the equity index over the last 36 months.

Pros	Cons
Simple to apply	Do not properly reflect the volatility of equity market.

Option 2: Widening the corridor to the SA from currently +/- 10% to +/- 17% for type 1 equity, type 2 equity, qualifying infrastructure corporate equity and qualifying infrastructure equity **and** introducing a floor of 22% to the capital charge.

Under that option, undertakings with a high share of equity investments that are subject to the SA should be required to report the impact of the VA on the SCR for equity risk to their national supervisory authority. No further safeguards are suggested given that the measure only becomes effective in case of extreme movements in equity markets.

This would result in the following possible risk charges

Equity type	Shock without SA	Range of shock with +/-10% corridor	Range of shock with +/-17% corridor
Type 1	39%	29%/49%	22%/56%
Type 2	49%	39%/59%	32%/66%
Qualifying infrastructure corporate equity	36%	26.8%/45.2%	22.9%/49.1%
Qualifying infrastructure equity	30%	20.8%/39.2%	22%/43.1%

Pros	Cons
Reducing the risk of procyclical investment behaviour of the undertakings (fire sales). In a financial crisis, an increase of the amplitude of the SA would have the effect of reducing the equity risk module shock coefficients, which would lead to lower capital requirements. During periods of market exuberance the increase of the amplitude would result in higher capital requirements thus increasing the residence with regard to future downturns	Further decreasing the risk charge for equity compared to other asset classes might imply unwanted incentives for investment strategies and risk management.
	By introducing a floor of 22% the measure will not be any longer be fully symmetric (in case such a floor is triggered). The equity exposures subject to the floor are typically very small compared to the overall equity exposure. Equity module

	would also be complicated because of the asymmetry introduced.
	The higher the corridor to the SA is, the further the SCR for equity risk can depart from the true value at risk.
	Could result in higher volatility of the equity shock and to a certain extent of the overall SCR.

Transitionals on risk-free interest rates and on technical provisions

Current advice

EIOPA identified three issues with respect to the transitionals, one of which is the approval of transitionals after 1 January 2016 where currently no consistent approach is applied as the regulation does not foresee any clarification in this respect. The advice currently proposed to add such clarification with respect to late applications and approvals by allowing them in specified circumstances, such as an undertaking newly falling under Solvency II because it has passed the thresholds of Article 4 of the Solvency II Directive or a portfolio transfer that is already subject to a transitional measure. There are diverging views whether the advice suggests an open or a closed list of circumstances where late applications should be possible.

New evidence

COVID 19 may potentially have a relevant negative impact on insurers' solvency position. The transitionals were identified as one of the measures of the current regulatory framework allowing for flexible reaction in case of deterioration of undertakings' financial position. It is therefore considered to extend the use of the transitionals and increasing its impact. In practice, new applications are currently being reviewed and approved by some member states.

This supervisory practice may therefore be seen as conflicting with the original advice which only reflected new applications/approvals in case of transfers of portfolios or for undertakings newly falling under Solvency II.

A questionnaire to NSAs on the magnitude of these new approvals has been prepared and shared with NSAs to collect information on the current market practice on new applications/approvals of the transitionals. The feedback was gathered by 5th June 2020. A summary of the feedback is presented below.

Feedback from NSA questionnaire on late applications

On the legislation / supervisory framework for approval of the use of the transitional measures beyond day 1 of Solvency II, only 6 member states (19,3%) answered that there is no such framework currently in place (Cyprus, Malta, Portugal, Luxembourg, Bulgaria and Iceland). Thus, for the vast majority of countries, a late approval of transitional measures is allowed for in their national legislation/regulatory framework.

However, most of those 25 countries do not yet observe or expect to receive late applications since March 2020. Only two countries, Germany and Italy, do so. Germany identified two cases of late applications on the transitional on technical provisions (TTP). Italy expects late applications on the transitional measures but not too many as the transitional measures were not considered very effective. In Italy, no applications have been received so far.

For further details, please refer to annex 5. This also provides further details on alternative means applied by undertakings to increase the effectiveness of the transitionals.

Analysis of the evidence

The transitionals only apply until 2032 and are not a permanent measure, so are no generic measure for crisis such as COVID 19. Would such a crisis occur later than 2032, the transitionals would not apply. The question on whether such a tool would be required permanently is a discussion in the macro context and not considered here.

Now due to Covid-19 new applications of the transitionals are observed and a broader use is considered sensible, hence the advice needs to be reassessed to avoid conflict between advice and current market practice.

The reasons for the current advice still hold, clarification on late approvals should be sought to increase consistency and the underlying fundamental of the transitional, intending to ensure a smooth transition to the SII framework is kept.

Before this background, the following options are considered.

Options to change the current advice

Option 1: No change to the advice

One option would be to keep the advice as is.

Pros	Cons
Ensuring more consistent NSA practices with respect to late applications.	

Option 2: Keep status quo, delete advice

Another option would be to delete the current advice on this issue.

Pros	Cons
	Inconsistent practice with respect to late applications persists.

Option 3: Redraft advice

Option 3 as included in the consultation document could be redrafted such that it captures the current situation. This can be ensured by leaving the advice more open with respect to future situations that may trigger the need for new applications. The advice could be changed as follows:

2.3 *Allow new approvals for the transitionals in exceptional cases, which, among others, may include:*

- *An undertaking newly falls under Solvency II because it has passed the thresholds of Article 4 of the Solvency II Directive*

- *An undertaking transfers a portfolio that is subject to the transitional to another undertaking*

The NSA should assess whether accepting new applications is appropriate in each circumstances.

Pros	Cons
Ensuring more consistent NSA practices with respect to late applications.	The requirement would be weaker than under option 1, therefore to some degree inconsistent practices with respect to late applications may still persist.

Annex 1 – Own funds buffer for compressed spreads

Framework for the own funds buffer for compressed spreads

One of the objectives of the volatility adjustment is to mitigate the impact of exaggerations of bond spreads on own funds. The proposed new design for the VA achieves this objective for spreads that are too wide. The VA does however not address spread compressions as they were observed, for example, before the financial crisis during 2006. The own funds buffer aims to complement the VA with regard to such excessive spread compressions. It introduces symmetry in the treatment of spread exaggerations and ensures that undertakings build resilience during times of market exuberance.

The introduction of the own funds buffer is in line with the recommendations of the ESRB on the VA design. As the own funds buffer relates to all fixed-income assets, including mortgage loans, it could also be used to address macroeconomic issues in relation to the provision of mortgage loans by insurance and reinsurance undertakings as suggested by the ESRB.[4]

Insurance and reinsurance undertakings should build up buffers of own funds during times when risk premia on fixed income assets are excessively compressed. For that purpose national supervisory authorities should be allowed to impose such buffers for their national market. The buffer would apply to all undertakings irrespective of whether they use the VA.

The imposition of the buffer should not be automatic but based on assessment of the national supervisory authority of the need to increase the resilience of the national market in view of bond market developments. The size of the buffers should depend on a spread adjustment decided by the national supervisory authority. The spread adjustment, and thus the size of the own funds buffer, should be limited by a maximum spread adjustment calculated based on the country representative portfolio for the VA. That adjustment should also serve as a non-binding indicator for spread compression.

The own funds buffer is an amount that should be deducted from the amount of eligible own funds to cover the SCR.

The own funds buffer should be calculated as follows:

(a) Calculate the annual effective rate (*AER)* of the fixed-income portfolio of the participant. This corresponds to the single discount rate that, where applied to the cash flows of the fixed income assets, results in a value that is equal to the value of the fixed income portfolio (*FIP). AER* is calculated such that:

$$\sum_{n=1}^{N} \frac{Cash\ Flows_n}{(1+AER)^n} = FIP$$

[4] The ESRB suggested the introduction of a loss-given-default floor for residential mortgage loans which authorities can increase during times of exuberance.

(b) Recalculate the value of the fixed income portfolio (*FIP)* by reducing the annual effective rate (*AER)* with the spread adjustment (*SA)* explained below.[5] It results in a new value of the fixed income portfolio (FIP^*).

$$FIP^* = \sum_{n=1}^{N} \frac{Cash\ Flows_n}{(1 + AER - SA)^n}$$

(c) The size of the own funds buffer (*OFB*) is equal to the difference:

$$OFB = FIP^* - FIP$$

(d) One calculation of the buffer should be carried out and all fixed-income assets, irrespective of the currency they are denominated in.

(e) The fixed-income assets relating to index and unit linked insurance and fixed-income assets in matching adjustment portfolios should not be included in the calculation of the buffer.

The maximum spread adjustment is calculated per country as follows:

$$\mathrm{SA}_t = -0.35 \times \left(CS_t\ - Av(CS_t)\right)$$

where:

- CS_t corresponds to the credit spread at time t for the reference portfolio of a given country; the credit spread is calculated as the difference between the yield of the assets of the reference portfolio and the basic risk-free interest rate term structure[6];
- $Av(CS_t)$ corresponds to the 7-years average of the credit spread for the reference portfolio of a given country.

For countries that fall under the peer country approach for determining the government bond spreads of the VA the spread adjustment should be chosen to be equal to the adjustment of the peer country.[7]

The maximum spread adjustment should be calculated centrally by EIOPA.

<u>Example calculation for a zero coupon bond with a duration of 10 years and nominal value of EUR 100</u>

Assumptions:

- The 10-year risk-free interest rate is zero.
- The credit spread of the bond is 10 bps.
- The spread adjustment for the calculation of the own funds buffer is 20 bps.

The market value of the bond (FIP) is EUR 99.01. The annual effective rate (AER) for the bond is 0.1%.

[5] Note that the sign convention for the spread adjustment was changed compared to the technical specification for the holistic impact assessment. Otherwise calculations are identical.

[6] Note that the full credit spread is taken, i.e. no risk correction is deducted from the credit spread.

[7] See table 12 on page 62 of the technical documentation of the methodology to derive EIOPA's risk-free interest rate term structures.

The adjusted market value of the bond (FIP*) is EUR 97.05. Hence the own funds buffer (OFB) is EUR 1.96.

Annex 2 – Industry comments on the own funds buffer

HIA participants were invited to comment on the method to derive the maximum own funds buffer for compressed spreads. Most participants, just described the calculation they have carried out, stated that they had no comment or left the comment cell blank. Few participants did provide comments on the method as listed below. Duplications have been removed. Company names have been replaced by XXX.

- Given the definition of maximum Own Funds Buffer, XXX understands that the general purpose of the own funds buffer (based on « the symmetric VA » rationale) is to detect compressed risk premia and give the chance to the national supervisory authority to require a buffer in order to increase the resilience of the national insurance industry. Indeed, the VA is designed to provide a relief to companies when the portion of spread is assumed to be an ''exaggeration''. Therefore, XXX understands that this buffer is built up when risk premia in FI is deemed excessively compressed, forcing the companies to build resilience in ‘‘good times’’ (i.e low spreads). In order to build the resilience, this adjustment seems to be applied directly on Own funds (==>decreasing OFs when spreads are negative offsetting partially the assets market value increase).

  From this perspective, XXX considers that if the OFB is used in practice, the OFB and VA must be used symmetrically. Indeed, this means that will require to define the OFB trigger accordingly to the evolution of the VA ; which isn’t clear so far in the technical specifications given for this data call. However, in case of negative VA (new formula), this buffer seems to be useless (direct negative OFs adjutment via TPs); and even bring over conservatism in some situations; for example, when the spreads are closed to 0 (and therefore VA too), the OFB could be build up leading to decrease the OFs, which is not necessary justified from economic point of view .

  According to XXX, other major limit of OFB current calculation is due to the lack of taking into perspective the current credit risk of the insurer portfolio. In other words, given the same market value of their portfolios, an insurer with high quality bond portfolio and another with very low quality bond portfolio will have the same requirement regarding the OFB (e.g based on the market value approach).

  In addition, for the method, XXX requires more clarity regarding the assessment of the parameters used to assess this maximum own funds buffer, such as the « 35% » and the « -7bps » (for France, including the average period calibration) and the frequency of OFB calculation. Regarding the trigger of this buffer, it is also mentioned that ''the size of the buffer would depend on market situation and the need of resilience'' without details. The buffer triggering should be also specified.

- Model is complex and unpredictable and mechanism how it is applied does not seem to be transparent. Companies do take the current level of spreads into account in their planning at the moment.

- EIOPA's considerations regarding the introduction of an own funds buffer in the event of narrowing spreads should be dispensed with, as this would lead to an unjustified additional burden on insurance companies.

  The calibration and parameterization of the standard formula is, in our view, sufficiently conservative, so that further markups and buffers are not necessary.

  Although a narrowing of credit spreads leads to rising market values and thus to an increase in economic capital, the higher market values also increase the capital requirements for the spread risk. Adequate consideration of the narrowed spreads in the SCR calculation is therefore ensured.

- It is not entirely clear how the own funds buffer is applied within the Solvency II framework. We question whether the proposed own funds buffer is effective in absorbing spread shocks. It will not have the same counter cyclical effect as the current use of the VA. Note on the method: we have included mortgages in the calculation of the own funds buffer.

- We don’t believe that the OFB calculation is adequate for the insurance business becouse we believe it isn’t a regulatory measure consistent with the typical production of insurance companies

- It's not clear if a look through has to be implemented for the calculation of the buffer. XXX did so.

- This measure is only one measure as presented by the ESRB in their recent paper. The real question is whether this single measure will meet the objective of acting as a counter cyclical measure. The methodology as applied does not take into consideratyion the actual locailisation of the investment portfolio as per country one "negative spread" is to be applied.

- This method does not consider the interaction with the liability side.

- It is operationally simple to calculate this component in its current form. However the negative spread adjustment is based on the country the entity is being regulated in as opposed to the specific asset holdings that it has on its balance sheet. These holdings may be made up of assets from a number of different countries. i.e. government bonds from Germany, France, Ireland, Italy etc.

- Definition of fixed income assets includes Unit Linked assets, therefore the calculattion of the own funds buffer includes items that have no own funds impact. (Overstatement is approximately 25% for XXX.)

- Article 156 and 157 are not clear on when these buffers would apply and how they are applied exactly which makes it hard to comment on these. From what we understand this buffer would apply on a national level. Thus is does not take into account the specific situation of an insurance company, such as the actual spreads that are earned on assets. In addtion we believe this would introduce holding double capital as we already hold capital for losses on fixed income assets and also these buffers will increase when spreads tighten as that leads to an increase of market values of those assets; capital charges are calulated based on market values."
- Note that NSA -14 bps is used (which refer to BG country). However, the portfolio of company includes various multicurrency assets (due to multicurrency liabilities). Morevoer, the functional currency is CZK, which implies that more precised definition of OFB should be introduced to capture all technical details.
- The Company has no objection to the proposed buffer calculation method.
- Use of the formula paragraph 162. We think that S2 has not to employ this buffer (Not in market value and asymetric).
- It is not clear what is the reference portfolio for each country. Also the FI asset profolio of the company contains bonds from various countries but the NSA is not in accordance with the issuer.
- Companies in larger countries may mainly invest in their own country's bonds, but companies in smaller countries probably don't. Would an issuer based adjustment be more appropriate (even if it requires more effort to calculate).
- XXX do not expect this to have a material impact on the Company at YE 19 given the nature of its business. In creating a disconnect between economic value and Solvency 2 own funds, this measure could create inappropriate risk management incentives

Analysis of the comments

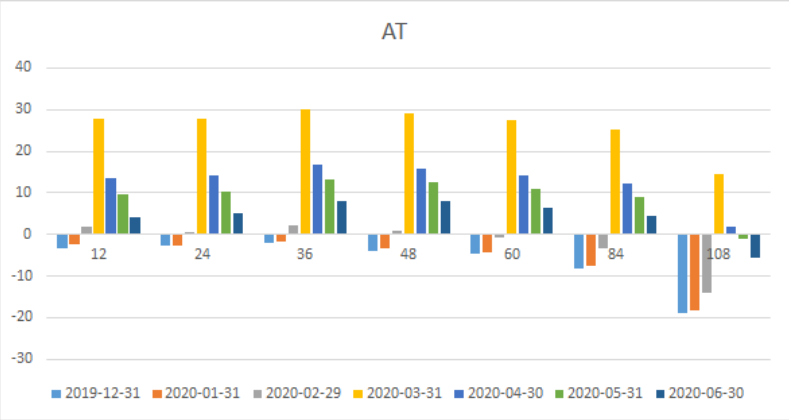
The main comments and resolutions are set out in the following table

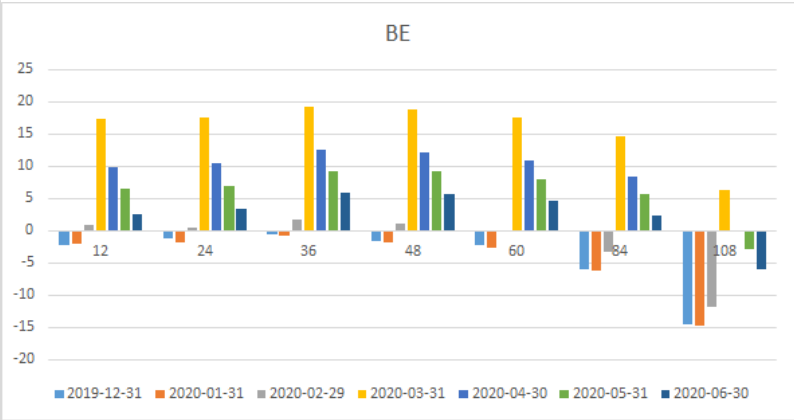
Comment	**Resolution**
The buffer introduces unnecessary prudence into Solvency II. In particular, the risk of spread widening is already taken into account in the SCR.	The additional prudence is necessary to account for the risk of compressed spreads. It ensures a symmetric treatment of spread compressions and spread exaggerations.

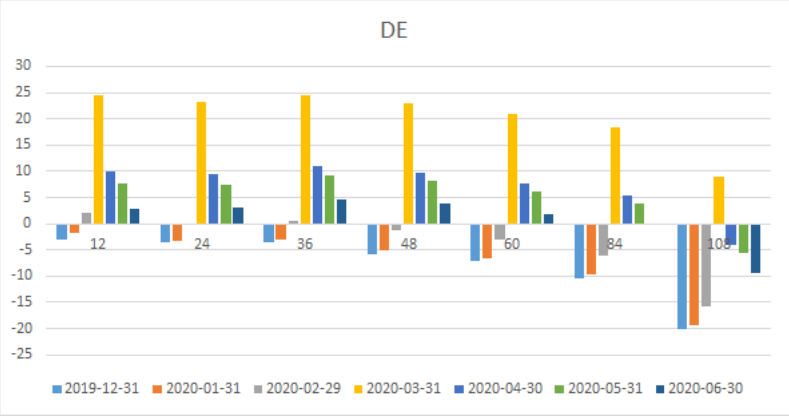
The application of the buffer is not sufficiently transparent and predictable.	It is acknowledged that the buffer is not an automatism that has implications for its predictability. At the same time, basing the buffer on supervisory judgement has many advantages, in particular to avoid that the buffer is imposed when it is not necessary.
The calculation of the buffer does not take into account the characteristics of the liability.	The maximum buffer is independent from the liabilities, but national supervisors could reflect liability characteristics when deciding on the actual size of the buffer.
The calculation of the buffer does not take into account the asset characteristics of the undertaking, in particular the credit quality of the assets.	The maximum buffer does take into account limited information about the assets, similar to the VA. But national supervisors could reflect additional asset characteristics when deciding on the actual size of the buffer.
The buffer is also based on unit-linked fixed income assets that results in an overstatement.	The framework clarifies that the calculation of the maximum buffer should not include unit-linked assets.

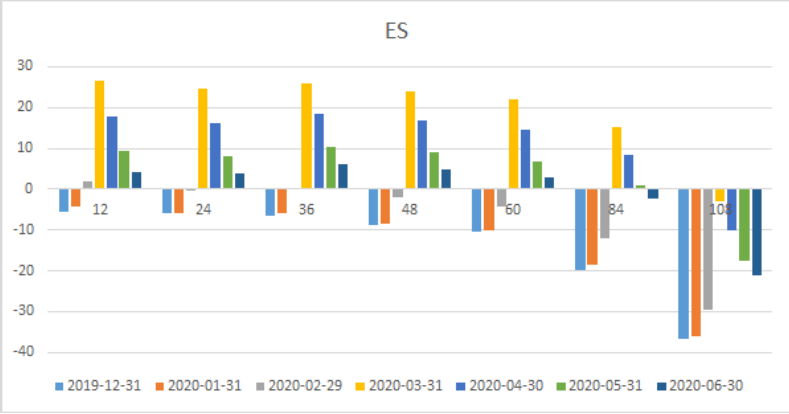
Annex 3 – Own funds buffer: Sensitivity with regard to the averaging period

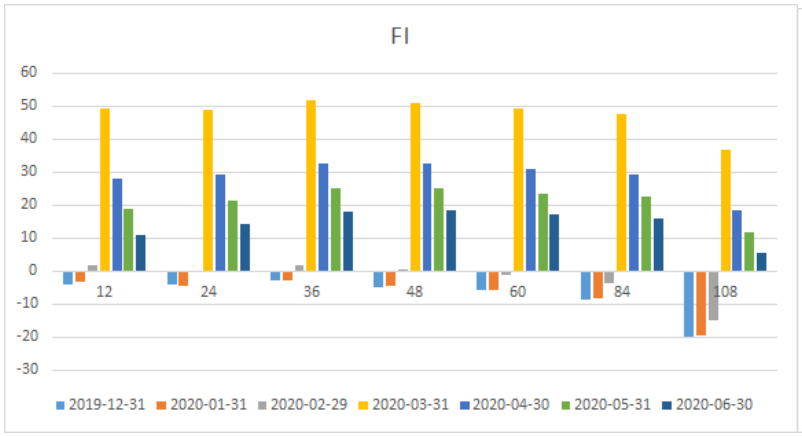
The following charts show the value of the maximum spread adjustment (y axis) as a function of the averaging period (x axis, in months) for each EEA country in the period December 2019 – June 2020.







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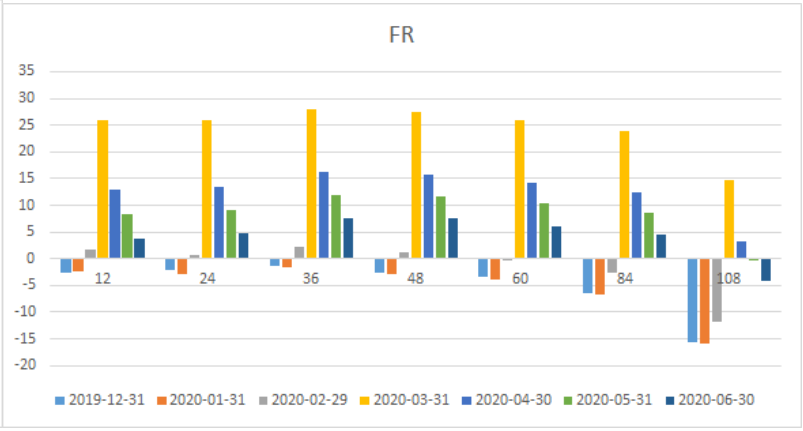
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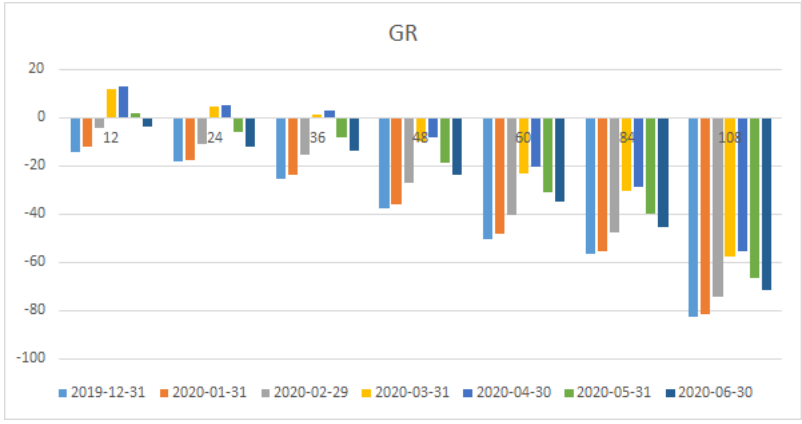
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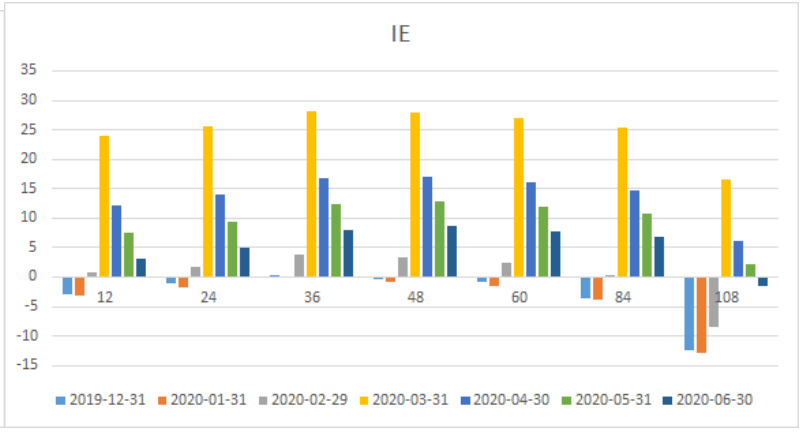
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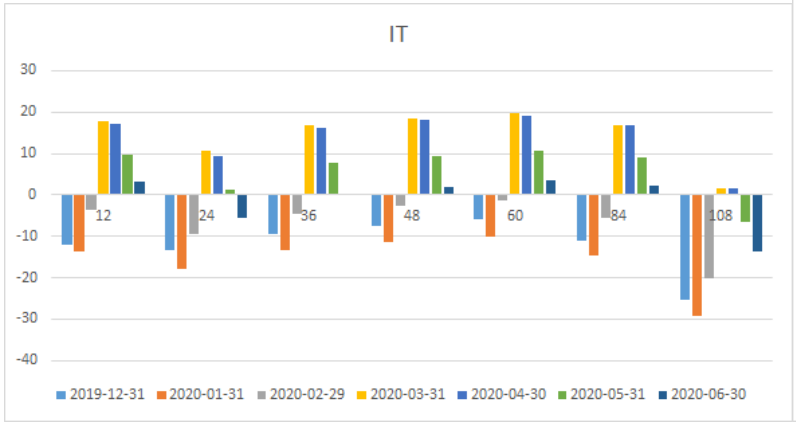
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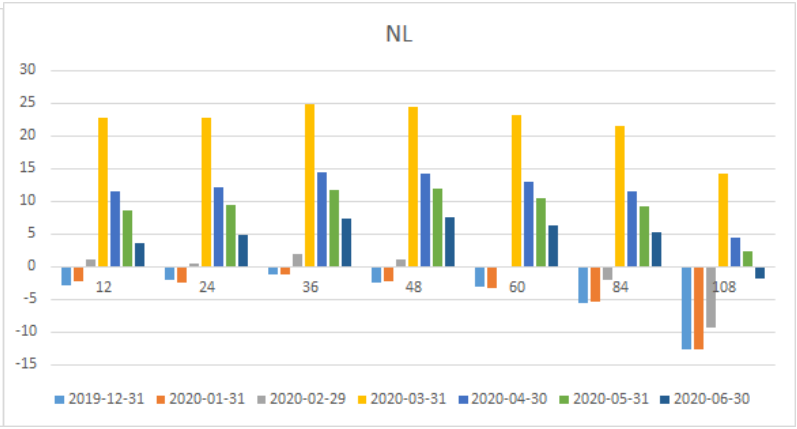
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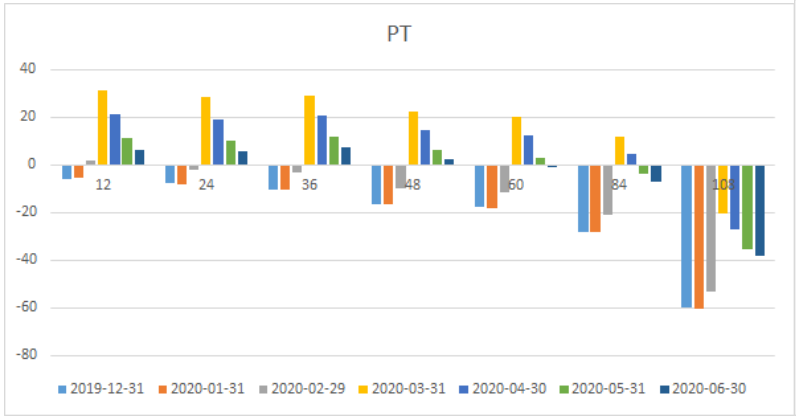
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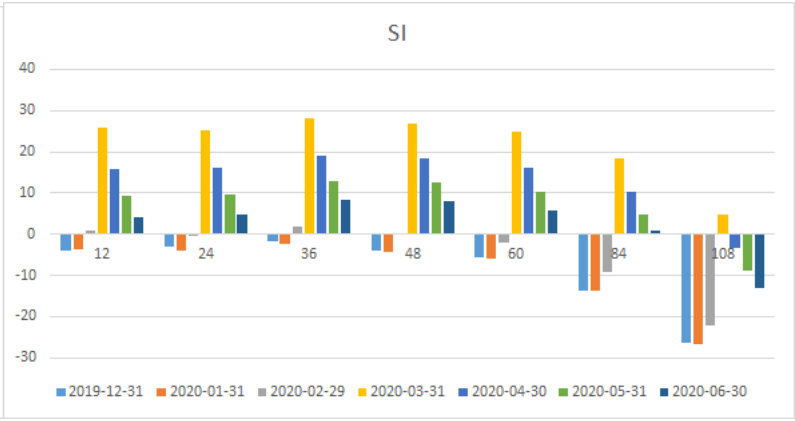
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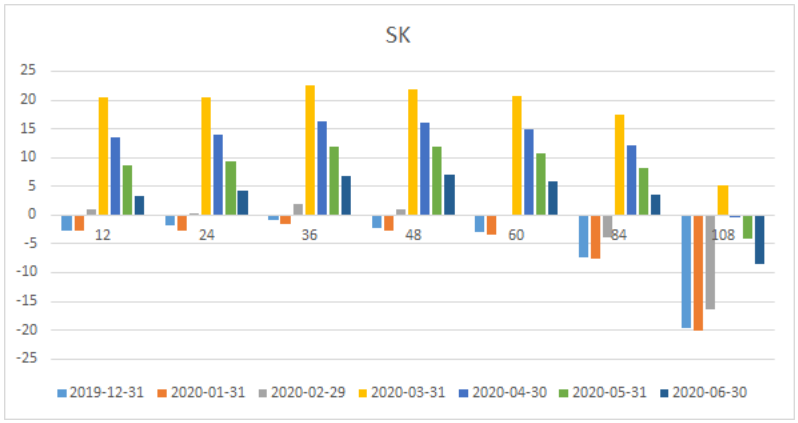
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Annex 4 – Symmetric adjustment to the equity capital charge

If the measure would be applied to all undertakings that calculate the SCR for equity risk with the standard formula, lowering the SA from -10% to -17% would result in a change in the SCR of less than 3% at the European level. Life and composite undertakings would benefit more than non-life and reinsurance undertakings.

The estimated maximum impact at the end of 2018 would be as set out in the following table (data YE2018):

Impact on SCRs of lowering SA from -10% to -17%					
	Total	**Life undertakings**	**Undertakings pursuing both life and non-life insurance activity**	**Non-Life undertakings**	**Reinsurance undertakings**
Equity risk	-19.4%	-20.9%	-19.7%	-12.0%	-4.2%
Market SCR	-5.6%	-5.8%	-6.7%	-5.1%	-2.4%
BSCR	-3.4%	-4.0%	-4.6%	-2.1%	-1.1%
SCR	-2.7%	-3.4%	-4.0%	-1.8%	-1.0%

The estimated maximum impact at the end of 2019 would be as set out in the following table (data YE2019):

Impact on gross SCRs of lowering SA from -10% to -17%					
	Total	**Life undertakings**	**Undertakings pursuing both life and non-life**	**Non-Life undertakings**	**Reinsurance undertakings**
Equity risk	-18,4%	-19,5%	-19,8%	-12,5%	-3,4%
Market SCR	-6,6%	-7,3%	-7,2%	-6,1%	-2,0%
BSCR	-4,3%	-5,1%	-5,1%	-3,1%	-1,1%
SCR	-1,6%	-2,0%	-2,2%	-1,3%	-0,5%

Impacts of the change in the SA's corridor at the end of 2019 are slightly lower than at the end of 2018. This is mainly explained by different diversifications effects between SCR modules.