Comments Template on Discussion Paper on the review of specific items in the Solvency II Delegated Regulation		Deadline 3 March 2017 23:59 CET
Name of Company:	Legal & General	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-16-008@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.** The numbering of the questions refers to the discussion paper on the review of specific items in the Solvency II Delegated Regulation.	
Reference	**Comment**	
General Comment	Legal and General Group Plc (L&G) welcomes the opportunity to respond to this extremely important consultation that has the ability to impact the productivity and well-being of citizens across the EU, and directly links to the EU's focus on delivering jobs and growth whilst ensuring the financial stability of the Union. As you may know, Legal & General, established in 1836, is one of the EU's leading financial services groups. At 30 June 2016, we had almost €1 trillion in assets under management for the benefit of our customers. We have made a commitment to investing in infrastructure, including urban regeneration, housing (including the private rental sector), clean energy, care homes and hospitals and we have already made over €8 billion of these types of direct investments.	

As a result of this, we believe that to deliver a strong European Insurance sector, we need a globally competitive and vibrant insurance sector underpinned by a regulatory framework which:

1. Delivers financial stability and confidence in the market place, which is essential for customers and firms;
2. Supports the sector creating and maintaining as many jobs as possible, with the associated societal and tax benefits this brings;
3. Encourages capital to be deployed as effectively as possible, with money invested in the most effective way to drive productivity and growth;
4. Drives down costs to consumers and/ or improves the value of their capital returns.

It is these objectives that we believe EIOPA should use in any assessment of the effectiveness of the current regulatory regime. In our view reform of parts of SII could bring about substantial benefits. In particular:

A. As a firm, we have already committed to deliver c.€17 billion of infrastructure investment. We could do this even more quickly than we currently are, which would deliver much needed development and investment. Indeed, if this is scaled up to consider other insurers, we believe the figure across the industry would be in excess of £50bn. This would equate to delivering c€170bn of economic activity, and therefore a significant improvement to the European Union's GDP[1] as well as the investment the country needs;
B. You could bring jobs, skills and expertise back to the EU, and stop the inevitable offshoring of key activities, especially in the reinsurance market.
C. A more proportionate regime would also allow firms to have a higher risk appetite for business with longer term guarantees, in-turn providing a greater pool of long-term assets for even more long-term growth and funding for infrastructure projects. It would also increase the sector's ability to facilitate the management of the pension liabilities of major corporates.
D. Enhance the simplicity and transparency of the regulatory framework, which would increase even further investor confidence in our sector and therefore allow our sector to play its full part in strong Europeanconomy.
E. By allowing resource to be deployed to more economically useful activities such as customer proposition design and away from unnecessary reporting and compliance requirements. We alone have already spent almost €200m implementing Solvency II, with thousands of hours to be spent going forward on unproductive and unnecessary compliance activity costing millions more.

F. Ensure regulatory effort is spent on the macro prudential issues rather than the policing the micro detail of business activity which regulators are not resourced to do.

We believe all of these benefits can be realised without negatively impacting the financial stability of the EU or eroding the high levels of consumer protection that are already in place.

L&G is an internal model firm. Given that many questions are directed at Standard Formula (SF) firms we have only answered questions which are relevant to our business and internal model. We continue to see the following issues as the key areas for review:

1. **Risk margin**

   The risk margin as formulated under Solvency II is demonstrably out of line with the market price for transferring risk. We provide in our response suggestions for alternatives that do align.

2. **Matching Adjustment changes**

   Whilst we recognise that this is predominantly a UK issue, we are raising it as the UK's supervisory authorities have recently inidicated to the UK Parliament that they feel constrained by the Directive text. We would recommend a more principles-based approach to the Matching Adjustment, resulting in considerably less operational complexity and a less binary split between eligible and ineligible assets. Any risks arising from assets should be allowed for via an appropriate allowance in capital requirements rather than resulting in complete ineligibility of a particular asset class.

3. **Balance sheet volatility & definition of Solvency Capital Requirement**

   The current formulation of the Solvency II balance sheet results in significant volatility in regulatory surplus. This is partly due to the risk margin, but also due to the strict use of a 1-year horizon for the capital assessment, with little regard to the position in the economic cycle. We recommend calibration of capital requirements to withstand the troughs of the economic cycle. We would also recommend reconsidering the approach of holding risk capital against a one-year event with a risk margin on top for long-tailed risks (e.g. longevity) – we believe it would be more appropriate to hold risk capital against the full, long-term risk directly.

	4. **Regulatory focus on "macro not micro" activity.** We recommend use of professional services/audit firms to provide on-going assurance over model integrity and review/oversight of model change in place of such review being done by the regulator. It would also allow for a more responsive model change and improvement process, allowing for more flexible and responsive deployment of capital (for example in infrastructure investment) and product innovation. The regulator could then opine on the more strategic issues which impact its statutory objectives. 5. **Transitional provisions** The approach to the calculation of transitional measure on provisions is highly complex. As currently formulated the transitional forces firms to maintain the capital calculation from the old Solvency I regime. This adds huge cost and complexity. We propose a simplification of the transitional regime allowing transitional provisions to flex in line with changes in market conditions without the need to constantly refer back to a redundant regime. To provide certainty and stability, we need a more principles based approach to recalculation to give a methodology that responds to changes in the market and the business and allows firms to make changes without needing regulatory approval (sign-off) for every change. 6. **Pillar 3** The disclosure requirements under Solvency II are excessive and of limited use to regulators, investors, intermediaries and policyholders. This produces a significant ongoing cost to insurers of producing the required information. Solvency II also requires quarterly reporting by insurers. The general trend for disclosures across global markets is to reduce the frequency of reporting to prevent short-termism. We recommend annual detailed reporting with more limited half-yearly updates. [1] The Institution of Civil Engineers state that every £1 of infrastructure construction raises economic activity by £2.84.	
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Q3.10	No. We can see no obvious reason for the differential treatment.	
Q3.11	One of the key issues we see to ensure a level-playing field between financial services, to promote competition and fairness, is consistency. We can see no obvious reason from a financial stability perspective for there no being a consistent approach between the legislation, and therefore would request that unless evidence can be provided to the contrary, then SII should incorporate the categorisation set out in Article 115 of the CRR.	
Q3.12	Please see answer to Q3.11.	
Q4.1	When SII was originally designed there was not an observable market for hedging longevity risk.	

	As a result, the ability to transfer longevity risk (along with other insurance risks) via reinsurance was not allowed for in the calculation of the Risk Margin. However, there is now a demonstrable market for longevity risk transfer and therefore an exponential growth in this RMT. This was not the "fault" of legislators as this market was in its infancy. However, there is now clearly an observable market. The size of the risk margin is of particular concern to any firm offering long tailed insurance risks, such as annuities in the UK. Without reform to allow for this development, SII damages the EU market now because: • The size of the Risk Margin means longevity risk cannot be retained in the EU causing business to be transferred to the United States, Canada and Switzerland. • In the short term, without reform to SII, we expect over 90% of the UK's longevity reinsurance will be undertaken by non UK insurance companies, whilst in the longer term we expect the whole business activity to be transferred out of the EU. These issues create a number of substantial consequences to the EU economy: • The consumer is made to buy products designed and manufactured outside of the EU system. This means the associated revenue, taxes and jobs will be outside of the country. • Additionally, the intellectual property, skills and capability will be outside of the EU. • The combination of (a) and (b) will help to cement the position of the United States and weaken the position of the EU as a global financial services hub. Indeed, as an example, the USA already manages and manufactures c.45% of the world's fund management industry. As a firm, we are the only top 10 player in the world headquartered outside of the USA, and we are tenth. • The impact of the Risk Margin on prices and the attractiveness of retaining risk is substantial. Firms are not deciding whether to reassure/retain risks on economic grounds but to avoid the Risk Margin. We estimate that in order for UK companies to retain longevity risk within the UK would require a reduction of the Risk Margin to less than 25% of current levels.	
Q4.2	Our answer below relates to the longevity reinsurance market, referenced in our answer to Q4.1, and therefore our answer to this question should be read in conjunction with our response to Q4.1.	

	Firstly, there is a legal contract between two parties which defines the risk transfer. This meets the requirements of Arts 208 to 215. You ask if there has been recent change, and the answer is yes, especially in terms of an observable market and therefore increased capacity. Index trades are increasing but most of our contracts are OTC. The change has been observed in the last few years, which is where the most considerable development has been. For example, we observe there to be 10-20 players willing to transfer many billions of longevity risk, with some single transactions as large as c€19billion. As an example, between 2011-2016 L&G transacted approximately €18bn of longevity re-insurance. This represents just over 25% of L&G's gross longevity exposure of €72m and is heavily weighted to more recently written business, including almost 90% of L&G's 2016 new business (exluding any new business which was accompanied by a transitional measure on technical provisions which substantially mitigates the Risk Margin). The inappropriate calibration of the risk margin has prompted us and other firms to now reassure up to 90% of new longevity risk, crucially to counterparties outside of the EU. We expect this to rise to 100%. Whilst the SCR reflects the longevity reassurance the definition of risks that can be hedged for the Risk Margin does not. The relevant legislative sections are : • L1 text, recitals 54 and 55 • L2 text, recitals 18, 19 and 130 ; and Articles 37-39	
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Q18.1	We do not have any specific concerns to raise with respect to the calculation of DTAs and DTLs on the base balance sheet that cause issues with the calculation of LAC DT. Fundamentally the	

	approach follows the principles of IAS 12, which are well tested and understood.	
Q18.2	We do not believe that specific assumptions on the returns on assets and liabilities should be set, and we consider that an approach such as the 'averaging' approach put forward would be significantly more onerous that the requirements of IAS 12. We would, however support the agreement of a set of principles to be applied at a local level. Such guidance should explicitly apply to both Standard Formula and Internal Model firms. Our response to 18.14 outlines some areas in which we feel guidance could be helpful to local regulators.	
Q18.3	Asset returns are modelled for a number of purposes, including in setting the BEL, and calculating both SII and IFRS audited balance sheets. The matter of uncertainty is therefore as much involved in these calculations as in the calculation of LAC DT. Given auditors and regulators reach a level of comfort in these cases, we consider that is should be equally possible for the calculation of LAC DT without a prescribed set of rules specific to this matter.	
Q18.4	In some jurisdictions the use of tax losses are subject to restriction – for instance through allowing offset of only a prescribed portion of losses in any period, or through expiry of unused tax losses after a certain amount of time. In these cases we would expect a firm to need to project both SII and fiscal profits and losses in order to model both the current and deferred tax impacts of a shock loss and subsequent recovery. For example, if the shock loss gave rise to a fiscal loss that would expire after five years, projections would be required to demonstrate both whether there were sufficient fiscal profits to utilise those losses within five years, and whether there would be sufficient SII profits to reverse any timing differences giving rise to deferred tax between the two accounting bases. Where there are no such restrictions it may not be necessary to undertake both sets of projections: Given the underlying presumption in IAS12 that assets and liabilities will be settled or recovered at their carrying value, then there is an assumption that any SII shock loss and subsequent profits would also emerge on a fiscal basis. Where losses can be offset in full against profits as they arise there should not be any need to then further model the timing of this.	
Q18.5	The primary considerations are : 1. The ability to recapitalise after stress in order to support the writing of future new business (for instance through raising debt or equity finance, or through other capital management	

	activities). 2. The number of years of new business we can assume, and the volumes of new business we might expect to see in those periods given the shock event. 3. The number of years' worth of profit we can model on that new business. 4.	
Q18.6	See response to 18.5 and 18.7	
Q18.7	When considering future profits it is relevant that, for long-term contracts, we undertake detailed modelling over the lifetime of these contracts for other purposes, and that modelling is reflected in our pricing and the liabilities recognised in the audited IFRS and Solvency II balance sheets. We do not consider that a different approach should apply to the LAC DT calculation than is applied for the purposes of other parts of the SII balance sheet. For new business, we understand it was envisaged that such projections should be based on a firm's usual business planning horizons. Regard should be had to the fact the businesses will project new business assumptions for an extended number of years for a number of purposes. For instance we are now producing projections for the ORSA process (which reflect up to 50 years of new business), and we consider longer term new business projections for a number of other purposes (e.g. when considering the supportability of dividends, the supportability of the Transitional Measure on Technical provisions for the PRA, and when looking at project initiatives). Given this we consider it appropriate to reflect longer-term projections in the calculation of LAC DT than were perhaps previously taken into account when business projection horizons were typically significantly shorter.	
Q18.8	The appropriate time horizon to apply will depend on a number of factors, including the type of business written and the actual shock loss scenario, and to limit the time horizon to an arbitrary figure would go significantly beyond the requirements of IAS 12. The significant work performed by firms on projecting future cashflows for other regulatory and internal management purposes should provide support for the ability to recognise profits over appropriate time horizons.	
Q18.9	We do not consider that this would be an appropriate simplification in the majority of cases, other than perhaps where a company does not write any new business and where the whole of its DTL is of a type that is appropriate to offset against a shock loss. Again, this simplification would mean effectively disregarding the rules set out in IAS 12. It is also relevant to note that we would expect the ability to recognise LAC DT against the DTL on	

	the base balance sheet to be one of the first points considered when firms are considering the recognition criteria of IAS 12. Therefore, to the extent that the simplification can be applied, we would expect it to already be so.	
Q18.10	As noted above we do not think this is appropriate. Some issues that would need to be considered that have not been set out in the discussion paper include: • The ability to carry losses back against profits of previous periods. Where this is possible the ability to recover the LAC DT is not in any way uncertain as it is based on past events, and therefore the considerations regarding uncertainties around future profits do not apply. In these circumstances a firm should be able to recognise this element of benefit. • Actual taxable profits emerging could be significantly higher than the gross DTL, due to the inherent discount in the DTL.	
Q18.11	We do not consider a full calculation would be necessary – just the material elements.	
Q18.12	Compliance with MCR and SCR should be taken into account fully in the calculation of LAC DT as it has to be assumed that the business is a going concern.	
Q18.13	To the extent that actions would genuinely be open to management then the calculation of LAC DT should reflect these. The ability to recapitalise is already a constituent part of the approach taken by many firms to justify the ability to write new business to support the DTA.	
Q18.14	As outlined in our response we do not consider there are any specific features of the LAC DT calculation which require additional regulation. We would however welcome further guidance, and in particular in respect of the following areas • Treatment of the risk margin (this has been the subject of significant debate in the UK). • Recognition of DTAs in respect of future group relief, and the evidence required to support this. • Economic assumptions for Solvency II cash flows and tax cash flows (earned income), and whether as a general principle it is possible for firms to assume investment returns greater than risk-free (including mean reversion), i.e. consistent with the IAS 12 treatment. • Projection horizons for new business. • How LAC DT impacts the ranking of scenarios.	

	We are aware that the CRO forum issued a detailed paper in 2016 based on discussions with firms across Europe, and this paper addressed a number of these points. Having reviewed the contents of this paper and light of our own interactions with the UK regulator (both through our internal model application process and through our membership of trade bodies) we remain concerned that the PRA would be unlikely to accept a number of these principles. In light of this, further guidance from EIOPA could be useful in guiding future interactions between the PRA and local firms as regards LAC DT.	
Q18.15	See our response to 18.14 – as outlined in our response we do not consider there is a specific need for further regulation, restrictions or relaxations in the calculation of LAC DT. Fundamentally there is no ‘one size fits all’ approach, and the ability of firms to apply the principles of IAS 12 in an appropriate way should stand as initially envisaged. However further guidance around principles could be helpful to inform discussions with local regulators concerning implementation.	
Q18.16		
Q19.1	Please also see our responses to Q 4.1 and Q4.2 as we believe one of the key issues is the treatment of reinsurance, in paticular longevity reinsurance We believe that the Risk Margin can result in inappropriate outcomes for long dated contracts with insurance risks, such as UK annuities and whole of life contracts. This has been seen as interest rates have fallen. We note that the fall in UK interest rates has been unhelpful for long dated liabilities, this may be less of an issue for long dated EUR denominated liabilities as the UFR has remained unchanged. The resulting risk margin does not result give a total TP that is market consistent, i.e. it does not represent the market observed cost of transferring the risk to a third party. Currently (Q3 2016) the RM is around 15% of the BEL for UK annuities, whereas the typical cost of reassurance is currently c.2%. UK firms are making decisions due to the uneconomic nature of the Solvency II capital regime. In practice, we would need a RM of c5% before we became economically indifferent to retaining/reassuring the risk and then made purely risk based decisions. In recent years we have seen the development of the longevity reassurance market, as we set out in our response to questions Q4.1 and Q4.2. In practice, this has been driven by large risk margins and firms needing to manage their balance sheet effectively. We beleive that the list of risks in Art	

38(1)(i)(i) should be reconsidered to recognise that the reference undertaking could reassure risks transferred to them.

We have developed an approach to the calculation where RM is underpinned by the observed market price for reassurance and which we believe meets the Directive requirements. If this were followed we would make economically rational decisions, based on our appetite for risk, without impacting on our financial stability.

There are potentially two options for delivering reform. These represent either end of a spectrum of changes and it would be possible to combine some of each approach. It may be appropriate to adopt alternative 2 in the short term as this requires less regulatory change, whilst drafting the revised regulations for alternative 1 (our preferred outcome).

Alternative 1 for resolution ("recapitalisation cost"):

1. We would advocate that a provision representing the insurer's cost of recapitalising themselves, following a 1-in-200 stress event such, which would, conceptually, deliver the same outcome as the risk margin, but allow for a more evidence-based and economically rational calculation. We would not advocate a detailed set of rules for the calculation of this, but would expect the following broad principles to apply:
   a. The recapitalisation cost is based on the cost of supporting the Solvency Capital Requirement[1] over the lifetime of the business;
   b. All components (including market risk) of the Solvency Capital Requirement would be included;
   c. Management actions would be allowed for, including taking actions to "de-risk" through internal and external measures;
   d. The cost of capital would be based on the insurer's own cost of capital; and
   e. Where the insurer's liability is long term in nature, excess returns on the assets invested to back the capital can be allowed for.

Alternative 2 for resolution ("modified risk margin"):

2. An alternative approach would be to modify the existing risk margin rules to make them

[1] The Solvency Capital Requirement (or SCR) is the capital required to be held by insurance companies (and insurance groups) under Solvency II. It represents the amount the company could lose over one year with a 1-in-200 probability.

	more principles-based and future-proof: a. The definition of risks as hedgeable/non-hedgeable to be removed from the regulations and replaced by an assessment by the regulator/firms; and b. Future management actions to be explicitly allowed for in the risk margin formulae (arguably these are already implicitly allowed for, but this, or clear guidance from EIOPA, would make it explicit), including taking actions to “de-risk” through internal and external measures;	
Q19.2	The Cost of Capital is a judgment. In our opinion the Risk margin problems do not stem from the CoC rate but from the combination of low interest rates and the longevity stresses used. Provided that the calculation is adjusted for developments in the longevity reassurance market (see Q19.1) and to allow the resulting risk margin to be referenced to market observed prices for risk transfer, we do not see a strong case for changing it. For UK annuities, in current market conditions, we would need the CoC to fall to c.2% to give a RM that we think is market consistent, which we think is unfeasible. We also have material concerns that a CoC that is dependent upon market conditions could be pro-cyclical and equally judgmental. It is not clear to us that the CoC could or should be linked solely to interest rates ; if it linked to wider market conditions it becomes increasingly difficult to set objectively.	
Q19.3	Yes. As economic conditions have changed (falling interest rates and rising inflation expectations) the risk margin has increased from approximately 7% of BELs on end-2010 market conditions to approximately 12.5% as at end Q3 2016. Whilst we have a transitional measure on technical provisions to offset the change on pre-2016 business the risk margin on new business is not ‘hedged’. L&G now reassures 90% of its longevity risk and we expect this to increase to 100% - notwithstanding the fact that we believe that this is a risk for which we are rewarded if we retain it. As we set out in Q19.1, we would recommend that EIOPA should recognise the ability of firms to	

	de-risk by purchasing longevity (and other) reassurance. The RM should be underpinned by the cost of purchasing reassurance.	
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