

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

Name of Company:	Legal and General Group plc	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ 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 <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, <u>in Word Format</u>, to CP-17-006@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p> <p><u>The numbering of the reference refers to the sections</u> of the consultation paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. Please indicate to which paragraph(s) your comment refers to.</p>		
Reference	Comment	
General Comment	<p>We welcome the opportunity to respond to EIOPA's consultation paper CP-17-006 on its second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation.</p> <p>L&G is an internal model firm and so many of the sections are not relevant to us. We have restricted our comments to areas which do impact our balance sheet, or which have the potential for read across from the SF to Internal Models.</p>	

**Comments Template on
 Consultation Paper on EIOPA's second set of advice to the European
 Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
 5 January 2018
 23:59 CET**

Introduction		
1.1		
1.1.1		
1.2.1		
1.2.2		
1.2.3		
1.2.4		
1.3		
1.3.1		
1.3.2		
1.3.3		
1.3.4		
1.3.5		
1.4		
1.4.1		
1.4.2		
2.1		
2.2		
2.3		
2.4.1		
2.4.2		

Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
2.4.3		
3.1		
3.2		
3.3		
3.4.1		
3.4.2		
3.4.3		
4.1		
4.2		
4.3		
4.4		
4.5.1		
4.5.2		
4.5.3		
5.1		
5.2		
5.3		
5.4.1		
5.4.2		
5.4.2.1		
5.4.2.2		
5.4.2.3		
5.5.1		
5.5.2.1		
5.5.2.2		

Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
5.5.2.3		
5.6.1		
5.7.1		
5.7.2.1		
5.7.2.2		
5.7.2.3		
6.1		
6.2		
6.3.1		
6.3.2		
6.3.3.1		
6.3.3.2		
6.3.3.3		
6.4.1		
6.4.2		
6.4.3.1		
6.4.3.2		
6.4.3.3		
6.5.1		
6.5.2		
6.5.3.1		
6.5.3.2		
6.5.3.3		
7.1		
7.2		
7.3		

Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
7.4.1		
7.4.2		
7.4.3		
8.1		
8.2		
8.3		
8.4.1		
8.4.2		
8.4.3		
9.1		
9.2		
9.3		
9.4.1		
9.4.2		
10.1		
10.2		
10.3		
10.4.1		
10.4.2.1		
10.4.2.2		
10.4.2.3		
10.4.2.4		
10.4.2.5		
10.4.3		
11.1		
11.2		

Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
11.3		
11.4.1		
11.4.2		
11.4.3		
12.1		
12.2		
12.3		
12.3.1		
12.3.2		
12.3.3		
13.1		
13.2		
13.3		
13.4.1		
13.4.2		
13.4.3		
14.1		
14.2		
14.3		
14.4.1		
14.4.2		
14.4.3		
15.1		
15.2		
15.3		
15.4.1		

Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
15.4.2		
15.4.3		
15.4.4		
16.1		
16.2		
16.3.1		
16.3.2		
16.3.3		
17.1		
17.2		
17.3		
17.4.1		
17.4.2	<p>In summary we are supportive of the aim of fostering supervisory convergence, and agree that it would be useful for further guidance to be issued to supervisory authorities with the aim of setting out some key principles. We also agree that proportionality should play an important role in the implementation of these principles, and that different levels of complexity should be dealt with by the application of such principles. However, ensuring that the availability of simplified assumptions does not result in inflexibility for internal model firms should be key – more complex firms should not find that overly prescriptive key principles result in an overly simplistic approach or a framework that is too prescriptive and sets too high a bar for deviating from those key principles.</p> <p>We've set out below some comments on the key principles being proposed. Whilst these proposals would only apply to SF firms we've considered how they might impact L&G if used as a basis for the IM firms where we would expect national supervisors to retain their current use of judgement.</p> <p>Key principle 1: Role of compliance with the MCR and SCR after shock loss</p> <p>We agree that compliance with MCR/SCR after the shock is relevant to calculations of future</p>	

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

profits.

- EIOPA have noted that they would not expect undertakings using the standard formula to explicitly determine the compliance with their MCR and SCR, however does expect that all undertakings reflect the extent of compliance with their MCR and SCR in their assumptions used for their projections of future profits – i.e. if the shock loss would be close to, or an actual breach of the SCR or MCR, assumptions regarding likely future profits should reflect this.

We think that this is reasonable.

- EIOPA have suggested the application of a formulaic approach. For instance:
 - If MCR not met after the shock loss, disregard all future profits;
 - If SCR not met, but MCR is met, take proportionate account of the likely future profits from new business;
 - If SCR is met take full account of likely future profits, taking account of the post-shock environment.

We do not support a formulaic approach requiring firms to take an explicit haircut of a specified amount. Part of the reason for this is that items such as management actions may be available to remediate this. To the extent that actions would genuinely be open to management (i.e. are capable of being carried out and would be likely to be carried out in a post-shock scenario) then the calculation of LAC DT should reflect these. This should be left to supervisory judgement and oversight.

It is also not clear how that the formulaic approach proposed meets the “probable” (i.e. “more likely than not”) principle for DTA recognition under IAS 12.

Key principle 2: Future profits stemming from new business – projection assumptions

EIOPA note that future profits stemming from new business should be calculated using assumptions which are consistent with those used to determine own funds, and that the

**Comments Template on
Consultation Paper on EIOPA’s second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

assumptions of these projections may need to be more prudent than for the calculation of technical provisions. In order to implement this principle they propose using the concept of “Economic New Business Value” which is the day-one profit or loss of contracts sold when these are valued according to the Solvency II valuation principles for technical provision.

In the UK this principle is not consistent with the PRA’s Supervisory Statement which says that new business profit projections need to be calculated on the tax base position of the entity in question which for the L&G UK insurance entities means the IFRS basis.

We disagree with the introduction of further prudence in to the assumptions used and think that the PRA’s approach is more appropriate.

Key principle 3: Future profits stemming from new business – projection horizon of future profits stemming from new business

EIOPA note that undertakings should ensure that any forecast of post-shock new business should reflect the impact of the shock loss on the amount of likely new business. The paper suggests that one possible way to do this would be to cap the total future profits stemming from new business after the shock loss at a proportion of the total profits stemming from new business realised in the recent past.

“One could expect the total future profits stemming from new business not to be greater than 50 percent of the total profits stemming from new business realized in recent years and 50 percent of the total future profits stemming from new business assumed in the business plan.”

Whilst we agree that it may be useful to assess new business profits post-shock by reference to evidence of new business profits prior to the shock, we do not support such a prescriptive formulaic approach as set out, and especially without an understanding of the calculation of the 50% threshold suggested. Not only does the 50% seem arbitrary even for impacted product lines, companies could also have multiple business lines, some of which may not be impacted by the shock (e.g. general insurance business not negatively impacted by a longevity shock). In these cases a ceiling of 50% on profits of that business line would be entirely inappropriate.

We acknowledge that some undertakings may prefer to apply such an approach for the purposes

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

of simplicity; however any guidance issued by EIOPA would need to be clear that this is not a default assumption, nor should the recognition of greater than 50% be subject to a higher level of scrutiny. The default approach should be to fully assess the impact of the shock loss, with the 50% ceiling route available for those firms who wish to apply a simpler methodology.

The paper also suggests that the uncertainty around projected future profits arising from new business can be reflected by limiting the horizon of projection of future profits from new business: for instance, applying a reduction factor to the profits from new business after the first 3 years, or only allowing 5 fiscal years of projected future profits from new business in full, and nothing thereafter. We disagree.

Businesses will now 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 for the profits arising on new business, consistent with current business management practices.

If it is considered appropriate to apply a cap or a haircut, such restrictions should be applied on a case by case basis, depending on the type of business involved.

Again, we acknowledge that some undertakings may prefer to apply such an approach for the purposes of simplicity; however this should not be the default assumption.

Key principle 4: Future profits stemming from new business – projection horizon of new business sales

EIOPA state that where used to determining likely utilisation of LAC DT, the horizon over which new business sales can be projected should reflect uncertainty. They propose restricting new business to 5 years' worth of new business. We disagree. Whilst we accept that a higher degree of uncertainty should be attached to potential sales beyond five years it is not realistic to assume that no new business would be sold – we would expect firms to be able to allow for business in all

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

future years but with an appropriate allowance for uncertainty. We note also that restricting new business to 5 years is not consistent with the principle of the entity remaining a going concern post stress.

Key principle 5: Future profits stemming from return on assets

EIOPA state that the return assumptions used should take into account the shock loss for market risk and its impact on the economic environment. They suggest restricting returns to risk free returns on assets.

We would not support this approach. Where there is good evidence to support returns above risk free it should be possible to reflect these in future profits for LAC DT.

Key principle 6: Future profits stemming from return on assets in excess of technical provisions – projection horizon

EIOPA suggest that the horizon used for the projection of future profits stemming from assets in excess of the technical provisions could be limited to the time horizon over which new business sales have been considered, with a maximum of, for example, 5 years, or a weighted time horizon of technical provisions.

Again we disagree. Returns will be made over the full run off of the business. In making these assumptions about the expected return, we recognise that asset return recoveries are something over which an undertaking may have minimal control, in which case a shorter time horizon may be appropriate to reflect the greater uncertainty.

Key principle 7: Future Management Actions (FMA)

EIOPA are concerned that allowing for future management actions without limitations and safeguards bears the risk that the eligible own funds after the shock loss and both the MCR and SCR after the shock loss are changed in such a way that LAC DT is unjustifiably maximized.

As noted in our comments on Key Principle 1, to the extent that actions would genuinely be open to management (i.e. are capable of being carried out and would be likely to be carried out in a post-shock scenario) then the calculation of LAC DT should reflect these. We appreciate EIOPA's

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

	<p>concerns around the possibility of assumptions being made purely for the purposes of maximising LAC DT and agree with comments on uncertainties arising due to externalities.</p> <p>EIOPA suggest various limitations to FMA which we disagree with. Again we would expect firms to be able to make thier own assessment and discuss this with their local surpervisor.</p> <p>Key principle 8: Role of system of governance</p> <p>Whilst we support strong governance around the calculation of and assumptions underpinning LACDT and consider linking to the ORSA desirable, we'd only support these proposals to the extent that they did not create unwarranted additional work and the level of governance is consistent with the materiality of the judgements being made.</p> <p>Key principle 9: Supervisory reporting and disclosure</p> <p>Whilst we have no objection to disclosing further information we would note that the disclosure burden under Solvency II is already considerable. As an internal model firm we already share a considerable amount of our work on LAC DT with our supervisor.</p> <p>As noted by EIOPA, the calculation of LAC DT is highly complex – any public disclosures would have to be carefully designed to ensure that the information provided is helpful and does not lead to confusion.</p> <p>Possible simplified calculation of LAC DT</p> <p>We have no objection to a simplified calculation being available for those who wish to use it; however we do not consider that such calculation should become mandatory for all firms.</p>	
17.4.3		
18.1		
18.2		
18.3	<p>The Risk Margin as formulated is excessively large, excessively sensitive to interest rates, and inappropriate for certain long-term products – in particular annuities. We are therefore disappointed that EIOPA have elected to conduct a very narrowly focused review – considering only a single</p>	

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

parameter in the Risk Margin calculation (the Cost of Capital rate). We would urge EIOPA to consider broader issues around the Risk Margin framework as soon as possible, rather than remaining wedded to methodologies first derived in 2007-2008.

We are also disappointed that EIOPA do not propose to make any changes to the Cost of Capital rate, despite extensive stakeholder input from across Europe demonstrating that the current 6% rate is too high. We consider that the derivation of the CoC rate does not take in to account the unique risk profile that the reference undertaking would exhibit. We consider that a value of 2-3% for the CoC rate is appropriate, yet remains prudent.

We would emphasise the purpose of the Risk Margin, as set out in Article 77.3 of the Directive – to reflect the cost of transferring liabilities to a third party. Market data suggests that the current formulation gives a Risk Margin that is far in excess of the market price for the transfer of (longevity) risk and therefore does not meet the Directive requirements. It is unclear what work EIOPA have done to assess the true transfer cost for different lines of business, and whether the Risk Margin genuinely simulates that in a reasonable way across a range of products.

We are aware that industry (CFO Forum, Insurance Europe and ABI) has provided highly detailed responses to EIOPA on the Risk Margin and we have provided input in to those responses and are supportive of the conclusions. In the interest of brevity we have not repeated those arguments in our response.

Detail – Allowing for Hedegability of Longevity Risk

EIOPA comment that it is not clear why the reference undertaking should apply more (or less) risk mitigation than the original undertaking. Equally, it is not clear why the amount should be unchanged – the reference undertaking adopts a subset of the original risks and will set its own risk appetite. Additionally, we note that there is already an implicit assumption that the reference undertaking hedges out all market risk, which is different to the approach of the original undertaking.

As currently formulated the Risk Margin exceeds the cost of purchasing reinsurance – it would be economically rational for the reference undertaking to reassure as much risk as possible to realise

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

	<p>the significant profit that the Risk Margin represents.</p> <p>In our original response we set out a formulation of the Risk Margin that allowed for the assumption of future management actions, including the costs of purchasing that reinsurance.</p>	
18.4.1		
18.4.2		
18.4.3		
19.1		
19.2		
19.2.1		
19.2.2		
19.2.3		
19.2.4		
19.2.5		
19.2.6		
19.3		
19.4.1		
19.4.2		
19.4.3		
19.4.4		
19.5.1		
19.5.2		
19.5.3		
19.5.4		
19.6.1		
19.6.2		

Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
19.6.3		
19.6.4		
19.7		
20.1		
20.2		
20.3		
20.4.1		
20.4.2		
20.4.3		
20.4.4		
21.1		
21.2		
21.3		
21.4		
21.5		
21.6		
21.7		
21.7.1		
21.7.2		
21.7.3		
21.8		
21.8.1		
21.8.2		
21.8.3		
21.9		
21.10		

Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
21.11		
21.12		
21.13		
21.14		
21.15		
21.16		
21.17		
21.18		
21.19		
21.20		
21.21		
22		
23		
24		
25		
26		
27		
28		
29		
30		
31		
32		
33		
34		
35		
36		

