Written evidence submitted by the Association of British Insurers (ABI) (FSMB27)

Financial Services and Markets Bill Committee

The UK insurance and long-term savings market and the ABI

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive and inclusive sector, our industry supports towns and cities across Britain in building back a balanced and innovative economy, employing over 300,000 individuals in high-skilled, lifelong careers, two-thirds of which are outside of London.

The UK insurance and long-term savings industry manages investments of over £1.9 trillion, contributes over £16 billion in taxes to the Government and supports communities across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

The ABI represents over 200 member companies, including most household names and specialist providers, giving peace of mind to customers across the UK. Please note we would be happy, and stand ready, to provide further information if this would be helpful to HM Treasury.

For the purposes of this response, 'insurers' refers to insurance, reinsurance and long-term savings companies.

Consultation response

1. We welcome the opportunity to feed in comments as the Bill Committee conducts its line-by-line scrutiny of the Financial Services and Markets Bill (FSM Bill). This Bill is the most significant affecting the regulation of our sector for many years. It has the potential to fulfill its fundamental need to adjust the regulatory landscape, developed while a member of the EU, to one better suited to the needs of the UK and allow Parliament to take up the opportunities offered by Brexit. The Bill makes much needed improvements towards the right balance of ensuring accountability of the regulators to those setting the policy outcomes, while maintaining the right level of regulatory independence, although we believe further measures are required to ensure the Government's ambition is realised and there is robust parliamentary scrutiny of the regulators.

2. Our starting position has always been the need for fair, robust external challenge that supports a regulatory culture that is honest and open, and that considers the full range of implications of its actions on the UK, and how they meet the policy outcomes intended by the UK Government. In an ever-evolving world, if the UK is to retain its enviable status as a global financial services centre then the process of developing regulation also needs to evolve and be improved. This is emphatically not about deregulation or undermining financial stability or consumer protection, it is about pragmatic reform and ensuring that we have a regulatory environment that meets the needs of the UK, is agile and able to adapt to changing economic circumstances while retaining world leading standards for policy holder protection that our sector is renowned for.

3. We offer our views to the members of the Bill Committee on the issues of most importance to our sector. We believe we are particularly well placed to offer insights through our current and live experience of how the review of Solvency II is developing, especially as it is one of the first fundamental tests of the regulators and their culture outside the confines of the EU. We look forward to continuing to work with Government and Parliament as the Bill progresses to ensure that the Government's objectives on Solvency II and the Future Regulatory Framework can be delivered.

Statistical objective

4. As expected, the FSM Bill introduces a new secondary statutory objective for the regulators on competitiveness and growth [Clause 24]. To date we have continued to argue for this objective to be primary if it is to be given the full and proper consideration by the PRA and FCA that is needed. Without a primary statutory objective for economic growth we are sceptical that there will be the meaningful change needed to evoke a shift in approach/culture by the regulators, and that in absence of an appropriate re-balancing of their primary objectives, regulators' existing primary objectives may override any genuine consideration of the contribution their work makes to economic growth.

5. We are, however, mindful that there may not be appetite to take forward such a bold measure, and indeed if this is the case then it is crucial that there are sufficient tools and measures in place to ensure that the secondary objective is made meaningful. Regulators should not be allowed to simply give it token gesture, for example once a year in their annual report, [Clause 26], but should be required to demonstrate that they are considering it on an ongoing basis.

6. We do not believe the current proposals are sufficient, and the opportunity for improved accountability is falling short, however, the introduction of some additional measures will help to address this imbalance:
   - HM Treasury should set out key metrics that the regulators are to be measured against and the regulators should be required to report on them.
   - When notifying the Treasury Select Committee (TSC) of consultations the regulators should be required to comment on how they have considered the secondary statutory objective, even if they have not advanced it. "The notification must *specify the parts of the consultation* ***(if any)*** *that address the ways in which the proposals subject to consultation (a) advance the PRA's objectives.* **"** [Clause 36 (3). 36(4) for the PRA and (2) 28 (4) for the FCA] We believe removing "**if any**" and adding a requirement to comment on what consideration has been made of the objectives, should assist in securing its ongoing consideration when the regulators prepare regulation.
   - We also believe that the Bill should mandate the consideration of the statutory objectives in its Cost Benefit Analysis (CBAs) (see below), and that how this has been conducted and concluded should be made public.

Rule review

7. The new proposed powers for HM Treasury to require the regulators to review their rules [Clause 27] and to require the making of rules by the regulators [Clause 28] are welcome tools to enhance accountability and hold the regulators properly to account in formulating and implementing regulation within the legislative parameters set by Parliament.

8. The recent (and ongoing) experience with the review of Solvency II shows that there can be situations where the regulators are not willing to act in line with the policy intentions of Government/ Parliament, and that there could be situations where HM Treasury or Government should be able to ask the regulator to think again.

9. HM Treasury has been public and vocal about its objectives underpinning the ongoing Solvency II review:
   - to spur a vibrant, innovative, and internationally competitive insurance sector
   - to protect policyholders and ensure the safety and soundness of firms
   - to support insurance firms to provide long-term capital to support growth, including investment in infrastructure, venture capital and growth equity, and other long-term productive assets, as well as investment consistent with the Government's climate change objectives.

10. Despite this clear positioning, the PRA's subsequent Quantitative Impact Study (QIS) and Qualitative Questionnaire in July 2021 neither acknowledged HM Treasury's overarching intent nor demonstrated how the regulator's proposals would meet these objectives. It was unclear how the regulator's proposals in both of these exercises supported the creation of a modern prudential framework equipped to address these fundamental needs. An independent report by WTW from February 2022 on the impact of the QIS showed how the PRA's proposals would stifle insurers' abilities to play a much larger role in their capacity as long-term institutional investors and providers of long-term capital to underpin growth and investment consistent with the Government's green and Levelling up agendas. Another independent report also from WTW (July 2022) demonstrated that under the PRA's latest reform proposals from April 2022, there would be no net capital release from UK annuity providers, and hence no added capital for growth consistent with Government objectives.

11. We hope this offers members of the Bill Committee a useful example of the need for greater regulator accountability and underlines the importance of rule review clauses – particularly if the current rules are no longer appropriate, or if

there is evidence to suggest that the rules are not achieving their purpose.

12. To preserve the stability and certainty of regulation, which is of crucial importance to firms and their confidence in the market, these powers need to be used rarely. It may be that for those concerned about political interference or overstepping the line with regulators' independence, some key parameters are put in place to ensure the powers are not used flippantly. We, however, support the intention and the need for rule review powers.

13. As the stated intention is to ensure that legislation is operating as envisaged including in the public interest, we believe further additions could be introduced to enhance this:
    - Clause 27 (3RC): remove the 12-month time limit. If there are early signs of unintended consequences or implications that harm firms and their customers, it is difficult to understand why the process of review should not be immediate. Surely it would be preferable to minimise the detrimental impact rather than leave it to do further harm for an extra year.
    - Clause 27 (3RC): an additional factor under which HMT could require a rule review should be when the regulators continue to pursue regulation despite a negative assessment of the CBA panel.
    - Clause 28 (2) (3): it is self-defeating to constrain HMT's ability to set out preferred outcomes of a rule review, and undermines the value of this tool. This ability should be strengthened to enable HMT to be more specific about what rules they make and what outcomes they would like the regulator to achieve. This would tighten and provide clarity of scope for regulators' rules and enable accountability to be more rigorous. These constraints should therefore be removed.

Cost benefit analysis

14. The new Cost Benefit Advisory Panel [Clauses 40-42] will be consulted on the preparation of a CBA and the (new) CBA statements of policy, as well as keeping under review the general performance of the regulators on CBAs and any consequent recommendations. While this is a welcome step in the right direction to improve the quality of CBAs, we are concerned at the lack of required independence of the Panel members, and believe additional measures should be introduced to strengthen the CBA framework further so regulators give CBAs the full attention they deserve.
    - Clause 40 [(2), (7) for the FCA, and (3), (7) for the PRA] stipulates that the members of the panel are to be appointed by the regulators respectively. We are concerned that this arrangement does not offer the robust independent challenge that is much needed to ensure that the Panel is a supportive but also critical friend. We believe HM Treasury should be much more involved in the process of appointing members to the Panel, including issuing guidelines around the composition and giving approval to all appointees. This should also ensure there is no conflict of interest in those appointed.

15. Furthermore, the views of the CBA Panels are also not required to be made public other than "from time to time in such a manner as [the regulator] thinks fit".
    - Clause 40 [(2), (10) for the FCA, and (3), (10) for the PRA]. We believe any assessment or consultation of the CBA panel should be made public and given to the Treasury Select Committee. We recognise the need for members of the panel to be able to speak freely, but their final collective conclusions will not undermine this. Making the views of the CBA Panel public, and giving it to Parliament, will improve transparency and aid scrutiny, including supporting the work of the new Treasury Sub-Committee in scrutinising financial services regulations.
    - We also believe the CBA panels should be given an explicit power to recommend improvements to a CBA, and use a traffic light system to rate them. This is a well-established approach used by the Regulatory Policy Committee which considers how non-financial services regulatory proposals can impact business and civil society organisations. These views are then made available to parliamentarians when scrutinising proposed legislation. We believe this would be a good model to adopt.

16. The new requirement for the regulators to prepare and publish a statement of policy in relation to CBAs, includes information about the methodology used. In addition, we believe there should be a requirement to include information and engagement in consultation with industry, and for the CBAs to reflect the regulators' consideration of their statutory objectives.
    - Clause 41 [(2), (2) for the FCA and (3), (2) for the PRA] should see further mandated information in the statement of policy in relation to cost benefit analysis.
    - In addition, further amendments should be made to FSMA 2000 138I (FCA) and 138J (PRA) to formally embed the consideration of the statutory objectives in the cost benefit analysis, and not to solely explain it in the subsequent published draft rules, as currently required.

Legislation vs rulebook (Solvency II)

17. The Bill revokes EU legislation, including Solvency II, and gives power to HM Treasury to amend the legislation and designate activities to the regulators.

18. Unlike other financial services sectors, the prudential regulation of the insurance and long-term savings industry is not set by an international standard setter, such as the Basel Committee on Banking Standards. This means that there are no detailed regulatory perimeters within which the PRA must operate, and potentially an extremely vital level of oversight is lost. We strongly believe that where there are no international standards, such as in insurance and long-term savings, HM Treasury must have a greater role in setting out in detail some core assumptions in legislation that directs the PRA in its own rulemaking power.

19. The opportunities in Solvency II to realise the UK's ambitions on the green agenda and levelling up, including through investments in infrastructure, have been consulted on and discussed at length for several years, and should be ready for legislating. It is therefore welcome that the Bill allows for HM Treasury to amend legislation in a transitional period ahead of it being revoked, including when it is in the interests of "facilitating the international competitiveness of the economy of the United Kingdom and its growth in the medium to long term" (Clause 3. 2.e).

20. Solvency II reform must be implemented in a way that is fit for purpose and provides industry with the levels of certainty it needs to operate. To facilitate this, there is a need for key elements of the framework, including crucial features and core principles to be in legislation, ensuring these elements remain in place in the medium and long-term. This would offer industry the necessary certainty while also enabling proper scrutiny of the regulators and their policies, and giving the regulators freedom to implement technical detail and adapt their regulatory and supervisory approach to changes in the external environment.

21. For these reasons getting the right balance of legislation and delegation of rule-making to the PRA for the insurance and long term savings sector is crucial to the successful delivery of Solvency II. We believe the Bill gives HM Treasury the right tools to do this, and we will await the relevant legislation.

The Insurance Practitioner Panel

22. The Insurance Practitioner Panel is to be established to represent the interests of practitioners involved in insurance. [Clause 39]. The PRA is only required to appoint "one person representing PRA-authorised person engaged in the activity of effecting or carrying out contracts of insurance". We recognise that this does not prevent the PRA appointing additional practitioners, however given the varying interests and perspectives of the insurance sector, we believe that there should be a minimum of two to ensure expertise in both general insurance and the long term savings sector.

Critical Third Parties

23. It is the view of the ABI that in designating a third party as critical under Section 312L(4)(a), HMT should take into account views from relevant regulated firms with the aim of providing useful industry insights, highlighting any issues that may arise in practice and mitigating against any inadvertent consequences.

24. To ensure that the relevant regulator and relevant regulated firms are aware of any unintended, and potentially detrimental, consequences by virtue of a power of direction under Section 312N, the regulator must produce an impact analysis. A direction by a regulator to a CTP to do, or refrain from doing, something may result in a market concentration risk for regulated firms if only few viable alternatives to the CTP and the services they provide exist - which may also lead to suppliers' price increasing as demand rises by promoting an anti-competitive environment where consumers face poor service continuity and may, as a consequence, suffer detriment.

25. The ABI agrees with the current proposals for the relevant regulator, when issuing a power of direction under Section 312N, to provide notice to the Critical Third Party. However, the ABI believes when issuing a power of direction, the duty to give notice should be extended to regulated firms receiving services from that CTP. Failure to notify relevant firms is likely to promote an environment where consumers face poor service continuity as relevant firms, if not made aware of the notice, would not be given the opportunity to adequately prepare, mitigate any risks to consumer protection, and/or apply such measures as necessary to protect consumers' best interests. In addition, extending the duty to give notice to regulated firms receiving services from relevant CTPs would also allow firms to adequately manage their own operational resilience and accordingly conduct internal

risk assessments to reduce any unintended and/or detrimental consequences which may occur as a direct or indirect consequence of the direction.

Insurers in financial difficulties

26. The Bill introduces enhanced regulations around insurers in financial difficulties. This includes provisions [Clause 51] on powers of the court in relation to liabilities of an insurer that is or is likely to become unable to pay its debts (write down orders) [Schedule 12] and the enforcement of contracts where the insurer is a party in insolvency proceedings [Schedule 13]. We recognise that these provisions are needed to appropriately adapt the framework to a UK model and to introduce the clarity and necessary enhancements to the existing provisions as a result of a HM Treasury consultation on Insolvency Arrangements for Insurers, however, we would urge against further amendments that would predetermine the outcomes from a forthcoming HM Treasury public consultation on a UK specific Insurance Recovery and Resolution regime.

Advice and Guidance

27. With implementation of the FCA's new Consumer Duty and the introduction of the Financial Services and Markets Bill, we believe that now is the right time for Government to work with the FCA to reform the rules on advice and guidance. The FCA's announcement of a review is welcome, and it is right to approach it in a holistic way. As the Bill progresses through Parliament, we urge HM Treasury to set out its own role in the review and expectations of it, including timing and the necessary amendments to the MiFID definition of financial advice. The need for reform is urgent, with consumers facing complex retirement decisions and investing in an uncertain environment, so we urge the Government and the FCA to take action in the meantime where it is needed.

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