Pension Insurance Corporation plc
Response to "Call for written evidence: Financial Services and Markets Bill"

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Executive Summary

1. Successive Governments have evolved a regulatory architecture and an approach to financial services regulation which could be summarised as extremely risk averse, inconsistent in approach – not least between the heavily regulated parts of the financial services sector and the shadow banking sector – and lacking democratic accountability. This has allowed an overly technocratic approach to the political problem of how best to balance the economic needs of the country with the protections that we must maintain for the end users of financial services, including policyholders.

2. Aside from undesirable regulatory arbitrage opportunities, such as the much debated pension superfund concept, the system as currently constituted means that insurers, asset managers, and pension schemes (to take a limited number of business model examples), are all overseen by separate regulators. Each have their own areas of focus, and none are tasked with not only looking at the financial services sector as a whole, but also how the financial services sector can best support the wider economy over the long term.

3. The recent problems resulting from the use of Liability Driven Investment ("LDI") strategies by defined benefit ("DB") pension schemes to manage their assets and liabilities amply demonstrate the real world consequences of this approach, including but not limited to higher interest payments for the taxpayer on Government debt, the mortgage market gyrations, and the grave political consequences.

4. The Financial Markets and Services Bill offers an opportunity to re-evaluate the effectiveness of the existing regulatory architecture, develop greater levels of Parliamentary accountability and transparency, and help prevent similar occurrences in the future by ensuring a coordinated approach to regulating the entire financial services sector, properly managing macro risks.

5. As a leading, long-term investor in the UK's economy, with more than £10 billion invested in areas like urban regeneration, social housing, the UK's universities, and renewable energy in order to securely back our policyholders' pensions over coming decades, we believe this Bill also presents a generational opportunity to create a virtuous circle of greater investment in UK economic growth, leading to more pensions being protected whilst maintaining existing policyholder protection, in part by streamlining and clarifying regulatory roles and duties.

6. Our key asks for the Bill, and the wider reform process, are:

    a. **The right regulatory architecture, including expanding the regulators' objectives to include growth and competitiveness**. Notwithstanding the PRA's stated intention within its latest discussion paper[1], our view is that the right set of duties includes a rationalisation of the existing set of objectives to clarify the regulators' approach to their primary objectives, secondary objectives, statutory principles and 'have regards'.

    b. **Systematic, and sustained, oversight of regulators by Parliament**. The Bill makes progress in certain areas, but we feel that it still falls short of the forms of scrutiny and debate necessary between regulators, industry, consumer groups and others on how regulation has been delivered in line with the regulators' objectives. Given the substantial impact of regulation on the ability of long-term investors to support growth, as well as consumers' access to finance, and financial resilience, we believe there is a pressing need for a new scrutiny mechanism to support the Treasury Select Committee and the Treasury.

    c. **Transparency from the regulators**. We welcome many of the measures in the Bill around cost-benefit analyses, industry panels and transparency to Parliament, noting the PRA's recently stated recognition of the importance of this type of approach[2].

7. These reforms would ensure that the regulators have an appropriately prioritised set of clear objectives, that these objectives are carried out in an efficient and transparent manner, and that the regulators are held to account in discharging their duties.

Regulatory architecture

8. We strongly support expanding the regulators' objectives to include growth and competitiveness. Regulators should take an approach that ensures consumer / policyholder protection and financial stability and which complements, rather than detracts from, potential investment in the economy.

9. While certain initiatives, including the "strong and simple" regime for challenger banks are welcome, there is no substitute for embedding clear objectives across all decision-making, ensuring that there are guide rails for every initiative or decision

[1] The Prudential Regulation Authority's approach to policy - Discussion Paper | DP4/22
[2] The Prudential Regulation Authority's approach to policy - Discussion Paper | DP4/22

taken by the regulators that meet the Government's objectives, whilst maintaining independence.

10. We are concerned that the proposal to relegate "growth" to a secondary objective will create confusion and will not deliver the wider economic benefits that the country needs, which support policyholder security over the long term, and which also sets the scene for regulatory backsliding in future years.

11. The existing approach to the regulators' secondary competition objective clearly demonstrates that the regulators do not sufficiently embed secondary objectives into their decision-making. For example, in a recent speech[3], Andrew Bailey said that, "These [promoting the safety and soundness of the firms it regulates…contributing to the securing of an appropriate degree of protection for those who are or may become policyholders] are the so-called primary objectives, they take pole position." In short, secondary means secondary.

12. We therefore believe that growth should feature as a primary objective, accompanied by clear guidance from Government and the regulators themselves about how the new objectives will be prioritised. We do not think, for example, that it would be necessary for the regulators to advocate for the financial services industry in their international engagement at the IAIS and elsewhere. But the PRA should, for example, regularly consider how its approach could be refined to incentivise and removing barriers to investment (whilst protecting policyholders), and whether regulation is acting as a disincentive to long-term investment in the economy.

13. We believe that a proliferating set of regulatory principles and "have regards" is also creating confusion and often resulting in redundant or repetitive duties. For example, the two separate statutory principles (one in the Financial Services and Markets Bill, and one from the Financial Services Act 2021) relating to the 2050 net zero target strikes us as potentially confusing and unnecessary. This Bill provides the opportunity to streamline and clarify how these duties interact.

14. We believe that the annual remit letters from HM Treasury to the regulators provide the right forum to re-state Government policies, to which regulators should "have regards" – allowing for a balanced approach that reflects a range of initiatives, including Environmental, Social and Governance ("ESG") goals. These "have regards" should also reflect the over-arching purpose of finance, including:
    a. A measurable and sustainable increase in finance to the UK economy, long-term productive investment including urban regeneration and regional infrastructure.
    b. Affordable financial services, widening the range of products available to consumers, and giving more consumers the ability to take advantage of the benefits of such products.
    c. Innovative financial services, offering new products and services to consumers.
    d. Higher productivity to drive growth in real GDP per capita.
    e. The reputation and trust in the financial services industry as a whole.
    f. Wide participation in savings and investments to build financial inclusion.

[3] Reforming Solvency II: Delivering policyholder protection, 1 December 2021

15. We support the drive for more investment across assets supportive of environmental goals, but are increasingly concerned by a narrow approach, which focuses on environmental targets while giving too little weight to other goals, such as the creation of social value by increasing investment in the fabric of the economy and across society, even where these types of investments, such as environmentally friendly Build to Rent and social housing developments, also help move the UK towards its net zero targets. We believe that whether included as statutory principles or considerations via remit letters, all elements of ESG should be equally balanced.

16. Putting climate change at the heart of regulators' objectives could see long-term investors effectively penalised for focussing on investments which create social value, such as urban regeneration (which may also help achieve our environmental goals), rather than on specific environmental investments, like renewable energy.

17. A failure to account for a holistic investment strategy could risk creating asset bubbles, whereby high demand for a narrow range of qualifying assets artificially inflates their value, whilst other forms of productive investment are viewed as undesirable. This is not consistent with financial stability, policyholder security over the long term, or indeed a financial sector that supports the UK economy and society.

<u>Parliamentary accountability</u>

18. It is vital that, whilst regulators are independent, they are sufficiently accountable to elected representatives, who in turn need to be sufficiently well resourced to be effective scrutinisers of regulatory initiatives, and robust enough to hold the regulators to account. We believe this requires several key changes:

    a. We would welcome a power of veto, as is already the case for appointment of the Chair of the OBR – rarely used, but as a last resort – to be extended to Prudential Regulation Committee and FCA Board appointments. The Treasury Select Committee does hold pre-appointment hearings for members of important regulatory committees but has regrettably ceased similar processes for re-appointments.

    b. The work of the Treasury Select Committee should be complemented by a sifting Committee modelled on the Joint Committee for Statutory Instruments ("JCSI"). A "Joint Committee for Financial Instruments" could evaluate regulatory proposals as they are laid and query their rationale, while also conducting post-implementation reviews into whether the new regulations had the desired impact. A joint committee would benefit from the expertise of long-standing members of the House of Lords and the democratic legitimacy provided by members of the House of Commons.

    c. In our view, ex-ante line-by-line scrutiny or vetoes of regulatory rulemaking by Government or Parliament are inconsistent with the UK's approach to policymaking. This would damage the independence of regulators and, by extension, the UK's attractiveness as a well-regulated market.

d. We think it is sensible for the Government to have the power to change the regulators' statutory duties via statutory instrument on an ongoing basis. A Minister's power to set the regulator new "have regards" would be an essential mechanism for addressing consistent failures, as well as streamlining and clarifying where duties conflict. Statutory instruments would be a good compromise to allow the Government to reflect new public policy concerns in the regulators' mandates – unlike the annual remit letters, which apply in a cross-cutting way to regulators' activities across all areas of regulation. The Government should also have the power to refine to avoid consistent confusion and repetitive duties. Whilst long-term investors need regulatory stability in order to ensure enduring investment flows, and this proposal may create a platform for frequent change, we note that there has been considerable change over recent years under the existing set up, and believe that democratic accountability should be at the heart of the system.

e. We also support proposed "call in powers" to ensure that regulators are accountable to democratically elected Parliamentarians and Ministers. This will help build legitimacy for the regime, even if these powers are rarely used in practice. However, clearer criteria for how these powers would be used must be implemented to ensure clear parameters are set and regulatory independence is maintained.

19. Regulators should have to produce a cost-benefit analysis ("CBA") of each new regulatory initiative, looking across the financial services industry to understand how the wider ecosystem would be impacted and what the expected outcomes would be for all stakeholders.

20. Having a thoroughly securitised CBA means greater confidence that regulation will work for the economy and the system as a whole, which makes ex-ante reviews of new regulations by the Government unnecessary, also helping to preserve regulatory independence.

21. Significant proposals should be 'red teamed' to test them rigorously before publication. There should also be a requirement for that analysis itself to be challenged if it is considered deficient or misleading.

22. We would advocate a phased model where regulatory publications are submitted to CBA panels for pre-publication comment, but also reviewed once they have bedded in, to ensure that time is given after every new regime is introduced for it to work in practice, and for a CBA to be conducted effectively based on experience of the practical implementation of the regime and whether it has met its intended outcomes.

<u>Regulatory engagement</u>

23. We believe that there should be a "clear feedback loop between the regulated and the regulators" to ensure costs to businesses are minimised and that the "regulators have the right powers and duties to enable this".[4]

[4] The Benefits of Brexit: How the UK is taking advantage of leaving the EU

24. We would support a more formal role for practitioner panels to ensure a formal mechanism for challenging regulatory proposals. The panels could be strengthened in several ways.

25. Panels should have the opportunity to input into policies at all stages of policy development. Involving the panels before the issuance of discussion papers and cost benefit analyses could help regulators consider valid concerns before devising policy. The panels should, where possible, be able to publish their advice for the purposes of transparency.

26. The composition of panels should also be changed to ensure a greater diversity of views. In the case of the insurer panel, the membership should have to include smaller and specialist insurer firms to hear a diverse range of views, and to ensure it is not dominated by a small group of large incumbents.

27. An expansion of the number of members for panels would not in itself solve these issues. Instead, a requirement to refresh the membership of these groups regularly could ensure the presence of new voices and ideas at the decision-making level, alongside longstanding experts and market leaders. Through a mixture of permanent and rotating panellists, including from those particularly impacted by potential changes, we believe the right balance between institutional expertise and fresh perspectives can be struck.

28. There is also scope for improving discussion of topical issues, with a particular emphasis on expanding the "working group" approach. In many aspects of policymaking the UK has a strong track record of wide consultation and policy formulation involving different stakeholders, particularly in terms of co-ordinating the different perspectives and expertise of HM Treasury, the Bank of England, FCA, trade bodies and market participants. The current working group on Productive Finance is a good example of this approach.

29. However, regulators should be obliged to respond to substantive suggestions made by industry and others via systematic feedback statements and respond, briefly, to each suggestion made in consultation. This will increase transparency and constructive engagement.

About PIC

30. PIC is a specialist insurer providing pension insurance buyouts and buy-ins to the trustees and sponsors of UK DB pension schemes. At half-year 2022, PIC had £44.1 billion in assets and had insured 293,400 pension scheme members. We have a clearly articulated purpose, which is to pay the pensions of our current and future policyholders.

31. Our investment strategy prioritises the management of key risks, including environmental, social and governance, as integral to paying the pensions of our policyholders over the coming decades.

32. Our investments with a lasting impact on current and future generations in areas like renewable energy (£1.5 billion invested), social housing (£3 billion invested), and

national infrastructure are socially beneficial outcomes of our focus on our purpose. Excellence in customer service and balanced stakeholder relationships are fundamental to our approach.

33. Key outcomes of our purpose:
    a. Policyholders: Pensions for life; excellence in customer service
    b. Employees: Stimulating, fair, and rewarding workplace
    c. Economy: Significant investments in urban regeneration, social housing, and areas that balance intergenerational equity
    d. Environment: Increasing investments into renewable energy, with concurrent reduction in exposure to carbon-producing industries
    e. Society: Active engagement in public policy debates around purposeful, long-term investment in the economy, and stakeholder capitalism
    f. Capital providers: Growing store of value expected to provide secure, long-term returns