House of Commons

Treasury Sub-Committee

Oral evidence: Financial services regulation consultations, HC 1149

Wednesday 13 September 2023

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Watch the meeting

Members present: Harriett Baldwin (Chair); Rushanara Ali; Mr John Baron; Anthony Browne; Douglas Chapman; Dame Angela Eagle; Emma Hardy; Danny Kruger; Dame Andrea Leadsom; Siobhain McDonagh; Anne Marie Morris.

Questions 1 - 86

Witnesses

I: Sam Woods, Deputy Governor for Prudential Regulation, Bank of England, Chief Executive Officer, Prudential Regulation Authority; Charlotte Gerken, Executive Director, Insurance Supervision, Bank of England; Gareth Truran, Director, Prudential Policy, Bank of England.

Examination of witnesses

Witnesses: Sam Woods, Charlotte Gerken and Gareth Truran.

Q1 **Chair:** Welcome to this afternoon's Treasury Sub-Committee evidence session in relation to Prudential Regulation Authority consultations. Can I start by asking you to introduce yourselves?

Sam Woods: I am Sam Woods, head of the PRA.

Charlotte Gerken: I am Charlotte Gerken, executive director for insurance supervision at the PRA.

Gareth Truran: I am Gareth Truran. I am a director of policy at the PRA.

Q2 **Chair:** Thank you very much for coming in this afternoon to give us evidence on your consultations. I want to start with Solvency II. This was an announcement that was made in last year's autumn statement, so the Chancellor made it last November. We have then been passing the legislation via the Financial Services and Markets Act, and that got Royal Assent on 29 June.

In your consultation, you state that the full scale of the implementation of the reforms that you are consulting on will not take effect until the fourth

quarter of 2024. Can you understand why some people think that you are dragging your feet?

Sam Woods: I can understand that, though of course I do not agree with that. I will invite Gareth to quickly explain the timeline, and then I will offer a comment on that.

Gareth Truran: As you mentioned, Chair, we published our consultation in June on the vast majority of the reforms that we propose to implement under Solvency II. You will see from the document that that covers a large number of reforms that are aimed at simplifying the regime, making it more flexible and improving access and entry to the UK market. That consultation just closed. We are looking at the responses now.

The next big milestone is our final big consultation on the reforms, which comes very shortly, in the next few weeks. That will be on the matching adjustment.

Q3 **Chair:** Why did you separate them into two? Again, that looks like foot-dragging to some of us.

Gareth Truran: It really reflects our judgment about the fastest way we could get information out to firms that they could then look at and respond to. The work involved on the matching adjustment is very detailed and complex. We have been working very quickly on it this year. In order to give firms sight of the rest of the reforms, we felt that it was better to put those out earlier to allow us to complete the work on the matching adjustment.

Sam Woods: The best way to put that is that we did not want to hold up the stuff in the June package because we needed to take until September to do the matching adjustment package. Therefore we split them to get the earlier part out sooner.

More generally on the thrust of the question, I have frequently asked that question myself to the team—"Can we go more quickly?"—because we want to get this done. If you think about the industry, it is a £2.6 trillion industry, and if you just look at the matching adjustment bit of it, there are 8 million annuity policies in this country. It is a huge industry and the work itself is quite detailed.

You will have seen the consultation paper and all the annexes. There are 180 pages just in the consultation paper, and another 400 pages of text, changes in rules and things to go with it. It is a very detailed process, and I have become convinced that we need to do this properly. We are doing it at the maximum speed that is consistent with doing it properly.

Q4 **Chair:** You were thought to not be terribly enthusiastic about the reforms in the run-up to the announcement that the Chancellor made last November.

Sam Woods: It is important to draw a distinction here. I want to say categorically that the debate, which is a very good debate to have in the public domain, up until that autumn statement has in no way, not even by one day, slowed up the work that has been going on since the autumn statement. There is just no connection between those two things. If people had that fear, they should take it out of their minds.

Q5 **Chair:** You think that two years between the announcement and the implementation is just fine.

Sam Woods: No, I think that it is just realistic. There is a limit to the speed at which you can do these things. The team is working incredibly hard.

Q6 **Chair:** What limits you? What is the limit? What is the constraint?

Sam Woods: There are a number of constraints. One, of course, is the bandwidth in the PRA. This is very expert and detailed work, which has to be done by the experts. We cannot just double our size to do things such as this. That is one constraint, but it may not be the most important one.

The other constraint is that we need to do the thinking. Then we need to consult with the industry. In fact, a certain amount of feedback on the consultation—we have already reduced the consultation times—has been, "Could you not give us a bit longer?" Firms themselves also need a bit of time to get ready for these changes because of the complexity of what we are doing. It is all of those things together.

The Government have been very keen on moving as quickly as possible. Some of the changes are being brought forward more quickly, particularly the risk margin cut, to the end of this year. We have worked with the Government to enable that. The whole package cannot be done any faster at the quality that you would expect for something this important.

Q7 **Chair:** The reason it is being done is that the Chancellor has claimed that the reforms will lead to a £100 billion boost to investment in the UK economy. Assuming you buy into that figure, how long do you think it will be before the British people see that boost to the economy?

Sam Woods: Maybe I can bring in Charlotte, who heads our insurance area, on the £100 billion first. Then I might add a comment.

Charlotte Gerken: The £100 billion relates to the proposals to be made in the consultation around the matching adjustment, which is the consultation paper Gareth referred to as being due to issue in a few weeks' time.

Q8 **Chair:** Do you have a date for that that you are aiming towards?

Charlotte Gerken: We are aiming towards the end of September for that consultation. The improved flexibility of access to the matching adjustment—changes to the adjustment itself—has led to the firms

committing to the Government that £100 billion of investment will be made over 10 years, I understand.

In that consultation, we would plan to issue a policy statement, depending on the feedback we get on that consultation, by April next year.[1]

Q9 **Chair:** It is going to be published by the end of September, and then it would be a 12-week consultation.

Charlotte Gerken: Yes, it would be.

Q10 **Chair:** So it would close sometime towards the end of the year.

Charlotte Gerken: Yes.

Q11 **Chair:** Then you would take some time to reply to it.

Charlotte Gerken: Yes. Following the issue of the final policy, which would be, as I say, at the end of April next year, we would plan to implement those changes at the end of June next year. It is the changes around the matching adjustment that will enable firms to get going with the investment they have committed to. Actually, they would be able to make those plans ahead of the rest of the package that Sam referred to being implemented at the end of next year.

Q12 **Chair:** By and large, the British public will not feel any change to the economy from this until 2025 at the very earliest.

Sam Woods: It depends on how firms choose to play it, to be honest. Our desire and commitment to the Government, and indeed to the industry, has been that we would get out our package by the end of September. At that point, the industry can see what we are planning in full. How much confidence they can put on that being the final position, to be honest with you, will depend quite a lot on how the industry reacts to it. If there is an enormous disagreement around the way forward, they should place less certainty on that being the final position. If there is not, they can probably put more confidence on it.

We have said to firms that, if there are things that they are thinking about investing in in the nearer term, they can come to us and have a word, and we will try to give them some kind of a steer on it. It could be sooner than 2025. We are aiming for this part of the package to go live mid-2024.

By the way, there are some important dependencies on the Treasury here. Part of what we are doing here needs to rest on a statutory instrument that it will put forward. That needs to have some bits in it that enable us to do what we are talking about. The Treasury is working hard on that, and we are co-ordinating with it.

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[1] Following the session, the Bank of England clarified that the policy statement should be issued during Q2 2024, as per the consultation document.

Q13 **Chair:** I am hearing that the second consultation is about to be published. You will take on board what is in it. You will then publish your reply by March 2024. I cannot quite understand what it is that is happening between March 2024 and the end of 2024 that delays things another six months.

Gareth Truran: Our aim is that the matching adjustment changes, as we said, will be in force by the end of June.

Chair: That is 2024.

Gareth Truran: Yes. The rest of the package, which is the elements we consulted on in the June consultation, is really around streamlining and improving flexibility. Those are not directly about the investment barriers that firms say they need to improve. Those are other areas where we think we can improve Solvency II alongside that.

Q14 **Chair:** How early do you see any change in behaviour that could have an economic impact happening?

Gareth Truran: From the investment side, the first thing is that the Government are committed to cutting the risk margin part of the package by the end of this year. That will free up resources that the insurers have said they will use to increase investment.

The bit we supplement next year through our matching adjustment consultation is to make even wider the range of assets that they can include in the matching adjustment. Insurers can still invest in those assets today. It is just that the matching adjustment will give them a slight extra benefit. By the end of this year, insurers would have had the main financial benefit from the risk margin.

Sam Woods: To complete the picture, the June package is all about de-bureaucratising the regime and making it work better for our market. We will perhaps come on to that. I think, Gareth, unless you correct me, we are aiming to publish our policy statement early in the new year, probably February or something, but to go live at the end of the year. You might say, "Why is there that gap?" The reason is that firms need to get ready for it. We are changing reporting. We are changing how group capital requirements are done and those sorts of things. Firms need a bit of time to work that through.

Q15 **Chair:** The legislation that I referred to also created a cost-benefit analysis panel. I wondered whether you could share with us how the PRA is planning to handle the advice it gets from the cost-benefit analysis panel. Is that something that you will share with this Sub-Committee and more widely with the public?

Sam Woods: Yes. We have to leave some discretion to the chair of that panel, once appointed, to decide how they want to run the panel, but our expectation is that it will be a very important feature of our new regime. We are in the final stages of running the recruitment process for the chair

of that panel. I have been delighted by the quality of expertise that has come forward in that process. I would expect that some, or maybe indeed all, of the commentary or views of that panel will be public or otherwise shared with the Committee. If I could, I would like to reserve the position on that, partly because we need to have the chair of the panel in place.

Q16 **Chair:** When will that be?

Sam Woods: As I say, we are at the final stages of our recruitment process. The appointment of the chair of the panel has to be done with the agreement of the Treasury. We will quite soon be able to put a name forward to the Prudential Regulation Committee at our end. I expect that we will do that towards the end of this month. Under the Act, I think that we have to have this done by about two months from now, so that is roughly the timeline.

Q17 **Chair:** Will its cost-benefit analysis not be FOI-able?

Sam Woods: It is highly likely that it would be. I would defer to my lawyers on that, but I am not anticipating that the work of the CBA panel will be done behind closed doors in any way. We publish all of our CBAs. I am assume that the panel will do the same.

I suppose it is likely that the CBA panel will probably also engage a bit upstream. That would make sense, rather than waiting to the very end. The Regulatory Policy Committee, which does the Government version of this, I understand, actually comes at the very end. It is important that that occurs and is transparent, but it may also make sense for the CBA panel to engage with, say, Gareth and his team and say, "You are thinking about it that way, but why don't you think about it this way?", so that we can think about some of that upstream while the policy is being done.

Q18 **Chair:** Your intention is for it to be a transparent process.

Sam Woods: I think so.

Gareth Truran: If you take the example of the June Solvency II consultation, we have included a very full cost-benefit analysis in that package for each proposal and are looking at it in the round. The role that the cost-benefit analysis panel would play in the future would be, as Sam says, to advise us. The statutory role it will have is to advise us on our cost-benefit analysis in terms of the methodology we apply generally. It would help us understand, challenge and review whether we can improve the way we do it as a process.

On the vast majority of the cost-benefit analysis we do on individual consultations, you will see our CBA when we publish the consultation. That will have benefited from the advice, input and challenge that the panel has given us through that process, whether upstream or in the final stages.

Q19 **Chair:** We will continue to follow that with interest.

The pension superfunds consultation was out there for a long time. I wondered, Sam, whether you could state the PRA's position on pension superfunds. Are they a good thing or not?

Sam Woods: Maybe I will say a word, and then bring in Charlotte. Our perspective is that it makes perfect sense to think about ways in which smaller pension funds could be brought together in order to save costs and maybe improve their investment performance. That has always seemed, to me at least, to be a plausible idea.

Our interest in the topic has been only a very narrow one, but it is quite important. There is one superfund already up and running. If that sector develops and becomes a significant sector, insurance companies might want to run the superfunds themselves. That is a possibility. If that happens, in order to make the superfund regime work, it is deliberately operating at a lower standard than we require if pensions come over into the insurance sector.

Our worry is a very simple one. If that gap is too big, or the way that insurance companies play in that market is not thought about carefully, when and if it comes to the crunch, it is likely that a superfund would get into trouble before the insurance fund, given that that is held to a higher standard. At that point in time, we are worried that the pressure on that insurance company to bail out the superfund would be absolutely massive. Then, in effect, you have a blended level of security, where the superfund in the insurance company is a bit higher de facto, and the insurance standard has been lowered de facto, because, if it comes to the crunch, the superfund will have to be bailed out. That has always been our worry. That is quite a narrow issue.

Q20 **Chair:** That is more about whether insurance should be able to do something in the superfund space, as opposed to blocking superfunds altogether.

Sam Woods: That is exactly right.

Charlotte Gerken: Economically, a similar function is being performed by a pension superfund and an annuity provider, in terms of policyholders or pension scheme members relying on the promises that have been made. As Sam says, our concern would be if insurance policyholders were put at greater risk because of an insurance company needing to support a pension superfund-like subsidiary.

Q21 **Chair:** So what I am hearing is that you have been pouring cold water on the idea.

Sam Woods: I do not think that that is quite fair. We have just been representing, at Government discussions, "Here is the concern we would have from our perspective". In policymaking in Government, you often have to reconcile all sorts of competing tensions. We should not just sit back and say, "This seems irrelevant". It is obviously highly relevant, so we put that in. From the way you put the question, you may have been

given an exaggerated notion of our total opposition to superfunds as an idea. That is not where we are.

Q22 **Chair:** Could you give a straightforward, one-sentence answer on your position on superfunds? They are okay, but not for insurance companies. Is that what I am hearing?

Sam Woods: They are okay as long as they do not undermine the safety and soundness of insurance companies, and annuity business in the insurance sector in particular.

Q23 **Mr Baron:** Could I turn to the issue of balance of benefits when it comes to policyholders and, indeed, the insurers? There is a concern, as you are probably aware, that the PRA is relaxing rules on insurers at the expense of policyholders, at a time when the industry is very much under scrutiny for poor conduct performance. We know of the recent headline about the £30 million Direct Line will have to refund its customers for overcharging, basically. Each chapter of the consultation states, "The PRA considers the proposals in this chapter would advance its primary objectives of safety and soundness and policyholder protection". Can you set out the benefits to policyholders from these proposed measures, briefly?

Sam Woods: I will have a stab at that, and then you may want to ask more. You should separate in your mind the changes to the risk margin and the matching adjustment, which, by design, introduce a bit more risk into the system.

Q24 **Mr Baron:** Is that risk for the insurers or policyholders?

Sam Woods: Ultimately, it is for the policyholders, because the protection is somewhat lowered. There is great dispute about how much it is lowered, but the direction of that effect is clear. Put that on one side. We think that everything in the June consultation paper will make our regulation work in a more efficient way and reduce bureaucracy. That, indeed, is the aim of it. The benefit of that will go to one or more of three constituents. It will go to shareholders of firms, people running firms or policyholders. How much of it goes to policyholders depends on the level of competition. We actually think that there is, at least in many parts—probably all parts—of the insurance sector, quite a strong level of competition. If that is the case—if our regulation becomes more efficient, firms can become more efficient and we have not weakened policyholder protection—that should flow through as better pricing for policyholders.

Q25 **Mr Baron:** You mentioned competition, yet the consultations states—I am sorry to quote again—"The PRA recognises that the competition impact in retail markets is likely to be immaterial". That seems to be at odds with what you have just said.

Sam Woods: I do not think so, because the package that we are putting forward is not of itself designed strongly to boost competition, although there are some bits within it that are pro-competitive, particularly the idea of introducing a mobilisation period and the changes we are making

to the thresholds for small firms. The point I was trying to get across is that the measures generally take bureaucracy out of our regulation. As long as competition is working well, I do not think that the benefits of that will get trapped in the firms. They will be competed away and go through to policyholders.

Q26 **Mr Baron:** I am trying to be sympathetic here, but I have had two reasonably different answers in two sentences here. One minute you are saying that you believe the proposals will help competition because this is going to reduce bureaucracy. There is a logic in that. On the other hand, this sentence is stated almost everywhere: that you think the impact or the benefit—let us put it this way—for policyholders is largely going to be immaterial. You cannot have it both ways.

Sam Woods: I am not trying to obfuscate.

Mr Baron: I am not saying that you are. I am saying that there is a contradiction here that I am struggling to understand.

Sam Woods: Let me have another go. Within the package, there are these two things in particular that are likely to be good for competition. One is the introduction of a mobilisation period that is, if you like, a playpen for new insurers. It has been very successful on the banking side. That is one thing that is going to be good for competition. The other thing is that we are going to raise the threshold at which people move out of the less onerous, non-directive firm regime into Solvency II. Those are two elements that are directly good for competition.

As for the wider picture, the rest of it is, as I say, about taking bureaucracy out of the system. Maybe this where the slight confusion arises from. We do not think that any of that has a negative impact on policyholders in a reducing safety and soundness way. That is the point we are trying to make in the paper.

Q27 **Mr Baron:** I am not looking for a minimising of adverse impacts. I am looking for benefits for policyholders, and I am not hearing much from you at the moment.

Sam Woods: Let me give you a concrete example. Then we will see whether maybe Gareth can bail me out and do better.

Mr Baron: Am I being unfair, by the way?

Sam Woods: You are not being unfair. It is a good question to ask. I will try to give you a more convincing example. One thing we are doing in this consultation is cutting some reporting requirements. We are not cutting anything that we regard as important for policyholder protection. We believe that the reduced cost to the industry of doing that will be around £34 million per year. We think, by the way, that the cost of making the change may be between £30 million and £60 million, so you can think of it as a one or two-year payback. If competition is not working well, that could just mean higher returns for shareholders and it

could all go that way. If, however, competition is working quite well in these markets, ultimately you would expect that that £34 million benefit to the industry ought to be competed away in the form of better prices for policyholders.

Q28 **Mr Baron:** It appears from the outside that the PRA is reducing costs for the insurers, but there is no guarantee that those cost reductions, those savings, are going to be passed on to policyholders. You cannot guarantee that. You are trying to say, basically, that it should lead to greater competition, which may help premiums.

Sam Woods: I am saying that, as long as competition works, I think that some of that, or maybe all of that, will be passed on. You are absolutely right: we cannot guarantee it. Look at it from our end of the telescope. If we have a piece of regulation that we think is excessively bureaucratic, and more complicated than it needs to be to do the job, should we just leave it because we cannot be sure that, if we take it away, the benefit will go to policyholders? No. Of course we should take it away and let competition do its job.

Q29 **Mr Baron:** Do you feel you have any obligation to get the message out to the insurers? You have done your bit as a regulator. You have reduced bureaucracy, you are telling us, to the tune of £30 million or £40 million a year, perhaps. "We expect some of this to be passed on to policyholders". Is that beyond your remit?

Sam Woods: That would be a reasonable thing for us to say.

Q30 **Mr Baron:** Are you going to say it?

Sam Woods: I am happy to say it now that we would expect that to flow through to policyholders, at least to some degree. Can we enforce that? No. An interesting question is whether the FCA, under the consumer duty, would take an interest in that topic. It might do, but our job is prudential regulation, and that takes us so far. It is protection of policyholders. While we can say that as an aspiration, we cannot force it.

Q31 **Mr Baron:** Time ticks on, and I have a couple of other quick questions. On the new rules drafted for insurers, can you give us examples of where the industry was asking for something that would have diluted policyholder protection and you said no?

Gareth Truran: The consultation period has just closed, and we are in the early stages of looking at the responses, so it is a little early to give a definitive answer. If I stand back from what I have seen so far of the responses, there are a number of areas where they are supportive, and a number of areas where they are looking for clarification; we will look at those and decide whether we can give that. I am sure that there will be some areas within that where firms would like us to go further. Reporting is an obvious one. We have had a number of discussions with insurers where clearly they regard some of the reporting obligations in Solvency II as onerous. We have looked hard at those through the package, and we

think we have managed to deliver a significant reduction, but as Sam says, without affecting our objectives. If you asked them, they would probably say, "Please can you go even further?".

Q32 **Mr Baron:** You felt that you have pushed back robustly enough on that particular issue.

Gareth Truran: Yes.

Q33 **Mr Baron:** The reason I am asking this line of questions is that there is a view—I think that you are aware of the criticism—that you are, to use the terrible term, a little bit of a captured regulator, only managing rules where it suits the industry but not changing rules where it increases protections for policyholders. You will say that that is grossly unfair, but it is worth addressing just for the moment.

Let me ask you it in another way. Why are none of the changes in this consultation dependent on the insurance industry improving in other areas? You have talked about reducing bureaucracy, but by "other areas" I am suggesting, for example, the observed price inflation that the FCA itself has identified.

Sam Woods: That is a very challenging question.

Mr Baron: It is meant to be.

Sam Woods: I thank you for it.

Mr Baron: You see the slight contradiction.

Sam Woods: I understand.

Mr Baron: There are clear signals here that you should be doing more on behalf of policyholders and yet—how can I put it gently?—there is an element of being in hock to the industry. I am trying to prise this out and give you the opportunity to say that we are wrong, but I have not been too convinced so far.

Sam Woods: I am hoping that we can convince you a bit more. I would categorically reject any suggestion that we are in hock to the insurance industry. The best evidence for that is that, going back to the earlier comment of the Chair, we tried very hard—the measure of the hardness is that the last time I was here, the Chair asked me whether I was going to resign, having lost this argument—to make a change that, in our view, would have improved policyholder protection.

Q34 **Mr Baron:** Can I stop you there, because I am running out of time and there is about to be a vote? Can I come back to that point about observed price inflation? There is a small example of the FCA having actually put this up in lights a little bit, quite rightly. Why did you not make some of your changes conditional and dependent on the insurance industry improving in areas such as that, which has been raised by the FCA?

Sam Woods: Our job is to assure the safety and soundness of the insurers, and policyholder protection to a degree that we consider acceptable and in line with law. It would be wrong for us to make those sorts of changes predicated on something that is in another lane and outside our bailiwick. If we did that, we might well be ultra vires. You would probably be asking us, "Why is it that you have linked those two things in that way?". That would be wrong, but that can be true and it can also be true that we can have some quite strenuous disagreements along the way, which I would say we have done.

Q35 **Mr Baron:** You have identified cost savings for the industry and for the insurers. You hope that that will lead to greater competition, but you have not identified one single benefit, have you, for policyholders in the changes you are proposing, certainly not when it comes to observed price inflation?

Sam Woods: As I was trying to explain, with limited success, we think that, if we reduce the cost of our regulation in a way that does not increase risk to policyholders, that will be a benefit to policyholders, because it will make the business more efficient. That is the benefit, and that is relevant.

It is true that, had we managed to get agreement to the other change we were hoping to make, I would have been able to give you a much more concrete and, frankly, satisfying answer. The reality is that we needed the Government's agreement to do that and, in the end, the Government were not persuaded, so we have moved on.

Chair: Andrea, will you kick off with your questions? We will likely have to pause for a vote.

Q36 **Dame Andrea Leadsom:** Hello. I wanted to talk to you about the balance of interests of insurers versus the wider economy as a whole. A straight question: the Treasury and the ABI have announced that the prospective changes to Solvency II will provide a £100 billion boost to the economy. Is that correct, do you think?

Sam Woods: Can I say a word and also bring in Charlotte, if I may? That is an industry number, as you say, which the Government have adopted. That is achievable, but whether it actually occurs depends on what the industry does next.

Q37 **Dame Andrea Leadsom:** Indeed, which is why I am asking you whether you think that it will happen. I am asking you what your personal opinion is. Will it happen or not? Then I would love to hear Charlotte's personal opinion.

Sam Woods: It may happen, but I cannot guarantee it, if that is what you mean.

Q38 **Dame Andrea Leadsom:** No, of course you cannot guarantee it. I just wanted to know whether you think that it is credible.

Sam Woods: It may happen, but it will depend on whether the insurers choose to invest in the way they have said they will or use the funds in other ways. Maybe I can bring in Charlotte, because she has been working with the industry a bit on this.

Charlotte Gerken: Looking at the £100 billion, as Sam said, that seems achievable over the next 10 years, given the projected transfer of liabilities from pension schemes to insurers, a trend that has been accelerating. At the moment, investments in infrastructure, which would be one of the areas that the insurers have committed to, is a relatively modest part of the firms' investment portfolios. Their matching adjustment portfolios are around 7%. If they increase their investments in that area, they could remain diversified in their investments.

As Sam said, this will depend on, first, the insurer's risk appetite as to whether it thinks that the assets on offer are in line with its risk appetite and suitable to back those promises it has made to annuity policyholders. Secondly, it will depend on how economically attractive those assets are, compared with the other assets they can invest in. I would observe that sale and leaseback and equity release mortgages are twice as economically attractive, in the MA benefit that firms can gain, as infrastructure and social housing. They will have to think about the economics and how attractive the investments are.

Thirdly and very importantly, it will depend on whether the insurers have the right skills and risk management abilities to manage what will be, perhaps, newer assets that they have not managed before. They will need to increase their capabilities, as will we, to assess those investments.

Q39 **Dame Andrea Leadsom:** You are both saying that £100 billion into the UK economy is credible. There is also one alternative, which is that the insurance companies simply use that money to pay bigger dividends. What is more likely?

Sam Woods: The Government have secured a commitment from the industry to make that investment.

Q40 **Dame Andrea Leadsom:** You have not, as the regulator.

Sam Woods: It would be wrong for us to do that, actually. You in Parliament have not set us up as a central planning authority for investment. You have asked us to be the prudential regulator. We see part of our role as being to set some tramlines within which we think investments can be made in a way that is consistent with the objective that you have given us. Within those—this is actually very important—investment decisions are for the boards of companies and their investment executives.

The extra dynamic we have in this situation is that, in the context of these reforms, and also in the context of not taking forward the proposal that I was talking to Mr Baron about, the Government got a commitment

from the industry to make that investment. I am sure that the Government will be extremely focused on holding the industry to that commitment. We will see how that plays out, but I think that that will be the main pressure.

Q41 **Dame Andrea Leadsom:** Do you see yourselves, as regulators, as having any responsibility for making sure that the sector abides by its commitment to the Government that that £100 billion goes into the broader UK economy?

Sam Woods: We need to make sure we deliver our part of the bargain, in terms of making the rules work in the way that the legislation is now set. Beyond that, of course we will take an interest from a prudential perspective, but it is fundamentally for the Government, with their wider objectives, to hold the industry to that commitment.

Sitting suspended for a Division in the House.

On resuming—

Q42 **Dame Andrea Leadsom:** We were talking about the £100 billion that the sector professes that it will invest in the UK economy as a result of the changes under Solvency II. I would like to get your thoughts, as regulators. Charlotte has already told us that the obvious risk return will be a key factor, but I think the sector has particularly proposed to invest in green infrastructure, to the benefit of the UK's net zero ambitions. How credible is that? Do you think that that is a ploy to persuade the Government to ease regulation, or is it a genuine intention, from your observations of the sector?

Charlotte Gerken: From the conversations I have had with chief executives of the large insurers, they have certainly been very serious about that commitment. In conversations with the Association of British Insurers, it has also been keen to explain to me the investment delivery forum that it has set up with some of its large members, and how it has divided that forum into three workstreams. One is around the energy generation, one is on energy transmission, and then there is a housing workstream. From the commitment they made, and the efforts and time they are putting into this—investment in terms of time, at this point—to develop their ideas, I have taken that they are serious about this commitment. Clearly, it is early days, as they are setting up, so the proof will be as they develop these, and as the projects come along for their investment.

Q43 **Dame Andrea Leadsom:** You think that this development forum is a properly constituted industry body that is going to meet regularly and take forward its stated aim of investing £100 billion in the UK economy.

Charlotte Gerken: From how it has been outlined to me, yes.

Q44 **Dame Andrea Leadsom:** May I ask you again, Sam, whether you agree that this £100 billion investment in the UK economy is likely to happen,

as opposed to it being the way in which insurers will be able to pay higher dividends?

Sam Woods: It is achievable. As Charlotte said, there is certainly a desire on the part of insurers to do more of that investment, for the reason that many of them want to grow their bulk purchase annuity business, which is the movement of pensions out of the pension sector into insurance. That is what is going to drive a lot of this investment. It would be wise for the Government—and you, to the extent that you have an interest—to keep asking those questions. That clearly has been the main motivation for the Government's position on a number of issues. The pressure should be kept on to make sure the deal is delivered.

Q45 **Dame Andrea Leadsom:** To be clear, you do not see it as a part of the regulator's responsibility to monitor, let alone to enforce, its agreements to invest in the broader UK economy.

Sam Woods: That is beyond our remit. If we did that, we would be straying beyond what we should do. In the reporting that we get in from insurers, that all has to be in service, if you like, of prudential objectives. If some of that is relevant and we can get the necessary gateways, of course we can help Government from that perspective. It would be wrong for us to be involved in directing investment in some way, using the powers that we have. That is not why you have given us the powers that we have.

Q46 **Dame Andrea Leadsom:** I am not talking about directing; I am talking about monitoring. They have said that they will do it. You regulate them as honourable, honest and law-abiding actors in a very lucrative sector. They have said that they are going to invest £100 billion in the economy and talked a lot about green infrastructure, but you do not see it as your role to monitor, let alone to enforce.

Sam Woods: No, the Government should do that. I think that the Government will do that. They have a very strong incentive to do so, but that is for them, rather than for us.

Q47 **Dame Andrea Leadsom:** Do you think that there is a temptation that this investment will go overseas, rather than to the UK? Is there any means by which you think there would be more of a tendency to invest in the UK?

Sam Woods: That is a risk. Charlotte was sketching it earlier, but the commercial incentive that insurers face in the current construct of the matching adjustment is effectively to find the asset that has the highest return for any given rating. That is the incentive that there is in that system. To the extent that those assets are non-UK assets, there will be a commercial incentive to do that.

On the other side of the coin, the insurers are based in the UK. The Government have all sorts of ways of applying pressure to firms. It would be very wise of them to deliver the commitment that they have made,

not least given the very considerable efforts that the Government seem to have gone to in order to secure that agreement.

Q48 **Dame Andrea Leadsom:** The clear message to the Treasury here is that it needs to be the one monitoring and enforcing, if anyone is going to.

Sam Woods: I would agree.

Chair: Our Committee has a part to play as well in that.

Q49 **Anne Marie Morris:** Could we move now to solvent exits for non-systemic firms? Why are you proposing this new way for non-viable firms to exit the market solvently?

Sam Woods: The reason we are doing this is that the PRA recently had its 10th birthday. As we came up to that milestone, along with all the other things we were doing, we thought that we should take a bit of time to reflect on what we have learned since we set this organisation up. In particular, what has proved to be different from what we thought at the beginning, and what do we need to change?

In thinking about that, we landed on three priorities, one of which is this. The reason that we landed on this priority is that, when we set the PRA up, how we described the supervision of smaller firms in particular was to talk about business as usual when things are going well, then recovery if the firm has got into difficulties, or, if recovery does not work, resolution, which will often be a modified insolvency procedure.

In practice, we have actually found that we spend a lot of time, when we come on to the pros and cons of this, on something in between recovery and resolution, which is solvent exit. To put one piece of flesh on that for you, around 45 banks, so deposit takers, have exited the market during the life of the PRA, which is much more, by the way, than most people think, and 64 have come in. We have often talked about that here.

Of those 45, a lot have exited for purely commercial reasons that were nothing to do with this—for instance, M&A; or where a local bank is owned by a foreign bank, the foreign bank changes its mind about its business strategy. Of the 45 in our assessment, 19 have gone through a process that is the sort of thing we are describing here. We have had to work very carefully with the firms to ease them out of the market without insolvency.

Q50 **Anne Marie Morris:** Can you give me an example of that?

Sam Woods: Yes, I can give you an example. I can actually give you all 19 if you want, but I will pick out a few for you. One was the Airdrie Savings Bank, which you may or may not have heard of. It was a bank that had been around for a long time. Its business models had run out of road. R. Raphael & Sons similarly ran out of road. Commonwealth Bank is another example. There are some others that are not technically within this definition but that are highly relevant to it.

Q51 **Anne Marie Morris:** What was actually happening? Were they distressed? What were the circumstances leading to the exit that enabled you to do it solvently, rather than scratch your heads because you did not really have the option of the resolution?

Sam Woods: It was different things in different cases. In the case of the Airdrie Savings Bank, it was the management looking forward and saying, "Our business model does not seem to work so well anymore, but we still have enough capital", and then a very careful process working with our team to enable it to exit the market in a solvent way—in other words, without going into insolvency.

Some of the other cases are different. There is another case that we have touched on here before, which is a bank called Wyelands Bank. That technically has not yet exited. It still has permissions, for various reasons, but all of the depositors have been paid out. That was actually quite a difficult thing to achieve. It required a lot of work. The sorts of things the team had to do there are very relevant to this.

You have plenty of entry into the market, which is a good thing we have often talked about here. For this also to work well, you have to have exit, and this is the main route.

Q52 **Anne Marie Morris:** It sounds to me like this exit is more often for commercial reasons, rather than because of distress. If it is a distressed exit, I am still trying to understand why this is a route, and why you would not, for example, use the resolution regime in a distressed circumstance, even if you have to amend the scheme to get them into it.

Sam Woods: We believe in trying to achieve a solvent exit for a firm that is running out of road. It might be highly distressed. For instance, quite a few of the ones that have exited are new ones that came in, tried to get going, and did not really work out, and we got them out again. We have nine in that category out of our 19.

If you look at what happens in an actual insolvency procedure, the best research is from the US here, because it has lots of banks it puts through an insolvency procedure. That research tells us that, on average, 20% of the value of the assets of the firm is destroyed in those processes because of the expense of the procedure, the confidence effects and all the rest of it.

We think that, where you can make a firm leave in a solvent way, that is better for shareholders, because they do not get wiped. It is better for depositors who are above the limit, because they do not get any sort of a haircut. It is better for the functioning of the whole industry because, in an insolvency, first, you may have contagion effects, but, secondly, if you have to pay out those depositors, it falls back on the industry. We did not, if you like, realise all that when we started the PRA, but ex post we have done a lot of it. We said, "Should we be doing that?" and we think

we should, but we want to get better at it and make firms better at it. That is why we are doing this.

Q53 **Anne Marie Morris:** There seems to be quite a range of reasons why there needs to be an exit. It seems to me that not all of them are necessarily going to be amenable to a solvent route. In which case, is there still an argument for an amendment to the resolution regime for some of them to get in there? How are you going to manage the rules and regs to try to work out how you then begin to decide, through regulation, in which ones actually there is serious distress? Maybe we can flex something through the resolution regime. Where is it simply commercial and therefore—I understand what you are saying—a case of, "get them out without all the cost of insolvency"? It seems to me that there are some nuances we have not yet unpicked. The size of the firm will also make a difference. The bigger the firm, the harder it is to stop the insolvency. They will start acting—it will be fairly visible—and the time you have to fix it will be relatively limited.

Sam Woods: You are quite right about the nuances and the different causes. The group of firms that have exited is quite varied, apart from maybe that one group of the nine that came in, tried to make it work and had to go out again. They are perhaps a little bit more homogenous.

I would say two things. First, in the consultation document we talk about two separate things. One is what we call a solvent exit execution plan, or SEEP. That is a very detailed thing, which we require firms to do if they are edging into this terrain. For the reason you are touching on, we have thought quite hard about whether we should require all firms to do one of those. We decided that, no, we should not, because in some cases firms will not need it; either they will never get into trouble or, if they do, they will take care of it in a different way. Instead of requiring everyone to do that up front, we decided to require them to do what we call a solvent exit analysis, which is a much lighter version of that. It will also be much lighter for the smaller firms within this spectrum. That is one way in which we have tried to accommodate the fact that it will not be necessary to use it in all cases.

You mentioned resolution. Separately and in parallel with this, we are looking at the question you asked. Do we need to amend our resolution regime and broaden the tools we have to deal with different types of failures? We can come on to that, if you would like.

Q54 **Anne Marie Morris:** How are you going to tweak it? Let us get on to it.

Sam Woods: This is really a lesson from Silicon Valley. We felt that Silicon Valley Bank UK went well. It was an extremely high-pressure and very rapid situation, which we think we steered to a good outcome.

During that process, it was very clear to us that the level of concern and discomfort there might have been around discontinuity of access to current accounts for both businesses and potentially individuals—it was

really businesses in that case—meant that perhaps it would be more difficult for us to put some firms into an insolvency procedure than we had previously considered.

One way to avoid this is to get better at solvent exit and deal with it that way, but we are not assuming that that is going to work in all cases. We already have a resolution tool that delivers perfect continuity of access called a bridge bank. That is basically where the Bank of England takes control of the bank. It is good for continuity, but the bad part of it is that, if there is any net cost at the end of that process, it comes back to the public sector through the Bank of England's balance sheet.

We are looking at what our options are for securing greater continuity of access without that more bailout type flavour. We have not yet settled that, but there are a number of ideas in that space.

Q55 **Anne Marie Morris:** This is quite a complex and fluid area. It seems to me that at the moment you have been relying on a degree of discretion to be able to do what you think fits the best case. Where is there a role for regulation and the formal amending of these different schemes, as against having the flexibility to make a judgment? I find that quite interesting.

In addition to that, what happens if you make a decision that a firm can go out solvently but then something happens that means that is wrong? How do you then fix that and reclassify it?

Sam Woods: In the latter case, the point of this proposal is to try to reduce the chance of that. It may still happen, of course, and it probably will still happen. In those cases, we will just have to flip to our resolution toolkit. That is what we will do. We do have full discretion to do that, subject to very strict legal procedures around whether a firm meets the threshold conditions and whether it may recover. There is a legal process around that, and we have operated that already, including for Silicon Valley Bank.

On discretion versus rules and ease of exit, when we get into these situations, we often find that firms are not prepared and have not thought about the sorts of things that could arise. Having been through it so many times, we now know quite a lot about it. Box B in the publication sets out our learnings about the kinds of things that can go wrong: customers who cannot be contacted, complexities around deposit aggregators and all that stuff.

The idea is to get firms to do a bit of thinking up front with this solvent exit analysis, which is a relatively light document, such that, if we actually then get into it, they are not starting from a perfect standing start. We will have discretion over that. This does not fetter our discretion. It will just make us better prepared and make firms better prepared.

In the resolution world, there is a very strict process governing how that works. It involves consultation between the PRA, the FCA, the Bank of England as resolution authority and the Treasury, which legitimately has an interest in that situation. Nothing we propose will change that basic set-up, but we will probably end up trying to add one more tool to the toolkit. We have not yet decided what that is, but we will add one more so we have another option there.

Q56 **Anne Marie Morris:** Have you done a cost-benefit analysis? Given that there is a cost to doing the preparation that you are talking about, is the cost-benefit argument in favour of getting the prep done as opposed to just being to help your administration?

Sam Woods: We judge it to be so. That is the case we have put forward in the consultation.

Q57 **Anne Marie Morris:** When you say that you judge it to be so, what have you done to reach that judgment?

Sam Woods: On one side of the ledger, you have the costs. We have taken a good stab at trying to work out what it would cost the firm to prepare one of these solvent exit analyses. The more detailed thing, which you have to do if you are actually in the crunch, we can already require them to do. We do not need more powers to do that.

We have put a range of £25,000 to £75,000 for the upfront cost, which is 43 person days at one end of that spectrum and 129 at the other. We think that will be enough time for firms to do the work we are talking about. That is the cost side. There is also an ongoing bit of that, but it is lower.

On the benefits side, the quantitative aspect that we have is around the destruction of asset value if you have to go into insolvency. We think that is quite an important thing. That is a benefit to shareholders, depositors and the rest of the industry. We also think that, if we want to run a market in which we have entry and exit and competition working properly, it is important that this exit piece works well. We have been doing a lot of this, in effect. We would like to regularise it and make firms better prepared for it.

The reason I say "judgment" is that it is a judgment. Are those benefits worth those costs? In our experience, given the volume of this that we have been doing and expect to continue to do, we think the answer is yes.

I am sorry to give a long answer, but I have one more point, which is about something we will have to watch quite carefully. You have this more detailed version of the plan, the solvent exit execution plan. If we go ahead with this policy and supervisors are expecting firms to do this lighter one, we need to watch internally to make sure that, in their enthusiasm, the supervisors do not require firms to do the super-detailed

thing in good times. That is something we are going to have to watch. If they did do that, the cost would be higher.

Q58 **Chair:** On that point, if I may, with regard to start-ups, are you going to require challenger banks to have a full solvent exit plan before they even come into the market? How is that going to align with your competitiveness objective?

Sam Woods: We already require from new and growing banks something called a solvent winddown plan. In many or possibly all existing cases, that existing material will be able to be refashioned to meet this requirement with really very little additional work. We think that will help here. Charlotte, do you want to add anything?

Charlotte Gerken: We have removed the part of the supervisory statement for new and growing banks relating to the solvent wind-down in order to rationalise it with this solvent exit proposal. They will have to follow this new policy, rather than do the solvent wind-down plan as previously required.

Q59 **Chair:** Does it affect competitiveness?

Sam Woods: Well, and competition as well. It is unusual for us, per many of our previous discussions, to come out with something that we are asking the smaller and growing firms to do and not asking the larger firms to do. Normally, it is the other way around. Our strong and simple proposal will be the other way around, in terms of making things simpler for the little ones.

For firms that are not in this category, we have already established that we are not going to put them into an insolvency procedure; we are going to use resolution and one of the tools is a bail-in. Those firms have to issue bail-in debt or MREL, as it is sometimes referred to. The cost of that is much higher than the cost of what we are talking about here.

Q60 **Chair:** It does affect competitiveness and competition, but it is something you judge as still worth taking forward.

Sam Woods: It is, and I also think it is necessary to make competition work well. You have two ends of the pipe. People have to be able to come in and they have to be able to go out. This way of going out is less harmful than resolution. In one sense, it should give investors greater confidence that they can put their money into a start-up bank, because there is a viable exit route. If things do not work out, they may be able to get their funds back.

Q61 **Danny Kruger:** I want to ask about the proposal for the 50% reduction in the fines firms will have to pay. Before we get on to that specifically, can I ask for your general views on the effectiveness of the enforcement regime you have? You have quite significant powers already. Before we get into this new change, what is your general sense of the way things are working, the powers you have and the way they are implemented?

Sam Woods: It is for others to judge, in a way, but internally it feels as though that part of our toolkit is doing quite a useful thing for us. To give you a sense of the scale of it, we have opened 64 investigations since the PRA was concluded; 52 of those have concluded; and just over half of those resulted in an action.

I feel like that is a good number because it shows we are testing the boundaries of where we should be. The actions in those cases and the £300 million-plus in fines that we have levied so far act as a very significant deterrent. They do not remove all bad behaviour and problems, but they do act as quite a significant deterrent.

The way it works internally is that, when something bad happens in a firm, we have to make a judgment on whether it is sufficiently bad that it needs to go down the enforcement route. It is very important for supervisors to have the option of handing it to enforcers, if things are beyond a certain degree of badness.

Q62 **Danny Kruger:** In terms of the fines that can be levied, is consideration given to the impact on the firm itself? There is the potential to harm them. In a sense, that is part of the intention: to make them feel the effect of what they have done. You do not want to undermine their commercial viability.

Sam Woods: A lot of consideration is given to that. You are right: there is a little bit of a tension there, particularly at the limit. What we have proposed in this consultation is an improvement on that. It is very straightforward, actually. We have suggested that we have a kind of matrix, which is the starting point for settlement discussions. It has two axes: how bad is what has occurred; and how big is the firm? You will see that there is a big gradient between the top left-hand corner, low badness and small firm, where the starting point for a fine might be 20 grand, and the other corner, where the starting point would be north of £100 million. That is directly for the reason you have just raised.

Q63 **Danny Kruger:** There is another factor, which is how they behave once the charges are brought and whether they confess and plead guilty. Will the proposal for a 50% reduction if you plead guilty early act as a realistic deterrent? Is that going to be effective?

Sam Woods: I think it will. To remind you, we have been given by you and Parliament powers for unlimited fines. This does not act as a cap on those in any way.

We already have a 30% discount, typically, for firms and individuals who choose to settle rather than contest all the way. That is a completely normal thing to have in an enforcement regime. The new proposal is this thing called the early account scheme. At the moment, notwithstanding the settlement point, there is really very little or, some would say, no incentive for the subjects of investigations, whether firms or individuals, to fess up and say, "Okay, we got it wrong. It was all a disaster. Here is

how it all went wrong" early in the process. It makes sense to do that later. That is often how it plays out.

We think there is a public interest in getting these things through more quickly. In some of the cases we have experienced, we think an additional 20% discount would have been enough of an incentive for the firm—most likely a firm, but maybe sometimes an individual—to come forward and say, "Okay, we got it wrong", so it is cleared more quickly. The remaining 50% will be enough of a deterrent.

Q64 **Danny Kruger:** Going back to your point about the size of the firm and therefore the impact of the fine, one danger is that you hurt them too much; the other is that you do not hurt them enough.- Given that there could now be a 50% reduction if you plead guilty early, how can you be sure that the calculation the firm will make will not be such that they say, "We are going to risk breaking the rules. If we get caught, we will put our hand up and pay what will actually be quite a small fine"? How do we ensure you are not removing the deterrent?

Sam Woods: That is a very good question to ask. When these things happen, we investigate very thoroughly. Firms have to disgorge to us all sorts of documents and everything that has been going on internally. We will be very alert to any evidence that the misconduct has been deliberately priced in, in the cynical way you just described. If we were to find that, it would be quite a severe aggravating factor that would push the fine the other way.

Q65 **Danny Kruger:** Is it something you could identify? Would it be possible to determine that?

Sam Woods: Yes. If you look at the amount of detail our teams go through in these cases, we look at thousands and thousands and thousands of internal documents. We get a pretty good sense of what went on. There is often a dispute with the subject about what it means. Can you be sure? No. Will we have a good chance? Yes.

Q66 **Danny Kruger:** Given your discretion—as you said, you have the ability to levy unlimited fines—might you find yourselves in fact imposing higher fines that are then reduced by 50%? Could the effect be that the fines, in terms of volume, are just as large?

Sam Woods: Again, that is a good question to ask. We do not intend to do that. We are very conscious of that risk. We will not try to reverse-engineer this to get back to where we would have been before. We will not approach it in that way.

We are quite keen to make this early account scheme work. On the enforcement side, it will enable us to cover more ground with the resources we have, if it has the effect of making investigations shorter. We will do it in that way.

Q67 **Danny Kruger:** As I understand it, when the CMA issued fines for

Deutsche Bank and others earlier this year, Deutsche got a pass altogether because it was the first to confess. Is that a policy you might adopt? If a firm is the first to put its hand up, might it have its fines waived altogether?

Sam Woods: It is unlikely that we would do that because that construct is particularly relevant for cartel situations, for obvious reasons. What we are dealing with is rarely of that sort. Normally, it is where something has gone wrong in an individual firm. It is just less important to us as a way of getting things done.

There is one aspect of that idea that we do have, though. When it comes to calibrating the fine, the degree of co-operation is relevant. If you had a situation that was really like that, it could possibly come in that way. We do not need a formal thing of the kind that the CMA has.

Q68 **Dame Angela Eagle:** My apologies for not being able to be here at the beginning of the hearing. Solvency II was never a very popular directive in the EU or the UK insurance industry. It is not a surprise to some of us who have been around for a while that it is the first thing the Government had a close look at changing.

In aggregate across all the changes made in your consultation to Solvency II, the Government's changes to the risk margin and the changes to be announced to the matching adjustment, can you give us a figure of how much more likely it will be for an insurance company to fail?

Sam Woods: The best estimate we have of that is the one Andrew Bailey put in his letter to the Chair following the hearing we had earlier in the year. To reprise that, because it is the direct answer to your question, the way we approached that question was mainly about the funds that would be released from the cut in the risk margin. That is the main determinant.

Q69 **Dame Angela Eagle:** Is it the reduction in cost from £22 billion to £8 billion?

Sam Woods: That is right.

Q70 **Dame Angela Eagle:** It is a significant cutting of costs, is it not?

Sam Woods: That is right. It is a significant change. It has been brought in by the Government. It is a 65% cut for life insurers and 30% for the rest of the industry.

We addressed your question by looking at how a reduction in requirements of that size might impact the probability of default of insurance companies. We came at that in two ways. One was through an options modelling technique the team ran, and the other was using credit ratings. Neither of those is perfect, but they can both give you a read.

They indicated to us that the change in the stringency of the regulation could move the annual probability of default from 0.5% to 0.6%, an

increase of 0.1%. It depends how you view it. In one sense it is a movement from one small number to another small number. In another sense, it is a material move from 0.5% to 0.6%.

I must point out two things. First, the number that you gave, on which those are based, is based on the endpoint impact after all these transitionals have rolled off, which is 2032. The nearer-term impact will be lower because, at the moment, some of the risk margin is shielded by these transitionals.

The other point to make is that how big that effect is also depends on how much of the risk margin effect insurance companies continue to reinsure. At the moment, that level is very high. We have assumed it is 50:50, in line with the stock, but that can lead you to different views on the answer to that question.

Q71 **Dame Angela Eagle:** If costs are cut to that extent, albeit by 2032 in the end, what benefits can customers expect to have? Will you be keeping a close eye on how that goes? Will all of the extra efficiencies in costs be pocketed by shareholders and executives?

Sam Woods: That is a good question. It is worth separating two things. First, everything in our June consultation paper is about increasing the efficiency of our regulation for the industry without increasing risks to policyholders. We were discussing this with Mr Baron earlier. Whether the increased efficiency gets passed on to customers depends on how much competition there is in the insurance sector. We believe there is enough that those reduced costs will be passed on.

That is different for the part you are mainly focusing on in your question, which is the reduction in the risk margin and the widening of the sorts of assets that firms can invest in. The Government's stated objective in making those changes is to drive more investment in the economy.

Q72 **Dame Angela Eagle:** Riskier investment.

Sam Woods: It is the objective to allow some more risk in. The best example of that is to allow into the particular portfolios we are talking about here assets that do not have a fixed cash flow. That is an explicit choice and a judgment the Government have made. The Government want to drive that investment. That is why they are doing that. They believe it will be good for the economy. It is different across the two sides of the package.

Q73 **Dame Angela Eagle:** Would the LDI crisis have been exacerbated or would the Bank's ability to intervene during the LDI crisis have been harmed by the new rules you are proposing, for example on reporting requirements?

Sam Woods: Just to remind the Committee, I am still conflicted on LDI, but not in a way that I think prevents me from answering the question, if that is okay, Chair.

Chair: My colleague is perfectly entitled to ask.

Sam Woods: I feel I can answer.

Dame Angela Eagle: If you feel you can answer, that is fine. You may want your colleagues to answer. It is entirely up to you.

Sam Woods: It is okay. I feel I can answer. The answer to the question is no. There is nothing we are doing here that would have got in the way of what we were doing in the LDI crisis.

One result of the package will be a change in investment profile. In particular, the cut to the risk margin and the changes to the eligibility criteria for the matching adjustment may lead to greater flow out of the pension sector and into insurance companies than would otherwise have been the case.

If you look at it through that lens and you take a really long-term view, you might say that it would have been helpful in the context of the LDI crisis because you would have had less on the other side of the fence, where the problem arose. That is not the motivation for the measures. I do not know whether my colleagues want to add to that.

Charlotte Gerken: On the LDI side, at the time, some of the insurers had some operational difficulties knowing what assets they had with their custodians for collateral on derivatives.

Q74 **Dame Angela Eagle:** It is never very easy to unwind derivatives contracts, is it?

Charlotte Gerken: Depending on the investment mix of firms and how much collateral they may need to find in very stressed conditions, it could be more difficult, if more of their assets are not highly liquid investments.

Q75 **Dame Angela Eagle:** That might have led to a bigger fire sale of assets than the ones we saw during the LDI crisis for the mixed funds.

Charlotte Gerken: In very stressed conditions, yes, it could have done. The main issue was around the operational side for the insurers.

Earlier, we were discussing some of the reductions we are making in reporting under the Solvency II reforms. An area that we are working on with the firms is around liquidity reporting for insurers. We are in the early stages of working with policy colleagues on that.

Q76 **Dame Angela Eagle:** You think that might help to counter any of these issues in terms of knowing where the assets are.

Charlotte Gerken: Yes.

Sam Woods: Having a better handle on that would certainly be helpful on the insurance side of the perimeter.

Q77 **Dame Angela Eagle:** We talked about the Silicon Valley Bank UK

collapse. It was a thing that came out of what happened in California and it was non-systemic. When we asked you, Sam, whether the collapse of Silicon Valley Bank had changed your prudential approach to these matters, you wrote to say it would not. Soon after, you published this consultation, setting out a proposed new approach to manage the failure of non-systemic firms. Were you right the first time or the second time?

Sam Woods: I was right the first time, in the sense that it was genuinely a coincidence. I said in the autumn of 2021 that we were going to bring something forward in this space. Events then intervened in all sorts of ways and delayed our work for various prioritisation reasons. It just so happened that we had to deal with that resolution situation before this came out. It is not connected in that sense.

Indeed, this policy would not help with a Silicon Valley type situation. There are some things that we have to do on the resolution side, having learned from Silicon Valley, but they are different from these.

Q78 **Dame Angela Eagle:** When this was happening, you decided that you could not put it into insolvency as a result of its own resolution strategy. You had to do something else, which inadvertently handed HSBC a £1.2 billion profit for $1.25 or something like that.

Sam Woods: It was £1. It may well be $1.25, depending on where the exchange rate is.

Q79 **Dame Angela Eagle:** It might have been. Goodness knows where the currency markets go from day to day. What use are resolution strategies if, when something like that happens, you ending up gifting HSBC an asset worth £1.2 billion for £1?

Sam Woods: There is a lot of truth in what you say, but I would characterise it slightly differently. By the time we got to the Sunday evening of the weekend you are talking about, we had three fully operable options for the resolution. One was a transfer, which is a resolution power we have and is the one we used. The second was the bank insolvency procedure. The third was a bridge bank. The choice we faced was about which of those looked the best, all other things considered.

Given the presence of a willing buyer who was in the market for commercial reasons, as you say, it was our judgment that the first option would serve safety and soundness best, would reduce the risk of contagion and was the best way to go. I think that was the right judgment.

The insolvency procedure was there, but you are right: there were concerns about using it because of the disruption it would inevitably cause to current account holders, mainly business current account holders in that case. We were already doing this work to make solvent exit more likely. We were doing that anyway, and that will help. We were also already looking at whether we need to add something to our

resolution toolkit to give us more options next time we get into that situation.

Q80 **Dame Angela Eagle:** As someone who did the bank resolution Act, or whatever it was called, after the financial crisis, a resolution strategy is no good if it cannot ever be used.

Sam Woods: I have never thought about it in that way. I have always thought that all of this work on resolution and what we have done on ring-fencing is designed to give us options when we get into these situations.

It is true that you usually have a central plan. By the way, this is also very relevant to the quasi-resolution of Credit Suisse, which we were heavily involved in. You have a plan, but, when you get into it, it is likely that things will not be exactly what you prepared for. As I say, it is about having options. Based on that experience, we need one more.

Q81 **Dame Angela Eagle:** The business depositors at the bank came from a sector of the economy that is widely seen as important. Was that why you took the decision you took to gift HSBC £1.2 billion of assets for £1?

Sam Woods: You are right: there was a lot of concern around the disruption that could occur for the companies that banked with Silicon Valley Bank UK. It is true that those companies operate in quite a sensitive sector. It is not hard to understand why many of the stakeholders involved would be concerned about that.

My guess is that those concerns could arise in other cases where you have current accounts, either business or personal. It is not obvious to me that they would be present for a bank that was funded only by savings. That would be quite different.

Based on exactly that learning from that experience, we think we need to have another option or options that would enable us to secure that continuity without the current issue with the bridge bank, which is the fact that any costs at the end come back to the public purse.

Q82 **Dame Angela Eagle:** What cost is there likely to have been in Silicon Valley Bank UK, though? It has been so profitable for HSBC to take on the risk. It is a pretty good risk-return: £1 for £1.2 billion of profit.

Sam Woods: In that case, it has turned out that there is not a net cost. That is a very good thing. That is basically because the supervisor has done a good job of making sure there was enough capital in the UK firm to accommodate the problem that arose. However, there had been a fundamental loss of confidence in the firm. Something needed to be done, in our view a resolution, in order to deal with that problem.

You are right: it has turned out to be a good piece of business for HSBC. It is also an outcome that worked well for the PRA’s objectives and the wider public interest.

Q83 **Dame Angela Eagle:** Can you see why, in the light of what happened, resolution strategies and insolvency plans might be regarded with cynicism by other players in the market? They might even be mapping out what regulators are likely to do in similar situations to ensure they have the appropriate kind of depositors to make certain their insolvency will never occur.

Sam Woods: That is a plain risk, as you say. People are wrong to be cynical about the value of the work that is being done. You may consider this extraordinary, but my personal experience in these two episodes, both Silicon Valley Bank UK and Credit Suisse, has made me in fact much more positive about the value of all that work.

In those situations, I found that it was a practical matter. You get in there and you have things you can do. You have some options. A bank is going bust so none of them are great. That is just the nature of the thing. That feels to me very different from the situation in which we found ourselves back in 2008. It is not great, but it is definitely better.

Q84 **Chair:** Just to help me understand, if these changes had been in place at the time of the Silicon Valley UK weekend, would you have done anything differently in retrospect?

Sam Woods: We would have had a stronger competing option with the one we took, if we had had another option that delivered continuity of access to deposits without a risk to the public purse. That would have been stronger. Would it have definitely been better? I am not sure. We needed to re-establish confidence in the firm. What we did achieved that pretty well. It seemed obvious that it would. We would have had a stronger competitor. Of course, you will have other situations, but this is the vital point: you need a willing buyer, if you are going to make it work.

Q85 **Chair:** Would you have been less likely to choose that willing buyer option?

Sam Woods: We would have had another option that would have been more appealing than the others we had at the time. Does that mean we would not have gone with the transfer? I am less sure about that. We might have gone for the transfer anyway, but we have to think about other situations in which there is no one there to buy it.

Q86 **Chair:** From where I sit, it seems like that was a better outcome than the outcomes you had in the last financial crisis.

Sam Woods: That is my feeling about it.

Chair: Thank you for dealing with this very disjointed session. That has provided a lot of information for the Sub-Committee to look at with regard to the three consultations we have talked about today. Thank you for your time.