



## Industry and Regulators Committee

### Corrected oral evidence: Commercial insurance and reinsurance regulation

Tuesday 15 March 2022

10.30 am

Watch the meeting

Members present: Lord Sharkey (In the Chair); Lord Blackwell; Baroness Bowles of Berkhamsted; Lord Burns; Lord Cromwell; Lord Reay; Lord Trefgarne.

Evidence Session No. 6

Heard in Public

Questions 65 - 76

### Witnesses

I: Sean McGovern, CEO, UK and Lloyd's, AXA XL; Malcolm Newman, Managing Director, EMEA Hub, SCOR.

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## Examination of witnesses

Sean McGovern and Malcolm Newman.

Q65 **The Chair:** Good morning and welcome to the sixth session of the Industry and Regulators Committee on commercial insurance and reinsurance. It is a pleasure to welcome our witnesses for the session: Sean McGovern, CEO, UK and Lloyd's, AXA XL, and Malcolm Newman, managing director of EMEA Hub, SCOR.

The witnesses have before them a declaration of Members' interests. The session is being broadcast by parliamentlive.tv. A full transcript is being taken and will be made available shortly after the meeting to make any corrections.

Good morning, again. Before we address the main topic of the inquiry, perhaps we can touch first on Ukraine and the sanctions imposed by the UK Government. The FCO has told us in evidence that implementing these sanctions is a significant exercise, but it is confident that the industry can implement them, as it has previous experience.

Do you share the FCO's confidence that the industry can do that, how quickly can you implement the sanctions, and what do you estimate will be the effect of Russia being cut off from the London market both immediately and downstream? Perhaps, Sean, you would like to start.

**Sean McGovern:** Thank you to the committee for inviting me today and for your interest in the London market and the way in which it is regulated.

I am happy to start with Ukraine. Of course we are appalled by what is going on in Ukraine as a consequence of the acts of aggression, and our thoughts are with all the victims of that aggression.

With regard to sanctions, we can implement sanctions very quickly in the insurance market. Particularly given that we are an international insurance market accepting business from all over the world, we are well used to ensuring compliance with international sanctions. Obviously, the situation in relation to the sanctions that have been brought about by the Ukraine crisis have been implemented very quickly and they have evolved very quickly, and they have generally been implemented with immediate effect. That has required the industry to act quickly, but, speaking for my own firm, we have a lot of expertise in sanctions compliance and I am confident that we are able to adapt and address the sanctions issue very quickly.

One of the challenges that we have had through the quick evolution of the sanctions has been some of the differences that emerged between sanctions imposed, for example, by the US versus the EU, but we are seeing those ironed out as the sanctions regime continues to evolve so I do not see that as a particular challenge for us now.

Addressing your final question about the impact of Russia being cut off, as you say, from the international community, clearly it is going to have

an impact on the flow of business into London, but I do not think that is going to be material in the scheme of things for the market overall and certainly not in relation to my own business.

**Malcolm Newman:** Similar to Sean, we implement sanctions immediately they are announced and, like Sean and all the other companies, we have many years' experience of dealing with sanctions. We have processes in place. We have the ability and desire to comply with all the sanctions. That is our duty and we will continue to do that.

I have nothing much to add on the impact on the London market. It should be relatively minor.

Q66 **The Chair:** Thank you. We now turn to the main business of the inquiry. We have heard from several witnesses that regulators can be excessively interventionist, sometimes acting almost as a shadow board, requesting a great deal of information and a great number of meetings. Do you recognise this characterisation and, if so, what effect does this kind of behaviour have on you and the wider London market? Sean, would you like to start?

**Sean McGovern:** The regulatory regime in the UK on any basis is very demanding and the information that is shared with our regulators and the meetings that we have with them are just two dimensions of that regulatory regime, which I will come on to in a moment. We have a very significant body of regulatory requirements with very high expectations of the management of those companies and, indeed, their boards of directors.

It is right, of course, that we have those high standards because it is part of what creates the confidence for business to flow into London and for investors to deploy their capital there. That significant body of regulation has accumulated over a very long period. We have a significant body of formal regulation and lots of informal requirements that the committee has heard about from previous witnesses.

I have been around the London insurance market for 25 years and I cannot think of any regulatory requirement that has been removed in that period, so regulation is only ever cumulative in its effect. That creates a very significant and growing compliance burden on the firms that operate in the market. We have to build the frameworks; we have to embed them; we have to document them and be able to audit them; and we have to be able to show that they are subject to the appropriate level of governance and controls. All of that creates costs to our business and obviously creates some level of lost opportunity cost.

The reason why I say that is that this puts an enormous amount of pressure on the business and it puts a lot of pressure on the boards who are responsible for the stewardship of that business. To illustrate the point, our board packs, when you take combined committee materials and the board materials, can often run to 700 pages. That is an enormous amount for our boards and our non-executives in particular to

have to absorb. It is an important dimension and we look at the impact of regulation.

When it comes to what we share with the regulators, there is a significant volume of financial reporting. That really ramped up after the implementation of Solvency II. We saw a significant increase in financial reporting and we are very pleased and welcoming of the commitments of the Government and the regulators as part of the Solvency II reform to look at reducing that financial compliance reporting burden.

As to the meetings we have with the PRA, I will be honest—we do not find those to be a particular burden. I would estimate that we have about 35 meetings or phone calls with our regulators in a year and I do not think that is disproportionate given the scale of our business.

**Malcolm Newman:** There are often what I would describe as unnecessary interactions with the regulators. The regulator tends to work on a one-size-fits-all basis. When they want to know something or they want to inquire generally in the market, they tend to contact all firms regardless of whether that firm is involved in that activity. All those inquiries come through and require you to formulate your answers internally. They also require your board to be involved in that process to sign off any answer that comes back to the regulator. They demand an enormous bureaucracy around what you have to do in responding to their queries. It is not so much the volume—like Sean, we have a similar level of activity—it is really the way they choose to do those inquiries. If they were more proportional in their approach to the regulated community, they could reduce the number of queries that they ask.

I can give an example of my own firm. We were contacted recently about the general insurance pricing inquiry. We are a pure reinsurer. We do not sell policies to the public. We do not have any general insurance policies. We have a letter now from our regulator that we have to answer. I said to my compliance community, "Please contact the regulator. They must have sent this in error. This cannot apply to us". The regulator's answer was, "You just send in a nil return". To send in even a nil return you have to go back to your board; you have to explain to them why the regulations do not apply to you; you have to convince them that you genuinely have a nil return, and then you submit that back to the regulator, all for something that did not need to happen in the first place.

To me, the key is more proportionality from the regulator in the way they interact with the regulated community. That would make sure that the meetings were focused and necessary.

**Q67 Lord Blackwell:** Malcolm, could I pick up further on this point about the one-size-fits-all approach? You have given the example of general insurance pricing. Are there other examples you can think of where either there has been a blanket approach or there is not a clear enough definition from the regulator of where the dividing line is as to whether something applies and, therefore, for safety reasons you have to go through the whole of the book?

**Malcolm Newman:** I have other examples. I think you had evidence from some academics about the “Dear CEO”-type letters, where they write to a person in your organisation. We have received those letters that are not addressed to a particular firm. Like most businesses in the London market, we have an array of companies. My own company has a syndicate at Lloyd’s, it has a regulated insurance company and two inbound EU branches, one doing reinsurance and one doing insurance. We have four different entities in different segments of the market. If we receive a letter, we do not know which entity it relates to. That is just an example. I do not know how they keep their database but you have to work out which of your entities it applies to; it is maybe all of them.

Then there is the element of what you do with those letters. To be safe, quite often you will talk to all the governing bodies of all your entities about the letter because you do not want to breach any regulatory requirements; you do not want not to do something that you are expected to do. There is that degree of thinking through what the regulator wants. They have some genuine concerns and it is interesting that they have developed a “Dear CEO” letter, but I would say it is too broad-brush.

**Lord Blackwell:** Is it just laziness on their part that they are not thinking it through enough or they do not understand?

**Malcolm Newman:** The root cause is the fact that we have a combined regulator for banking and insurance, and the rulebook is written to cover both banks and insurance. It is written at a very high level. The granularity that we seek is not embedded in the rulebook. When you work as a segment of the market as a pure reinsurer, for example, where your customers are other regulated businesses, that is a different risk to the regulatory objectives than if you are selling motor and home owners’ insurance. The rulebook still applies equally across all those businesses. Often they have to ask the same questions to all those businesses because that is what their rulebook demands.

**Lord Blackwell:** They have not gone through the rulebook to make that distinction clear between professional reinsurance and the commercial market.

**Malcolm Newman:** Until Solvency II came along there were no domestic insurers, with the exception perhaps of Pool Re and other special purpose vehicles like that. One of the reasons why reinsurers were not in the UK was because the UK regulated reinsurers as if they were insurers. It is too high a burden. Reinsurance is a cross-border business. You can sell reinsurance to customers in other countries. You do not necessarily need to be based in the London market.

Solvency II allowed the EU companies—I work for a French company—to create branches in the UK. Three of the four largest reinsurers in the world, of which we are one, are based in the EU and they have branches in the UK. We now have a reinsurance industry again in the UK, but the fear I have is that, if we do not change the proportionality approach and

we do not recognise that reinsurance is different from insurance, my firm and many others will contemplate why we are now onshore: why do we not revert to the pre-Solvency II status and do this business from our home state?

**Lord Blackwell:** Sean, do you have similar views on one size fits all?

**Sean McGovern:** I will pursue a point that Malcolm made about the roots being in the fact that we have come out from a legacy of regulation that really does not make a sufficient degree of distinction between insurance and banking. If you go back to the financial crisis—and a lot of regulation that we have in the UK was a reaction to the financial crisis—what we saw post financial crisis was a significant pendulum swing towards more regulation, and understandably so. However, the insurance industry found that it got swept up in that regulatory redesign and we are still living with the legacy of that today. There is a very significant level of requirements around senior management responsibilities but also things that were designed to try to solve what was a banking crisis around living wills and resolution planning. A lot of things were designed to address banking issues that were translated across, much against the will of the insurance industry at the time, and we are still living with the legacy of that.

The other thing is that one of the legacies of the financial crisis is that the re-examination of what went wrong inevitably raised questions about the performance of the regulators, and understandably so, but it created inevitably quite a risk-averse culture within the regulator. I think we are living with that legacy also.

More directly on the segmentation of the insurance market, the market in which the businesses of which I am the CEO operate is the large corporate specialty risk segment. The customers we serve are sophisticated corporate buyers who buy insurance through insurance brokers, yet some of the things that the FCA has imposed on the insurance industry are things that have been imposed on our business. The pricing review is a very good example of that. No one is suggesting that the mass consumer market, given the balance of power that exists between an insurer and the customer, should not expect a high degree of regulatory protection, but that argument does not hold in relation to the customer segment that my business serves.

The other thing that is missing from it is that most of the customers of my business are actually located overseas. The application of FCA requirements in relation to the protection of customers who are located in other jurisdictions who benefit from consumer and other protection arrangements in their own country of origin means that we are at risk of duplicating the requirements, which makes the London market unattractive to bring that business to.

There are issues around the legacy of where we have come from. There is not enough distinction between banking and insurance, but even within

insurance we do not see enough distinction between how it is applied to commercial insurance versus mass consumer market insurance.

**Lord Blackwell:** I assume from your earlier comments that the consequence of this lack of targeting is the immense board packs and time consumed of senior executives. One of the consequences of that, I assume, is that, if their senior executives are spending their time sorting out those requests, they are not spending their time doing other things that would be more productive in terms of customers and competitiveness.

**Sean McGovern:** It absolutely goes back to the point I was making. There are the very real costs. We have built a framework to go through the annual pricing review that the FCA requires. As a regulated firm, we have to meet the regulatory requirement. That requires resource. We have to hire that resource in. We have to dedicate the time and attention to it as senior management as well and it does create a distraction for the business when we should be looking at opportunities to grow the business.

**Lord Blackwell:** One of the other points that has been raised with us is that, if regulators are excessively cautious in thinking about emerging services and emerging firms, that can act as a block on the development of the London market. The specific example that has been raised is the insurance-linked securities market, which has not taken off here as it has elsewhere, and the lack of a captives market in the UK. Do you recognise that those are failures of regulation to encourage those?

**Sean McGovern:** Perhaps I can address captives; Malcolm is much more knowledgeable on ILS than I am. Captives are used by large companies, and indeed public bodies, to write their own insurance. They generally write only the risks within their individual group, and it is a tried and tested way for groups to manage the risks to their balance sheet over time. They have become increasingly popular; we have seen significant growth in the use of those captives globally, but of course we do not have any UK-domiciled captives.

I want to dispel a bit of a myth that the location of captives is driven by tax. That may have been part of the reason why we have seen captives located in offshore domiciles in the past, but I think that has changed dramatically over the last couple of years with the efforts that have been done at the OECD on base erosion tax to level corporation tax requirements across the world. Tax is no longer a factor. Indeed, many of the UK captives that are located in jurisdictions outside the UK choose to be tax domiciled in the UK. So I do not think tax is a driver of this.

The regulatory regime absolutely is, because the UK regulatory regime currently requires captives to be regulated as if they were any other insurance company. If you think about it, a pure captive has no interaction with the rest of the financial sector; it is not selling policies to third parties; it is only covering its internal risks but it is required to

operate as if it was selling policies to third-party customers. That is one of the reasons why we do not have captives here in the UK.

I also want to make sure it is clear that this is not just the preserve of offshore domiciles. Some EU countries have very successfully pursued the growth of captive insurance within their own jurisdictions. Ireland, for example, has designed a regime for captives insurance, and there are now 70 captives located in Ireland. Luxembourg has done the same and has now over 200 captives located there. Those countries both operate under Solvency II. There is no question about the robustness of their regulatory regimes, but they have made the necessary changes to ensure that captives are proportionally regulated and we have seen the results of that.

**Lord Blackwell:** Thank you. ILS?

**Malcolm Newman:** I worked as the chair of a joint task force between the Treasury, the PRA and the insurance community to create the ILS legislative framework. We had some discussions with the City Minister prior to that to point out that business opportunity for the UK was missing. He then agreed that we could set up this joint task force and I worked on it for three years before the legislation was passed. There was a strong desire from all parties, including the regulators, to create an ILS market onshore in the UK. The legislation itself went through both Houses and is on the statute book.

If we look at where we are now, the end result is that five issues have occurred in the UK, two of which have been done by my own firm. What was the issue that those people faced, or what was the issue that stopped others following that route?

Singapore, which has developed its own ILS framework, watched the UK framework. It has more or less transposed the UK framework into Singapore law. The framework is a very good one. It is a more joined-up effort between the Monetary Authority of Singapore, which is the regulator, and the financial authority of Singapore, which has duties to promote its market and grow its market. It has actively pursued the growth of its ILS industry. It has issued 18, having started after us. In the last 12 months it issued USD\$700 million-worth of ILSs. This is internationally mobile business in the sense that ILS issues can be done in a number of jurisdictions. You can choose where you are.

My own firm, thankfully, chose to support my efforts in this task force and we very much wanted to develop at that time an ILS centre within the EU. Dublin does ILS issues. We felt that it was strategically important not to depend so much on offshore jurisdictions where the ILS issues are. My own firm does not have any dealings in Bermuda; we do not deal with Bermuda. We prefer to deal with onshore jurisdictions and we felt that London would be a very good place for this market to develop. In London you have the infrastructure, the broking community, the customers, the banking community and the investment funds. You have the insurance community, the ideas and product construction.

Everything was in place and it came to going live. The PRA, in particular, had set up a specialist unit. I think it was essential that the PRA needed to be given the funding to create specialist units. If we go down the captive route, it needs the funding to create a specialist unit to authorise captives. It created this. It is a learning experience for it.

The first year was more difficult, more expensive and slower than we would have encountered had we followed our route. In the past we have issued in Ireland. We decided to go again the second year and unfortunately the experience was the same; nothing had changed. The market-leading turnaround times are measured in days in terms of regulatory approval. The legislation gives the PRA months. In a sense, as long as you know, with some definitive timeframes, you can work around months. There are some pinch points where you have to try to get all your documentation or your investors in line before you go live. There are some difficult issues there where time is of the essence. At those times that is where we had the most difficulty with the regulator. It undermined a little bit of confidence in that process. Things did not improve, so we did not do a third issue. We talked to them about a third issue the following year, but we decided to go back to Ireland.

**Lord Blackwell:** What has the regulator's response been when you have raised this with them?

**Malcolm Newman:** The leadership of the regulators is very supportive. It was on the task force; it genuinely wants an ILS framework to be used and to have some activity here. What is difficult for it is that it has its statutory objectives—safety and soundness. It is its only objective. It has to stop failures. It cannot afford one of these ILS vehicles to fail. In its mind, there is a high level of risk because it has not seen these before. It does not quite know how they work and what risks they pose, so it is ultra-cautious.

That is one of the arguments we have used to ask for the competitiveness agenda—something else to balance that out. It needs to be given some cover, either by Parliament or the Treasury, that allows it to take a different approach from its normal, very risk-averse approach. Obviously we do not want it to do anything silly, but there needs to be an element of, "Well, we've not seen this before. We've not done this with you before. We're in this together." In our case we are a French-listed AA-rated company, so the level of risk of dealing with us is lower than perhaps some other institutions. We have done this before. The investors we are working with have backed our other vehicles. All those things are low-risk factors that should allow it to take a more proportional approach. The thing that stops it is the fear of its primary objective.

**Lord Blackwell:** Some other jurisdictions have offered financial incentives, paying the upfront cost of ILS issues, as I understand it. That is not the major determinant.

**Malcolm Newman:** We were offered the financial incentive to do the one that we could have done in the UK and Singapore. We chose to do it in

Ireland. From the point of view of developing a market, it is very clever of the Singapore authorities to say, "We will cover the fact that you have to develop a whole new set of documentation". In the past most of these issues have been done under US law. We are now doing issues under UK law. This is new territory for the lawyers; it costs money to develop that. Once the lawyers have that technology on their books, they can resell that to other people at a more economic cost. We were willing to fund that ourselves to try to create the market in the UK. The Singapore authorities were willing to fund that to help create the market. I do not think you need to do that funding indefinitely. That is a kick-starter. If the UK was willing to do that it may have a marginal effect, but I do not see that as the reason why all those issues went to Singapore.

**Q68 Lord Burns:** Could I begin by following up one or two of the points you made about proportionality? What I am still struggling with in this discussion is to what extent the problems lie in the legislation, to what extent they lie in the rulebook and the way that the regulators have decided to implement it, and to what extent it is the actual way in which they are regulated and the whole question of delay, and just not being able to speed up the process. There are three parts of this that I can identify and I am still unclear.

One of the examples you gave seems to tilt towards the latter part of this in that it was the way it was implemented and somewhat sluggishly, but how far does it lie in the way the legislation has been set up? Where does the correction have to come from? That is the consequence of what I would like to hear about.

**Sean McGovern:** It is probably an element of all three of those, Lord Burns. Proportionality is embedded in the regime as it stands, but it is not delivering. You have heard from a number of witnesses that we are not feeling that proportionality in practice. Then it is how firms are supervised, which goes to some of the everyday occurrences that we have spoken about and how requests for information, supervisory questions, are asked, which again do not really show a sufficient degree of understanding or sensitivity to the individual circumstances of firms or sectors that we are operating in.

In relation to delays, we see some delays on some of the regulatory processes where we have to get regulatory approvals. Malcolm has spoken about ILS, but just much more mundane subjects such as appointment of senior managers have to go through an approvals process. On that latter point, the question for me is that it is not necessarily about the resource. It is whether the process within the regulator is truly adding value to getting to a better outcome. The firms are quite rightly held to a very high standard in going through the right level of due diligence about the individuals they appoint to their individual roles, and that is a responsibility very firmly on the shoulders of the boards of these companies.

We go through this very extensive due diligence and then we have to go through a very extensive application process with lots of form filling for

the regulator to put it through its own process, which takes a tremendous amount of time. We hope that the reframing of regulation may give us an opportunity to do that: has the regulatory process that has been built achieved the outcomes that were intended, or have we embedded a lot of non value-adding activity into the regulator, which then causes the delay and businesses getting the approvals they need from the regulator?

**Malcolm Newman:** It is really around the practices the regulator has developed and the bureaucracy within the regulator. We need the regulator's mindset to evolve. It has to genuinely believe in proportionality and not simply pay lip service to it. You heard from the regulator that the competition objective is a secondary objective. The regulator said that it could live with that and it would test its development of regulations against that objective.

That mindset shows it has not changed. If we have a competitive objective, it is to make the UK more attractive. It is to do positive things that improve the business environment here, which means that more investors and more clients will come here. You cannot do that by testing legislation you develop just against the secondary objective; you need to think about what you can do differently and what you can do to improve the business environment and make UK plc more competitive.

Our London market business is primarily an export business. It is one of the larger export businesses that the UK has. It is very productive, it is profitable, and it is a sector that the economy really needs to hold on to and improve and grow. That is the element that we think the regulator needs to have in mind and needs to do specific things to help that, as opposed to merely testing its existing approach against that.

**Lord Burns:** On the particular issue about the senior management applications, we have heard quite a lot about this and about delays. Is it an issue of resources, or is it just an issue of the working style of the regulator? Is it a serious problem?

**Sean McGovern:** I am not sure it is necessarily an issue of resources. There is probably an opportunity to recraft the regime, as I said, to look to see whether there is a way it can be made more efficient and rely on the due diligence that has been conducted by the firms, and ask some testing questions, but not necessarily require very significant levels of detail, which are probably reviewed by relatively junior people within the regulator, because I am not necessarily sure it is getting us to better decisions about who is running insurance companies or banks. I do not think it is necessarily an issue of resource; it is a question of reframing what is required and freeing up resource to help the industry look for opportunities to grow.

Q69 **Lord Reay:** I would like to ask you about the environment post Brexit. Does Brexit provide any opportunities to tailor the regulatory regime more closely to the circumstances of the London market, or would you favour maintaining a similar regime to the EU? Do you believe there are opportunities to make changes, and, if so, what changes would you

make?

**Sean McGovern:** There is an opportunity to try to get the best of both worlds now that the UK can chart its own course around the kind of regulatory system it wants to support the UK economy. Because we were a member of the EU, a lot of financial regulation was driven from the EU. I guess what we are saying is that it feels like a very opportune moment to be having the kind of debate that the committee has provoked with this inquiry. We are encouraged by the consultations that are under way by the Government on exactly this topic.

We are not seeking a wholesale revision to Solvency II. The industry invested huge amounts to implement the Solvency II regime. There is a lot in that regime that is very positive and very good, but there are clearly elements of it that can be improved. The EU is already looking at that from its own point of view, and the UK Government are doing the same. We are at a very good moment to choose how we want to recraft the regulatory regime, and for the Government, and indeed Parliament, to take more ownership over the policy that they wish to adopt for the industry.

On things like captives, at the moment there is no formal mechanism by which big policy questions like that can be debated. There is no process or procedure by which that can happen, so we are left having quite good and constructive conversations with the PRA, but effectively the policy decision is being taken by the regulator, not by Parliament and not necessarily by the Government. Creating a mechanism that gives transparency over what it is the industry would like to do, create the opportunity to debate that and come up with a decision that is then implemented by the regulator is very positive.

Going back to my point on Solvency II, as I said, there is a lot of good in it. We have a number of regimes in the world—I will use Switzerland and Bermuda as examples of that—that have been able to get Solvency II equivalence across all the elements of Solvency II. To achieve that, they had to convince European regulators that the outcomes that were achieved from their regulatory regime achieved equivalent outcomes to Solvency II, but they have done it in a way that does not involve all the bureaucracy and detailed rules that Solvency II has left us with the legacy of. They are able to chart a course that both marries strong regulation that is credible, because they have had to go through a process of assessment by the EU, and is competitive. We should aspire to try to do something similar in the UK.

**Lord Reay:** In terms of the Government's proposals for Solvency II, are you in broad agreement with the plans? Do you have areas of concern there as well?

**Sean McGovern:** We are very positive about the speech the City Minister made a few weeks ago setting out the agenda for Solvency II reform. In many ways, a big part of the elements of Solvency II reform that capture the most attention relate to the life sector, which is not my business.

In relation to the business that I run, the opportunity to reduce some of the bureaucracy but, importantly, some of the reporting obligations that we are under at the moment, which drive a significant degree of cost, is all very positive. We are looking forward to the next round of consultation. We think there is probably even more that we can do, but we are broadly positive about the direction of travel on Solvency II from a general insurance London market point of view.

**Malcolm Newman:** I would like to pick up on one of the points that Sean touched on, which is around solvency and capital. We are not seeking a race to the bottom. We are not seeking the UK to be a zero-capital or a light-touch capital regime. It is important that the UK maintains its reputation for safety and soundness. As a global business, we have invested, as Sean's business has done, in working with the solvency regime with our internal models and our calculations, which we can then apply across as many countries as we can apply because of the Solvency II regime. We do not want the UK to depart significantly from that approach. We are not seeking to do things with less capital. That is not really the problem that is putting people off coming to the UK.

We appreciate that our life colleagues may have different views about capital and Solvency II, and that is an issue specific to them. When we are in a global business, a level playing field is important—that we can compete at least equally with the others—and we support Solvency II and other international measures to have standardisation of capital models because that takes away one of the complexities around the business model that we have to adopt.

Q70 **Lord Reay:** Moving on to competitiveness, which, Malcolm, you touched on, are you in favour of the proposals to give the regulators a secondary objective in relation to competitiveness? Do you think that the London market may lose its reputation for stability and soundness if such an objective results in weaker regulation?

**Sean McGovern:** I absolutely support it. Zero failure cannot be the only measure of the success of a regulatory regime, in my view. A primary duty would be preferable, but what is more important is what is going to change within our regulators to breathe life into the new objective should Parliament choose to give that objective to them. What is going to be different when the new objective is in place and we avoid a situation where it is seen to be another box that gets ticked as regulators go through consultation processes?

I do not think that it would weaken the reputation of the UK from a regulatory perspective. I think the UK can continue to have a reputation for being very sound from a regulatory perspective. As Malcolm has said, it is very important to businesses like mine and the customers that we serve that we operate out of countries and regulated entities that are safe and sound. That is an important dimension of the competitiveness of the market to have that strong regulation. It is possible to maintain strong regulatory standards, but ensuring that the way in which regulation is framed, reviewed and ultimately delivered is supporting

what businesses are trying to do in creating economic activity in this country. Other regulators around the world manage to do this, and I am confident that our regulators will be able to manage having those two objectives.

**Malcolm Newman:** I repeat my concern about it being a secondary objective. That will not bring about a change of behaviour at the regulator. It will accommodate that, but it will not change anything fundamentally. It is for Parliament to decide whether it is primary or secondary and an objective tool. It is part of giving it a clearer direction of what it is trying to achieve for the UK.

**Lord Reay:** How would you like to see the objective being implemented by the regulators? What metrics should be used to judge performance? How should the regulators be held accountable?

**Malcolm Newman:** When the FCA said it was a leading regulator, you asked it how it measured that and what it had done to determine that. It had no answer for you because no benchmarking is done by regulators against other regulators around the world. They have a perception. They are held in high regard by other jurisdictions. Those are clear, but how do we know?

We need some objectivity, some benchmarking and some annual reporting from the regulator about how it is doing. It needs to have some performance goals and some turnaround times that it has to report against and be held accountable for so that you can see whether it is delivering what it is supposed to be delivering, and, if not, you and your parliamentary colleagues can take appropriate action. Absolutely transparency benchmarking reporting needs to be developed, and we need to hold the regulators accountable for that.

**Sean McGovern:** I agree with Malcolm. Just to echo a point that he made in response to another question, I do not think it will be enough if this duty is in place for the regulators to effectively confirm how it is that they are not damaging competition by their actions. We should ask them to confirm how it is that their actions are supporting and enabling competitiveness of the industry. That is the important first point.

A lot of it is about creating the right regime of transparency and accountability. First, why would we not require the regulators to publish a strategy on how they are going to bring this objective to life? Having that transparent process embedded within the regulator, and indeed within parliamentary process, is to address the big policy questions such as captives and why ILS is not delivering the kind of growth that had been hoped for.

There also needs to be a wholesale review of the current stock of regulation, otherwise we will be in a world where only new regulations get put through this new lens. We ought to be standing back and looking at the existing stock of regulation and asking how it is that that regulation enables or supports growth and competitiveness.

Just to echo the point about culture that Malcolm made, there needs to be an approach within the regulator that is intent on trying to help make things happen. That is not the approach that we have today. That is a cultural and attitudinal question. You can have very firm regulatory requirements and high standards, but you can do it in a way that helps the firms address those issues and questions to enable them to get to where they want to get to. That comes down to the approach that we have within the regulator.

As Malcolm said, we are largely an export-driven sector of the economy. Importantly, of the inwards investment that comes into the London market, 60%-plus of that comes from outside the UK. An important part is to create the right perception around the globe that the UK has strong regulatory standards but that we are open for business because perception matters. When businesses are choosing where to locate people and capital, the detail matters, but perception counts for quite a lot. There is something about being a bit more front-footed, whether it is within the regulator or the Treasury, and making it clear that for financial services, clearly, we are operating in an environment that appropriately sets high standards but that we are open for business. A competitiveness objective will start to get that message out.

**Q71 Lord Cromwell:** Can I follow up a little on that? On the metrics question, from talking with the regulators they are going to need the industry's help to work out the right metrics to be used. I am sure there is a group in the industry that can help them with that. You mentioned them possibly producing a strategy. A strategy can always be rather woolly. I prefer a plan with proper milestones, and I think you might too. Just setting aside the competition objective but recognising that there is an innate tension between competitiveness globally and being a super-regulator, if you look at the existing rules rather like a building, you are not talking about a new build; you are talking about renovation of an existing building, if you will pardon that metaphor. Do you think the regulators are culturally ready for even that, never mind the international competitiveness?

**Malcolm Newman:** Drawing on my experience of ILS, the leadership of the regulator is supersmart and it really wants to do the right thing, but the organisations it leads are very bureaucratic. To get a bureaucratic organisation to change will be quite a challenge. There needs to be some significant work on culture change within the regulators. There need to be strong signals from Parliament that that is what it wants and that is what is expected of the regulator.

**Sean McGovern:** There are a number of ways in which you can do that. I am not suggesting that what is done in other jurisdictions is necessarily copied and pasted into the UK regime. Having dealt with the Singaporean regulator, the MAS, no one would suggest that the MAS was a low-touch regulator. It sets very high standards, but it is very pragmatic in the way it applies those standards. Importantly, it has within the regulator a development arm that, in part, is responsible for helping the Government to pursue an agenda by incentivising businesses to come, but part of the

MAS is there to help make things happen. It understands what the business objective is and it works with the business and its supervisory colleagues to find a way through.

From my point of view, it is my answer before about what the regulators are going to do differently if this objective comes in. That would be a very clear statement of intent. Then you create a team and a culture within the organisation that is looking at everything through a very different lens than what historically has been the case. Maybe that is a way of approaching it: you do not try to dilute the integrity of the regulatory system and the supervisors, but you create a group of people within the regulators who are there to listen carefully to the industry and help the industry find a way through.

**Lord Cromwell:** Not to extend the metaphor too far, this is not a question of teaching old dogs new tricks, but you need some new dogs.

**Sean McGovern:** Absolutely.

Q72 **Baroness Bowles of Berkhamsted:** We have covered a lot of the issues that were the subject of my question, which was to do with hearing about our competitive rivals in other sectors, such as Switzerland, Singapore and Bermuda having a quicker regulatory process and a more proportionate approach. I was going to ask what could be learned from other jurisdictions, but you have already covered it in previous answers.

Moving on from that, is it possible for what we always call a leading global insurance market to be as nimble as the regulators are in other jurisdictions? Following on from what you have just said about the development arm in MAS, do our regulators sit back and think, "Okay, we invented the sandbox. That is our development arm. So we isolate everything there and don't let it influence anything until we are positive that it won't lead to failure"?

**Malcolm Newman:** The sandbox that lies within the FCA was an excellent invention. There should be more thought to creating a sandbox-type environment. That would have helped a lot with the ILS if the PRA had been given the safety of a sandbox environment. It will help a lot with the captives if that can be ring-fenced for a development period before it is subjected to whatever the regulation might be after that.

Those are good innovations. There are not enough of them coming out of the regulator. The sandbox was invented quite some years ago and has not really been used a lot. That is an example of where it could be more creative in addition to having the development people within its organisation.

There is another area where we could learn from other jurisdictions. We have practitioner panels who are there to work with the regulators. The regulators effectively veto and select who sits on the practitioner panels. They meet in secret. Nobody in the industry knows what is going on at a practitioner panel. The practitioners on that panel are told they are not to

speaking for their own business—they are there to speak for the industry—but how can they speak for the industry when the industry does not know what the practitioner panels are being asked or what is being discussed? There needs to be more openness in that interaction between the regulator and the industry.

There needs to be thought around tapping in some external expertise. If we go back to my firm, my chairman is on an advisory panel to the MAS in Singapore. It has a panel drawn from senior business leaders and academics to whom it can put policy questions. It can ask whatever it wants from that panel, and the panel will give it the benefit of its expertise as an input to development of policy.

What we do not have, and we have not probably needed to have, in our regulators is policy development. We have taken our regulation from the EU, and the policy development has been there. We need to think about how we develop policy. Do we leave it entirely to the regulator to develop that, or do we have some mechanism either jointly with industry or ideally with democratic input into what the policy should be in the first place? You need to think about those mechanisms. They do not exist today.

**Baroness Bowles of Berkhamsted:** If I could follow up on that, has the bird not flown, in that we are just going to have this very high-level framework with no extra parliamentary involvement, so to speak, because the Treasury Select Committee thinks that it does what it does and does not want any more, and everything will be left to the regulator? To be honest, I feel devastated, having been involved in Solvency II since the start and all of the proportionality that I bust a gut to get involved in, that it is just ignored. I was doing that on behalf of the UK. Everything that the UK poured in has just been ignored by our regulators.

How is that going to change? I admire the optimism that both of you have shown that you can get some change. I am just devastated. The notion that you can have any of the kind of dialogue that went on within the European context and that that is going to exist in some form is just not going to happen.

**Sean McGovern:** I do not disagree with you that we certainly have been encouraging the embedding within the new regime of more of a role for Parliament in addressing these issues. I would agree with you there. If we can craft the competitiveness duty and be clear on what the regulators are going to do differently if that competitiveness duty comes in, that gives us a path.

To address your question, given the size of the UK financial services industry and the size of the London market, I agree that puts us in a slightly different position from some other markets, but I do not think we should give up on the opportunity to try to create a more nimble, responsive regulatory regime. It is, frankly, too important to UK plc and to the UK economy that we keep trying to create a more nimble,

responsive regulatory regime that is capable of supporting economic growth. The industry is too important.

If I may use the example of Bermuda, which I am very familiar with, Bermuda manages to create a regime that is welcoming but is also very strong. It guards its reputation for soundness very strongly because it is too important to its economy not to. It went through Solvency II to get Solvency II equivalence. It was a very important recognition that the regulatory regime in Bermuda was delivering equivalent outcomes to any other EU member state's regulatory regime, and we should not forget that.

Not should we think that the Bermuda regulator is overseeing a tiny market. There is over \$50 billion of premium written out of Bermuda. This is a large, sophisticated market. It is half the size of London, but it has a regulatory regime that is able to do the best of both; it is able to give confidence to investors and to customers while being open for business for new ideas and new initiatives.

**Baroness Bowles of Berkhamsted:** If our regulators cannot provide the best of both, we should tell them that they have failed. Is that a reasonable yardstick? If they cannot match up to stability and soundness as well as not grinding everybody down with too many pages, inquiries and compliance checks that are not even needed, misaddressed or not properly addressed—if they cannot cut that out—they will have failed.

**Malcolm Newman:** Yes. We need an accountability mechanism, and we need reports and benchmarks that make that obvious. We need to measure these things.

**Baroness Bowles of Berkhamsted:** What is the sanction if they do not measure up?

**Sean McGovern:** That is ultimately a matter for government and Parliament. We are here to try to help find a way to create the infrastructure that sits across the regulators to ensure, whether it is through the right level of transparency to Parliament or the right reporting and the right metrics, that it creates the conversation around whether the regulatory regime is delivering the intent that Parliament is giving. If Parliament recrafts the regulatory regime and puts an obligation on the regulators to demonstrate that they are supporting growth and competitiveness, if we can get that accountability regime right and we get the transparency right, ultimately, what sanction, as you say, applies would then be a matter for Parliament and for the Government.

**Baroness Bowles of Berkhamsted:** When we heard from the regulator, Sam said that the Bank of England is on a hub-and-spoke type of arrangement. If something goes wrong, it is the people at the hub, the people at the top—who are, as you have said and I agree, very bright people—who get told off, but the problems are further down in the spokes. Is that because they do not have enough autonomy down in the spokes? Are the people down in the spokes where the actual supervision

is going on not given enough authority? How do you change those?

**Sean McGovern:** Any business or government department struggles with taking the strategy that is set at the top and driving implementation through the business. There are a number of mechanisms that you can do to achieve that. One way of doing it is to set up a specific department that creates a sense of urgency and a change of dynamic. It needs to be something quite significant to move the dial for the reasons that you have said.

I do not think that is any different from any other business. You have your objectives, you have your strategy, and you drive implementation. I do not think we should necessarily see the regulator as being any different from any other organisation that has to grapple with that challenge.

**Baroness Bowles of Berkhamsted:** But they are not generally people who have been in organisations grappling with that challenge, are they?

**Malcolm Newman:** Maybe not, but they are bright people, and it is not rocket science.

**Baroness Bowles of Berkhamsted:** Indeed, but it seems to have escaped them since the start of Solvency II, and everything that you have told us was said in September 2017 when it was first published. The proportionality is there and nothing has changed. Thank you for your efforts. The suggestions about something significant to move the dial are extremely important.

**The Chair:** Lord Reay and Lord Blackwell have additional questions.

Q73 **Lord Reay:** The Government have recently intimated that they want to reinvigorate fossil fuel exploration in the North Sea. We have also heard from witnesses—heads of insurance companies—that they have their own net-zero policies, and that can preclude insuring the development of new oil and gas projects. In fact, we heard the chairman of Hiscox say similar things last week. How can the Government make this happen if the industry will not insure it?

**Sean McGovern:** AXA group, which my business belongs to, has very clear positions around its appetite to continue to support oil and gas exploration, and that appetite is very limited. Certainly, in relation to providing insurance in relation to new exploration, we would have no appetite for that.

The reason is very simple. We are in a situation where we are grappling with the impact of climate change in relation to increasing frequency and severity of loss events, so it seems incongruous to us that on the one hand we would be grappling with the effect of fossil fuel supply on the climate as an insurer, and on the other hand continuing to insure the on-production of oil and gas, which is a contributor to the challenges that we all face from a climate perspective.

For us, it is a very simple equation. We are grappling with the increasing frequency of floods, tornadoes, wildfires, and how we continue to serve clients who are impacted by those events. We felt that we had to take a stand, as many other insurers have, in relation to their ability and willingness to continue to supply insurance for coal and oil and gas exploration.

**Lord Reay:** Thank you for that. You did not actually answer my question. I understand your position is similar to a lot of other insurance companies, and we will hear from Malcolm in a minute, but how can the Government get these projects financed if the industry will not insure them?

**Sean McGovern:** I cannot speak on behalf of the whole industry, but not everybody in the industry is taking the stance that we have. Some in the industry continue to have an appetite, and I am sure that they would be willing to make their capacity available to support such projects. I am not speaking on behalf of the whole industry, but there is a significant segment of the industry that is taking a very similar position to us.

**Malcolm Newman:** Our corporate position is identical to the one that Sean has outlined from AXA. This is very much a part of what we are trying to do in contributing to the fight against climate change. As an organisation, we have made public statements and commitments, and we intend to deliver on those. Our appetite for new extractions and new developments is extremely limited, as Sean's firm's appetite is as well.

**Sean McGovern:** I will make one additional point, if I may. We absolutely have an appetite to support alternative fuel sources. We see that as a massive opportunity for the insurance market. As part of net-zero commitments, a significant level of investment will be going into developing alternative energy sources. That will require insurance. This is cutting-edge technology that has some challenges around designing insurance to manage the risks associated with that. The London market has a very significant role to play in creating the environment where capacity is deployed to support alternative energy sources. AXA is making very significant commitments in exactly this from an investment point of view in terms of green bonds and supporting the race to net zero. We believe we can do the same on the insurance side as well.

Bringing it back to the subject of this inquiry, we believe it is really important as we are exploring those new opportunities that support the government agenda around net zero that we have a regulatory environment that helps us solve those problems. We are not standing here washing our hands of the fact that we need to create an alternative energy supply, but we are saying let us focus our efforts as AXA on looking at how we support new energy supply rather than defaulting back to the old energy supply.

Q74 **Lord Blackwell:** I am conscious of time, but I want to come back briefly to your discussion with Baroness Bowles. You have been very careful in distinguishing your comments about the quality of the leadership of the

regulators versus the bureaucracy that they lead.

In terms of the quality of the people, when you compare the UK regulators with what you have experienced elsewhere, supervision works best when you have knowledgeable, experienced people who feel confident to apply judgment. If you have less confident and less experienced people, they will tend to fall back on filling in all the forms and dotting all the "i"s and crossing the "t"s. Is there a quality problem in terms of the people in the supervisory teams being able to make judgments and cut through?

**Sean McGovern:** I do not want to generalise too much, but my experience in other locations is that you have fewer but more highly qualified individuals, which has the effect that you have highlighted. We also see more talent moving between the regulator and the industry. There is much more of a two-way street between people who have experience of being in the insurance industry, doing a spell within the regulator, and then coming back out into industry. Obviously, one has to put safeguards around that from a conflicts point of view, but it is entirely manageable because we see it elsewhere. You end up in a situation where you have much more informed people within the regulator because they have actually had the experience of operating within the environment on the other side of the fence.

**Lord Blackwell:** Do you agree with that, Malcolm?

**Malcolm Newman:** I absolutely agree with that.

Q75 **Lord Trefgarne:** Am I right in concluding from all of this that, if you get a major inquiry from an overseas customer, it is not open to you to say to the UK regulator that its services are not required because this particular customer has adequate protection at home?

**Sean McGovern:** There is a complete lack of clarity over the scope of the UK regime when it comes to overseas customers. The UK regulator feels unable to provide us with that kind of clarity. We have asked the question. It means that, out of an abundance of caution, you apply the rules anyway.

**Lord Trefgarne:** Two sets of rules.

**Sean McGovern:** With an absence of clear direction, the boards of our companies are very clearly reluctant to take any regulatory risks, so we apply them anyway.

**Lord Trefgarne:** Do you think that should be clarified?

**Sean McGovern:** Yes.

**The Chair:** We have time for one more question.

Q76 **Lord Cromwell:** In the example you gave of people moving back and forth between the regulator and the industry, are they or are they not taking a pay cut to do that? Would that apply in the UK?

**Malcolm Newman:** Speaking as somebody who has hired people from the regulator, having that on your CV is really valuable. It is not simply a question of maximising short-term remuneration; you have to look at how an individual wants to build their career. If you have a bright person coming from a university going into the regulator, learning regulation, then coming into industry, learning about industry, going back to the regulator and perhaps coming back to industry, that person would be hugely valuable. For periods of their career, they may be investing in themselves. There are many people out there who are willing to do that.

**Lord Cromwell:** That would be the same in our competitors.

**Malcolm Newman:** Yes, it would.

**The Chair:** That brings us to the end of this session. I thank both our witnesses for their input and their contributions this morning in a very enjoyable and informative discussion.