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Sent via email

25 April 2024

Business and Trade Select Committee

Dear Committee members,

Thank you for the opportunity to provide evidence at the industry policy inquiry on 16 April. During my session, I committed to writing to the committee on our sandbox initiative related to Solvency II reforms, which will boost investment in the UK.

The UK needs greater investment to unlock economic growth. To become a net zero economy, an estimated £2.4 trillion of gross capital investment is required by 2035[1] in climate solutions such as offshore wind, solar and energy efficient housing.

The single most important role for pension savings is to help fund retirement. We are very clear that our pension funds must deliver the best returns possible for our 12 million customers, and their interests will always come first, which is why Solvency II reform is critical to ensuring Phoenix can access a broader range of assets to help secure our customers' future.

Currently, the UK does not invest nearly enough in productive assets, that is assets which create a social and economic value. Out of the seven countries with the largest pension savings (P7), the UK allocates the least to private markets which include the types of social and economic infrastructure that the country needs to grow. Just 14% of UK assets are allocated in this way, whilst the average amongst other P7 countries is 20%.[3] As a result, pension savers are missing out on the value created by these types of investments, which many other countries benefit from.

The Solvency II reforms are critical to unleashing more capital towards the UK's infrastructure needs. Last Autumn, the Prudential Regulation Authority (PRA) published proposals designed to enable broader and quicker investment by insurers in their matching adjustment (MA) portfolios. The MA is a mechanism which allows insurers to recognise the reduced exposure to short-term fluctuations in prices of assets backing long-term fixed pension payments; so long as the cashflows are tightly matched between asset income and pension payments

The Government has already legislated to partially relax the requirements around which assets qualify for MA, allowing limited investment in assets which pay 'highly predictable' cashflows instead of 'fixed' cashflows. This is a pragmatic move in the right direction, but we have identified assets which qualify under legislation, but not under detailed PRA rules. More generally, we need the regime to be agile enough to quickly respond to future funding needs; for example, to support the net zero transition where we do not know what new technologies will emerge, or how this funding might be structured.

This led us to consider how we could enable the sector to invest in a broader range of assets while providing our regulator with the requisite reassurance over policyholder safety. As such, we have proposed the introduction of a "Matching Adjustment sandbox", targeted at investigating productive or sustainable assets that do not qualify under the existing rules.

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Firms like Phoenix would voluntarily apply to invest limited amounts in assets which would ordinarily be ineligible, in the sandbox for a short period of time. At the end of the sandbox period, once the PRA has examined the asset characteristics, the PRA would either amend its rules to facilitate sector-wide investment or decline to amend its rules, publishing the rationale for its choice.

Importantly, the sandbox would provide a mechanism to allow insurers to actively engage with the regulators and help fulfil the PRA's new growth and competitiveness objectives.

The new 'Solvency UK' regime is the first step on the journey to supporting greater investment in the UK. But we need to seize this moment to ensure it works even harder for savers, the economy and the environment.

Yours sincerely,

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