Phoenix Group – Written evidence (SCG0042)

About us

Phoenix Group is the UK's largest long-term savings and retirement business with £280 billion of assets under administration. As life expectancy continues to increase and the pension landscape continues to shift, we offer our 12 million customers a broad range of pensions, savings and life insurance products across our family of brands which include Standard Life, SunLife, Phoenix Life and ReAssure. Our vision is to help even more people on their journey to and through retirement, providing the right support at the right time.

Introduction

Phoenix Group welcomes the Lords Financial Services Regulation Committee's inquiry into FCA and PRA's secondary growth and competitiveness objective (SGCO).

The UK is a leading global financial centre, with one of the largest pensions markets, managing assets of over £3trn. However, the UK is an outlier compared to developed markets in three distinct ways. UK pension funds:

1. Are the most fragmented[1]
2. Underinvest in productive assets- 6% vs 20% global average[2] [3]
3. Underinvest in their domestic capital market- 4.2x vs 13.3x global average.[4]

Given the UK's world-class financial capabilities and accumulated wealth, we share the UK Government's assessment that there is opportunity for pension funds to invest more domestically, and in-line

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[1] Comparing the asset allocation of global pension systems (newfinancial.org)

[2] 20240909-ppi-pension-scheme-assets-main-report-final.pdf (pensionspolicyinstitute.org.uk)

[3] GPAS-2024.pdf (pgl.internal)

[4] Comparing the asset allocation of global pension systems (newfinancial.org)

with how international peers structure and invest in their own markets.

In order help facilitate growth and competitiveness in the UK, it is widely believed that there needs to be concerted effort by government, regulators and industry to help boost domestic investment. However, in the recent past, there have been disruptive events which have created both challenge and opportunity.

Following the Great Financial Crisis the UK's trend growth has halved from 3% from 1993 to 2007, to 1.5% between 2009 and 2023.[5] Moreover, the UK's departure from the EU has changed policymaking in two distinct ways, 1) the shift from legislation into regulators' rulebook, and 2) the onshoring of UK financial services policy, where government and regulators are entirely responsible for the UK regime.

Given this changed environment, we believe that in order for regulators to facilitate international competitiveness and growth they will require a much greater focus on outcomes rather than prescriptive rules, and a recalibration of risk- appetite. These changes are institutional and cultural, and will take time to embed. However, a more agile, nimble and growth-oriented regulator can and should remain focused on important objectives of consumer protection and financial stability. These key ingredients, working better together can help boost investment and, thus, growth in the UK.

Executive summary

Phoenix supports the adaptation of the secondary growth and competitiveness objectives (SGCO) by the PRA and FCA. We note the changing environment presents challenges and opportunities for regulators, as well as government and industry.

[5] Low growth: The economy's biggest challenge (parliament.uk)

In our response below, we state that regulators should apply principles to their approach to policymaking and supervising firms, these principles should be: outcomes-based, predictable, coherent, adaptable/agile, efficient and accountable.

Since the introduction of the SGCOs, regulators have embraced the new frameworks, but Phoenix agrees with the Chancellor in her remit letters to both the FCA and PRA that 'there is more to do to build momentum', and we can't only rely on stability as a pre-condition of growth. We need regulators, government, and industry embracing a new growth mindset alongside a recalibrated risk appetite.

Progress has been made, but there are deep structural issues, for example, in the pension system which have grown over many decades, which are not a direct result of regulatory practice. Successful reform will require government policy to lead, and regulators to implement change, such as consolidation, which can unlock the huge potential of the UK's £3trn pensions wealth.

Moreover, Solvency II reform is an opportunity for the UK's life insurance sector to significantly boost investment in the country's social and economic infrastructure. Phoenix has proposed a sandbox mechanism which would unlock more capital from our sector into critical infrastructure.

We believe that clear and simple metrics and data published by the regulator can help policymakers better understand how the market is functioning, and make better policy interventions as a consequence.

International standards are absolutely necessary for the UK's credibility, but we should not implement them in such a way that puts us at a comparative disadvantage. And, we should learn from

comparable non-UK jurisdictions how their regulators manage to successfully embrace growth and competitiveness, whilst having some of the best pensions and retirement systems in the world.

Phoenix is delighted to work constructively with all stakeholders to embrace growth and competitiveness, in order to benefit our customers, and the wider country.

Questions

1. What opportunities or changes should be prioritised in order for the regulators to meet their secondary growth and competitiveness objectives (SGCO) effectively?

Phoenix believes that the PRA and FCA must now discharge their SGCOs in such way that their policy and supervisory regimes create a more flexible and agile operating environment, and rebalances their risk appetites to deliver growth alongside appropriate risk management.

To embed the cultural and institutional change necessary to deliver their SGCOs, Phoenix believes that regulators should further advance the following principles to deliver their operational objectives:

- An **outcomes-based** approach that creates environment for healthy competition and innovation based on high standards of consumer protection and financial sustainability. The new Consumer Duty is one such example.
- **Predictable** but future focused regulation that avoids regulating for the problems of the past and is sign-posted to the industry on a "no surprises" basis. The FCA's recent proposals around enforcement are an example of where more could have been done to consult with industry on potential implications of the proposals prior to announcing them.

- A **coherent** financial services regime that seeks to avoid overlap, duplication, and confusion.
- To respond to a rapidly evolving financial services ecosystem, regulators need to be **adaptable and agile** in their approach to policymaking. We welcome developments such as Subject Expert Groups ("SEGs") and sandboxes but believe more could be done to collaborate with industry and jointly solve problems.
- We recognise the progress the regulators have made in improving their operational **efficiency** to better support firms (for example, in authorisations). Focus should now turn to enhancing the efficiency of the policy and rules-making progress to reduce the time it takes to move from inception to delivery (for example, Solvency II).
- We welcome the efforts by the regulators to demonstrate progress against their SGCOs and feel that **accountability** could be further enhanced through the adoption of KPIs or metrics that genuinely reflect the cost and experience of regulatory oversight and engagement as well as the opportunity cost of regulatory action/inaction (see Q8).

2. To what extent are the regulators focused on the objective to promote international competitiveness and growth? Are there areas where the ability of the regulators to fulfil their secondary objectives might be constrained by having to fulfil their primary objectives?

Regulators have made a clear and visible effort to adapt and change to the new circumstances. After consultation with industry, both the PRA and FCA have reported on the implementation of the SGCO. We also acknowledge positive steps have been taken, for example, by the PRA in working with industry through SEGs, and the FCA in driving the development of sandboxes to support regulatory applications and product innovation. These are examples of a commitment to growth and innovation which will enhance the

competitiveness of the UK.

A cultural mindset which considers growth and competitiveness will take some time to fully germinate throughout both the institutions. We have observed, until very recently, a tendency for the regulators to state that fulfilment of their primary objective of stability is sufficient to create the right environment to deliver growth and competitiveness.[6] We disagree with this view and support comments made by Nikhil Rathi (CEO, FCA) in his recent Mansion House speech when he stated that there needs to be "*a more candid conversation about our collective risk appetite'*.[7]

To support the UK's position in global financial markets and facilitate its economic growth and international competitiveness, the PRA and FCA should commit to reforms which involve a different balance of risk going forward. The FCA has already made some headway, with the recent changes to listing rules supporting investors to make their own decisions on risk (based on appropriate disclosure) and proposals that Targeted Support offered on a "better outcome" rather than "best outcome" basis.

The FCA has also had something of a head-start in this cultural shift in mindset having launched Project Innovate[8] in 2014 and recently conceding that *"the jury is still out on whether the FCA is helping to achieve growth"*.[9]

The PRA has also demonstrated progress in embedding in the SGCO,

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[6] "the case for robust standards is about more than just avoiding crises. Strong financial regulation also promotes economic growth in a subtler way. It helps to create a high trust environment where you can do business without constantly being worried about your counterparties falling over. This brings down risk premia in the financial sector – reducing the cost of lending for households and businesses, and promoting productive investment- and makes the UK an attractive place in which to do international business"

[7] Growth: mission possible I FCA

[8] 10 Year Anniversary: FCA Innovation Services I FCA

[9] Growth: mission possible I FCA

particularly in banking. In relation to life insurance there have been some signs of early adaption where the PRA has introduced SEGs, and is considering an investment accelerator in relation to the Solvency UK. We do, however, note that there appears to be some inertia with the PRA's adaptation of the SGCO.

We believe that there may be good reasons for this, given the long-term nature of life insurance capital, and the need to protect consumers. However, we fully agree with the Chancellor in her letter to the Governor of the Bank of England, Anderew Bailey, when she said that 'financial services regulators are key to driving for [the growth] mission', but there was 'more to do to build momentum', and that,

'While pursuing your primary objectives of promoting safety and soundness of PRA-authorised firms and the protection of policyholders, and your secondary objective, you should also consider how you enable informed and reasonable risk-taking by authorised firms. These are prerequisites for growth and for ensuring that everyone across the UK can benefit from growth.'

3. What are some of the barriers in the current regulatory framework (including the role and responsibilities of other regulators and bodies such as the Payment Systems Regulator, The Pensions Regulator (TPR) and the Financial Ombudsman Service) that could hinder efforts to drive economic growth and international competitiveness in (a) the UK economy and (b) the financial services sector?

The pensions and life insurance sector in the UK is characterised internationally as a complicated and fragmented market. The reasons for this are a result of years of government policy drift cultural practices and regulatory diffusion.

There can be overlap and duplication between the FCA and TPR in the regulation of pensions.Traditionally, TPR- regulated occupational schemes run by individual companies, whilst the FCA regulated other more commercial types of pension arrangements. This divide was also characterised by different legal frameworks, with TPR regulating schemes set up under trust law, and the FCA regulating schemes set up under contract law. The implementation of automatic enrolment has, however, created a much greater degree of overlap.

The outcome is that the UK pensions system is the most fragmented in the developed world with over 30,000 DC and DB schemes, and 8,000 open schemes. This diffusion has led to UK pension funds investing less in real assets such as infrastructure and housing, than all other comparable developed nations.[10]

The previous and current governments have identified fragmentation as an issue leading to sub-optimal outcomes for savers and the UK's investment and growth prospects. Government has therefore acted, and taken steps to unlock more capital into productive assets from the UK's £3trn pension funds. More investment from these funds can unlock growth in the UK, and help transition to net zero.

4. Do the regulators have the right capability and capacity to fulfil their regulatory objectives on growth and competitiveness? To what extent might the culture of the FCA and PRA influence their ability to fulfil their growth and competitiveness objectives?

[10] Comparing the asset allocation of global pension systems (newfinancial.org)

The shift from the pre- to post- Brexit regime has significantly increased the responsibility of UK regulators. Previously, much of the UK's financial services rules were contained within primary legislation and more broadly derived from the Acquis.

Now, the majority of those rules and regulations sit within the UK regulators' rulebooks. To that end, there should be serious consideration by government and regulator executives on the capacity to deliver a sound and competitive financial services policy and regulatory framework.

As markets evolve there will inevitably be questions over whether the skills and knowledge mix of the regulator is appropriate for the industries they regulate. Following the Mansion House Compact, where providers have committed to allocate 5% to unlisted equity, regulators will need to work closely with industry to appropriately monitor how these assets are managed on the balance sheet, without forcing industry to undertake unnecessary action, which would hamper investment into those assets. The way the FCA implements its Value for Money framework, for example, may inadvertently deter investment in private assets if reporting on returns is limited to a three or five year period in assets which are bought and held over a much longer time horizon.

More broadly, as discussed in question 1, regulators need to be adaptable and agile in their approach to policymaking. Formalising processes will not in itself change, however, embracing SEGs and sandboxes create a collaborative environment, which builds trust and enables firms to more confidently innovate knowing that their new product or asset has an enabling regulatory mechanism.

5. How effectively have the FCA and PRA consulted or

engaged with industry in relation to the new secondary growth and competitiveness objective?

See Q2

6. In delivering their secondary objective on growth and competitiveness, what opportunities are there for the regulators to help to promote and support innovation in the financial services sector? How effective has the FCA's regulatory sandbox been for supporting greater innovation in the financial services industry?

The new Solvency UK regime will be important in helping to unlock billions of pounds into real assets each year. The private sector DB and annuity market has assets approaching £1.5trn. In recent years, insurers having been writing up to £50bn of bulk purchase annuity business, which is well suited to financing social and economic infrastructure, such as social housing and clean energy.

However, the new Solvency UK regime, whilst an improvement on the previous Solvency II regulation, may not unleash the investment in new assets that the UK needs to build new types of infrastructure. In order to address this issue and boost investment into new productive assets, Phoenix has proposed a Matching Adjustment Sandbox targeted at facilitating more flexible and innovative investments in annuity funds. A mechanism such as the sandbox is one tool which regulators and industry could use to ensure the regime keeps pace with market developments.

We believe that introducing a sandbox-like mechanism would be a strong signal to policymakers and the market that safe innovation is being embedded and encouraged at the PRA. Further, a sandbox would ensure that prudential regulation in the UK organically evolves and adapts naturally over time to respond to market forces and

policy needs, without the requirement for continuaI government intervention.

For example, from inception to delivery, Solvency II reforms have taken five years. We should note that the PRA was dealing with a turbulent political environment for some of this period, but it is important that critical reforms are not delayed for extended durations. An example here where regulatory change could have advanced the SGCO, was to mirror the EU's approach to providing capital relief for qualifying infrastructure investments, to reduce (rather than increase) the regulatory reporting burden, and to deliver in the rules the investment flexibility which the legislation allows.

7. How should the regulators ensure that any measures introduced to meet the secondary growth and competitiveness objectives work for businesses of all sizes across the sector, including startups, scaleups, and incumbents?

Pension and insurance firms are the largest cohort of asset owners in the UK. The Mansion House Compact is designed to unlock more capital from pension firms in order to increase investment more in unlisted growth opportunities. One way of achieving greater investment is creating scale through consolidation of pension funds.

Whilst government may need to act through primary legislation to achieve this, it will, in practice be governed by TPR and the FCA. If government and regulators create an environment where providers can more easily consolidate, for instance from FCA-regulated schemed to trust-based schemes, it would quicken the pace of consolidation, and create larger funds which would be more capable of investing not only in start-ups, but in real assets, such as infrastructure.

8. Are there any additional metrics over and above those already agreed by the regulators that would better enable stakeholders to track progress and support scrutiny of their work against the secondary growth and competitiveness objective? How should a measure of growth be included in these metrics?

Phoenix submitted its response to the previous government's call for evidence on measuring the success of financial regulation. We proposed that government should not legislate for specific metrics to be used in evaluating regulatory outcomes. Rather, it should set principles and frameworks for accountability, within which all stakeholders can input. This will enable the most relevant and appropriate measures to be assessed and scrutinised in a periodic way. This process should be led by the regulators who would engage with industry, trade bodies, and consumer groups to identify metrics that are widely considered to be good measures of success.

There are three themes which we believe should be addressed under the new SGCO. We give examples below of the types of metrics which could be used to measure outcomes against each theme, but note this is not exhaustive, and other metrics could be equally valid.

Further, we recognise that many of these metrics are produced by firms and not directly within the gift of the regulator, however, reporting on clear and simple outcomes would help policymakers and parliamentarians more easily scrutinise the ecosystem in which firms operate. Indeed, other non-UK regulators publish similar data, such as Japan, alongside their objectives, despite not being primarily responsible for, example, the number of new licences issued.

Growth

Facilitating investment

- UK pensions and insurance asset allocation to productive assets vs non-UK firms- under agreed definitions of productive assets.
- Speed of regulatory approvals, number of approvals/rejections, number of new asset classes/modelling approaches approved, level of capital add-ans/adjustments before approval.

Innovation

- Measuring the number and volume of new products/services sold in the previous 12 months.

Competitiveness

- Sector growth
  - Number of new insurers/branches authorised in previous 12 months, split by sector.
- Cost of products and services
  - Cost of comparable insurance products vs international markets
  - Cost of re-insurance vs international markets.
- Cost of compliance, regulatory requirements, and regulatory change
  - Speed of approvals under the Senior Managers and Certification Regime
  - Level of, and justification for, the cost of any capital add-ons held in aggregate across the sector.

Consumer-focused metrics

- Number or percentage of adults taking advice at retirement.
- Number of individuals over retirement age requiring forms of income support.
- Retirement income levels measured against agreed standards (e.g. the PLSA Retirement Living Standards).
- Pensions contribution rates, both employer and employee.
- Customer satisfaction.

9. Does the requirement within the secondary growth and

competitiveness objectives to align with international standards create any constraints to fulfilling those objectives?

As global finance hub, it is important that the UK continues to align with international standards. We note that FSMA gives regulators the freedom to implement those standards in a way that is suitable for its market. It will be important to implement international standards, but not in an excessive way that means UK firms face more burdens for the same outcomes, as international firms face in their home jurisdiction.

The requirement to align with international standards is important for the UK to remain a global centre of excellence in financial services and the regulators should be heavily involved, as they are now, in the development of international regulation. We do not see the requirement to align with international standards as necessarily conflicting with the SGCO. but this will be dependent on how the regulators implement this requirement.

For example, for the global Insurance Capital Standard which Phoenix will be subject to, a number of rules are in principle aligned with elements of the Solvency UK regime but in practice are calculated in a different way to the UK rules. The PRA has already taken a pragmatic view in assessing such examples as equivalent using an outcomes-based assessment avoiding the need for a doubling of the regulatory compliance and reporting burden.

The additional rulemaking powers that have been afforded to the regulators since Brexit means they have significant flexibility to implement international standards in a way that doesn't undermine the SGCO. While we consider it unlikely that the regulators will seek to adopt a less prudent view than international standards which they so heavily influence, we could foresee a situation where the

regulators' implementation approach and/or assessment of equivalence is challenged internationally or by the markets which could negatively impact growth and international competitiveness. The key mitigants against this risk are the primary objectives focused on safety and soundness ensuring high standards are maintained, the strong technical expertise and reputation of our regulators, the transparency of the rationale for UK rules meeting the needs of the UK market, and ongoing dialogue and collaboration with international regulators.

10. Are the existing accountability measures around the secondary growth and competitiveness objective adequate?

During the passage of FSMA Phoenix argued that it was important to increase democratic accountability of the regulators, commensurate with their enhanced powers and responsibilities.

FSMA provides additional oversight by requiring the regulators to notify relevant committees when they publish a consultation, and a requirement for regulators to respond to Parliament. Moreover, the FCA and PRA are required to report twice to HMT within 12 and 24 months on how they have advanced their new objectives. Phoenix believes a more regular process to report should be established.

The boards of the regulatory authorities provide accountability for performance and have a critical role. They should have appropriate and transparent governance arrangements in place to measure, manage and report against performance.

11. Are there examples of regulatory policies in other jurisdictions that should be considered by UK regulators to help facilitate the new secondary objective? What might the FCA and PRA be able to learn and apply from comparable

supervisors in other markets in terms of applying secondary objectives on growth and competitiveness?

Switzerland, Australia, Singapore and Japan are examples of comparable regimes which successfully balance consumer protection with growth and competitiveness objectives. Moreover, Canada protects consumer interest whilst having regard for competitiveness. Australia and Canda are two comparable pensions nations, which the UK Government through its pensions policies is seeking to emulate. There is evidence that both of these countries outperform the UK in pension fund performance, and have large defined contribution markets.

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