EIC0884

Written evidence submitted by the Institute and Faculty of Actuaries (IFoA)

Summary

This response considers two themes:

- the potential financial impacts of COVID-19 life and health events on consumers and what can be done by life/ health insurance and insurance based savings product providers to support them;
- the application of institutional investments towards economic rebuilding.

In the short term, access to life and health insurance for consumers has remained very good, but with some restrictions on those obviously already ill or having travelled to high risk areas.

In the medium term we expect there to be additional life and health insurance claims indirectly as a result of COVID-19. Some consumers may also find that life and health insurance becomes less affordable.

Life and health insurance products may be considered more important in the longer term, particularly for key workers; key workers may see greater reward and recognition more generally, including enhanced employer provision. We may also see higher saving rates amongst consumers. This may increase demand for insurance-based savings products. Affordability in some part depends on the income status of an individual to purchase life and health insurance. The economic consequence of significant unemployment will have the knock-on effect of a national reduction in life and health insurance held as insurance and pension funding held through employers is a major source of protection.

If there is reduction in available and affordable insurance for a minority of consumers due to changes to eligibility criteria post COVID-19, this will require discussion and debate on whether this is acceptable to society, and if not, how could this be remedied.

The UK institutional investor market represents a total of £3,900bn of invested assets and is an important source of investment capital for the UK economy. This is particularly the case with UK life and health insurers and defined benefit pensions schemes, given their long-term investment horizons.

There are a number of potential routes for institutional assets to be invested in debt or equity which would support economic rebuilding, including purchase of government debt, and involvement in public-private partnerships and government sponsored investment vehicles.

A fit for purpose insurance regulatory framework is needed to ensure that the insurance industry is well-placed to support the economy as the UK moves towards life post COVID-19.

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to submit a supplementary response to the Treasury Committee's inquiry into the Economic Impact of Coronavirus (COVID-19). The IFoA submitted a first response to the inquiry on 27 May 2020, and in that submission we focussed on questions relating to the economy, public finances and monetary policy.

2. In this supplementary response, we look at the following high-level themes:

- (A) the potential direct and indirect impacts of COVID-19 on consumers and what can be done by UK providers of life and health insurance, and long-term savings products;
- (B) the application of institutional investments from life and health insurers and pension funds towards economic rebuilding.

3. The IFoA, as a professional body, can provide valuable insights into these developments as its members working the technical areas of product design, pricing, as well as the overall financial management of life and health insurers and pension funds. The view from the IFoA is however aimed at the public interest, not the commercial interests of financial institutions. This public interest is served by enhancing access by consumers to fair products to assist them manage the risk of financial outcomes of life and health events. It is also served by ensuring a healthy and robust life and health insurance market, particularly avoiding institutional failure, systemic risk and procyclical investment behaviour.

4. The life/ health insurance and pensions sectors are extremely large and critical pillars of effective economic activity. The themes we cover in this submission consider how these parts of the financial service sectors could support consumers and the economy generally. They should therefore provide additional insight to the Committee's questions on the support business and financial services could require.

5. We also note that general insurance and in particular, Business Interruption (BI) insurance, is the subject of much debate currently in respect of insurance coverage and liability (to COVID-19). At the time of writing, the Financial Conduct Authority has lodged a test case before the High Court in London in relation to BI insurance policies, with the aim of providing legal clarity on whether BI insurance cover includes disruption relating to COVID-19. Depending on the outcome of this case, it could have a material impact on insurers with exposure to BI business. We would also be happy to provide our perspective on any outcome of this test case, in due course. In the light of this, this note does not cover general insurance issues.

Theme (A): Potential direct and indirect impacts of COVID-19 on consumers

6. We consider the potential direct and indirect impacts of COVID-19 on consumers, and what can be done by UK providers of life and health insurance and long-term savings products. In this context consumers means both individual retail purchasers and organisations such as employers and associations who organise group cover. Providers could support consumers in relation to:

- short term (current):
    - accessing insurance;
    - dealing with the direct financial impacts;
    - dealing with the direct health impacts;
- medium term (later in 2020):
    - managing the indirect health fallout;
    - managing the economic fallout;
- longer term (2021+):
    - demand for insurance;
    - saving for the long term;
    - changes in underlying risk.

7. We consider each of these strands below in relation to individual and group insurance and savings products. We do not provide an exhaustive coverage of all products available in the market.

Short term: accessing insurance

8. In the lead up to social distancing measures being implemented in the UK, we saw an increased interest from consumers in life/ health insurance protection products such as term assurance and income protection, in part because of increased mortality salience resulting from coverage of the pandemic. Access has been limited to a small extent in some cases due to changes in underwriting and product distribution practices.

9. There have been changes made to underwriting to better reflect the risk of COVID-19 complications, with the addition of new questions by many providers. As understanding of COVID-19 has developed there has also be better recognition of the pre-existing health or genetic factors which are better predictors of COVID-19 complications in younger lives, as well as the impact of COVID-19 materially increasing with age. This may result in some providers amending their underwriting process to apply premium loadings to those customers that exhibit these risk factors, or restrict cover to certain ages. This may make the cost of insurance prohibitive to certain groups of customers. In the extreme, such customers may now be deferred or declined insurance cover, when otherwise they would have been accepted, although at higher rates.

10. Anecdotally, we saw an initial increase in protection sales, which may have been due to parties trying to get business through their pipeline. As the lockdown measures continued we saw a decline in activity as some advisers were unable to see customers face to face, and several firms have furloughed some of their employed advisers. We are now also likely to see a reduction of new mortgage related sales, due to the drop-off in house sales, since the lockdown effectively put the housing market on hold.

11. While insurance firms have taken steps to try and limit any reduction in access to insurance, for example through developing innovative new underwriting solutions, it is likely that some of the most vulnerable groups of customers have felt the impact most. This may be due to the solutions often involving new technology solutions that such customers do not necessarily have access to or simply cannot use. Firms should consider what more they can do to support these customers in continuing to access insurance.

12. Many financial services providers have had to change their working practices in response to the social distancing measures. For example, many customer services teams have had to move to a remote working practice for the first time while also managing higher than normal absences. This may have made it difficult to monitor and manage customer service quality, including claims settlement.

Short term: dealing with the direct financial impacts

13. For consumers who have contracted COVID-19, it is thought that many cases are asymptomatic. Of those that show symptoms, the majority will have only mild symptoms. However, some will suffer complications requiring hospital treatment, and some may also lose their life. Those that survive following serious complications could be off work for several weeks, leading to a significant loss of earnings, and in the worst cases, it may take many months until the individual is back to their pre-illness level of health. There is also emerging evidence of the length of time required for recuperation from more severe COVID-19 illness.

14. The financial impact resulting from serious complications or death should be partially or completely offset by life/ health insurance, particularly short deferred period income protection and life cover.

Some customers may also use savings to help cover any costs. In this respect, providers will need to ensure customers can claim or access their funds as quickly as possible considering the operational challenges such as increased staff absence they may also be facing. Life insurance policies do not include exclusions due to pandemic or coronavirus specific conditions.

15. A report published in June 2020 by Public Health England on disparities in the risk and outcomes of COVID-19[1] put the cumulative number of COVID-19 deaths between 20 March and 7 May 2020 at 35,400. The report stated that over 80% of COVID-19 related excess deaths were from those aged over 75. However, the provision of life and health insurance products is primarily to individuals and employers of staff of working age; i.e. under 65s. This means that many of those who died due to COVID-19 may not have had such insurance.

Short term: dealing with the direct health impacts

16. Whilst life and health insurance products are often aimed at providing a financial safety net to customers, some of their services may also be used by customers to access health care and treat symptoms of COVID-19. We also understand that there has been more engagement in virtual GP services as customers want to avoid face to face contact with their doctors.

17. Private health insurers may have been unable to provide access to private hospital care in the same way they normally would due to an agreement between Government and the UK private healthcare sector to provide more capacity to the NHS. In this sense, customers of some health insurance products many not have had as much value from them that they might have otherwise expected.

    Whilst these are direct health impacts, they have second-order economic impacts.

Medium term: managing the indirect health fallout

18. Besides the direct claims from COVID-19, there will likely be indirect claims arising from the lockdown measures. These could include:

    - the effects of isolation in lockdown or increasing unemployment is expected to lead to a deterioration in existing or development of new mental health conditions;
    - many people have been staying away from GPs and Accident & Emergency services, while others have had elective surgeries or treatments deferred. This has meant many conditions have not been treated appropriately at the right time, leading to some conditions deteriorating making it more difficult to treat and recover in many cases;
    - insurers could play a role in encouraging customers to seek advice on new symptoms using virtual GP services. This may encourage some customers to seek the help they need now and limit the impact on health;
    - there may also be indirect health impacts due to a combination of lifestyle changes, such as changes in alcohol consumption, exercise habits and (improved) air quality.

    These health impacts will have second-order economic impacts.

Impact on insurance

19. Consumers who are furloughed or lose their job may be forced to re-evaluate their spending; for some, they may be unable to continue paying premiums on their life and health insurance policies. This could lead to some policyholders lapsing their policy. However, health insurance is thought to be one of the last direct debits consumers will cancel, and this is particularly likely in the current situation.

1https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/892085/disparities_review.pdf

20. Some insurance providers have also offered premium holidays so that customers can keep their cover in place and pay their premiums when their income recovers. We have noted an industry-wide approach to trying to add flexibility to premium holidays, not only in extending the period of the holiday, but also in ways to repay the premiums missed during the holiday. Instead of requiring all the premiums to be paid in one go, alternatives could be to spread the cost over the remaining term, or to reduce the level of cover for the remaining term. However, this may not help customers with more extreme drops in income for a more sustained period, and those who choose a proportionate reduction in cover may be under-insured and be impacted even more financially, should they need to make a claim during the period.

Impact on savings

21. Another consequence of the economic fallout is that many consumers are expected to need to draw down on their savings, including accessing tax efficient vehicles like ISAs, LISAs and pensions. When withdrawing or switching funds, some older products may have exit charges or penalties which may compound the financial impact on those customers. Whilst there has been much focus on exit charges on historical products, providers should consider if there are any other charges that could be removed for customers wanting to access their funds.

22. Some customers may choose or have no choice but to liquidate investments at a time when asset values are depressed, crystallising losses. For those able to wait, asset values may recover somewhat in the short or medium term. However, income from savings and investments are likely to be suppressed for some time where interest rates are reduced and dividends are cut by companies, compounding the financial impact for some customers.

23. Insurance-based *savings* policies fall into two categories:

- Unit Linked policies where the policyholder decides on the investment allocation and often has great flexibility on the timing of withdrawing money from the policy. Some policyholders may choose to do so when asset prices are depressed, but this is the flexibility that they have with these policies;
- With profits policies where the investment returns for policies are smoothed over time and where there are restrictions of withdrawing funds from a policy. These designs are specifically aimed at protecting policyholders investments in troubled economic times.

Longer term: demand for insurance

24. It is likely that consumers will currently have a heightened awareness of their own health and wellbeing for a sustained period. As a result, more consumers may see the need for certain protection products, which may lead to an increase in demand for life and health insurance.

25. The pandemic has also highlighted the critical role that key workers like doctors, nurses, carers, delivery staff and food producers play in our functioning economy, with a change in the way they are perceived. Governments in Scotland and England and Wales introduced life assurance benefits for those front-line workers who lose their life in response to the pandemic. Many employers introduced additional pay or bonus for those working during the lockdown and there are calls for pay rises for many key workers. We may see greater reward and recognition for this group more generally.

26. While many key workers are currently direct or indirect customers of the insurance industry, there are a significant number who are not. This may change - through greater government provision, pressure on employers to provide benefits or increased demand for individual products from these key workers. Life and health insurance providers should consider what new products could be

created for these customers, if it is clear that there is an unmet need, or what changes to underwriting may be required to better serve this market.

27. However, care will be needed to ensure, as the insurance market evolves (in terms of products or markets served), that products meet specific consumer needs, and that widespread product mis-selling does not arise. Thought will also need to be given on whether such products can be sold on a sustainable financial basis, given the likely high claim cost in future periods of high unemployment.

28. As noted above, there has already been a shift by insurance providers to do more digitally in response to the lockdown measures, for example introducing new medical consultations for underwriting. While we can expect much of this digitisation to remain or expand further when the measures are lifted, it may exclude more customers, particularly more vulnerable customers or those in lower socioeconomic groups who are left behind in the digital revolution. Providers will need to consider how they can continue to serve these customers.

29. Medical studies of COVID-19 have also pointed to patients with underlying health conditions, at older ages or in certain ethnic backgrounds of being at higher risk of developing complications or fatality. If COVID-19 becomes a virus that we cannot eradicate in the near term and that we must live with, those customers in higher risk groups are likely to seek more protection and insurers will need to develop a better understanding of the disease and the risk it poses to customers. Whilst insurance firms are not able to discriminate on several factors, such as ethnicity and gender, there may be a change in underwriting or pricing terms for those with certain underlying conditions like diabetes. Firms will need to consider how any changes could further reduce access to insurance for certain groups of customers, especially if more customers are deemed to be too high risk to insure.

30. A further approach to address any underwriting ‘barrier’ could be for more employers to take out group protection insurance (e.g. death in service and income protection) policies on behalf of their staff (and their dependants). Group protection coverage does not typically require lives to be individually underwritten; and the pooling of risks would help higher risk individuals access life and health insurance at a lower cost.

31. The various support mechanisms introduced by HM Treasury such as the state-funded furlough scheme, small business grants and other support for the economy are expected to lead to a significant increase in national debt, in excess of levels which might have been considered normal pre-crisis. Some increase in indebtedness will likely persist for some time, and there is an expectation that some of this may have to be funded through tax increases. Whilst measures have been introduced to try and protect as many jobs as possible, there will no doubt be some jobs that cannot be protected, and there may be a long-term impact on unemployment. Both an increase in taxes or rise in unemployment will mean many consumers will have less money left over each month to pay for financial services products like protection, leading to a reduction in demand for such products.

Longer term: savings

32. Following the pandemic, it is expected that many customers will become more cautious in their outlook. They may seek to reduce their debt and build up more savings, and when it comes to investing they may prefer to hold more in cash, invest in more cautious portfolios, buy guaranteed products like annuities or purchase inflation protection. Some customers may also wish to make more money accessible quickly, in case of future financial emergencies, and prefer products that

allow more flexibility like ISAs, rather than longer term savings vehicles like pensions. We may also see a higher opt out rate of pensions auto-enrolment.

33. Providers should consider developing new tools or products to help more customers save and that is aligned with a more cautious, flexible approach to investment.

34. A consequence of higher savings in the long term is that customers could build up a larger financial buffer, and they may see less need for protection products that provide short term protection from financial shocks.

Theme (B): Application of institutional investments from life and health insurers and pensions funds towards economic rebuilding; connecting the vast debt funding needs of a recovering economy to the appetite of insurers to debt and other long term investment opportunities

35. Under this theme, we set out/ consider the following:
    - an overview of the institutional investment market, with a focus on life and health insurer and pensions investment;
    - potential investment channels in debt, to support rebuilding the economy;
    - key investment considerations.

Institutional market overview

36. The UK institutional investor market represents a total of £3,900bn[2] of invested assets and is an important source of investment capital for the UK economy. Different investors within the institutional sector have different requirements and it is worthwhile to consider sub-sectors which share similar characteristics.

Overview: life insurance

37. The UK life and health insurance industry consists of ca. £1,730bn[3] of assets backing long-term savings, protection and retirement products. Of this, ca. £1,090bn is held in unit-linked or index-linked savings products where firms have limited discretion over directing investments.

38. UK net life premiums were £170bn[4] in 2018. Life insurers are generally interested in long-dated investments which match the nature of their long-term liabilities, which can be up to 40-50 years in some cases. They typically seek to match these liabilities with high-quality corporate bonds or mortgages.

Overview: non-life (general) insurance

39. For completeness, UK non-life insurance represents £330bn of invested assets. In comparison to life insurance, non-life liabilities have shorter maturities - typically 1-3 years, however they have sizeable investment allocations to shorter dated fixed income investments.

Overview: defined benefit pensions

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2 For the purpose of this response, we focus primarily on UK insurance companies and private sector pension funds – other institutions such as foreign sovereign wealth funds, endowment funds etc are not considered.
3 https://www.eiopa.europa.eu/tools-and-data/insurance-statistics_en#Ownfunds Asset Exposures data. EUR/GBP FX Rates as at 31/12/2019
4 ABI Long-term insurance overview statistics

40. Defined benefit pension schemes represent £1,770bn[5] of assets. Defined benefit pension schemes have long-dated liabilities, and typically invest in a mix of long-dated corporate and government bonds as well as equity and other growth assets.

41. It is worth noting that most schemes are closed to new members and many are also closed to new accrual, so scope for capital growth is limited. However the majority of schemes are in deficit, and sponsoring employers continue to make deficit reduction contributions. The Pension Protection Fund estimate current buy-out deficit at £497bn, which gives an upper limit indication of new capital that could be deployed over the next 10 years.

42. The Pensions Regulator has increasingly applied pressure on scheme trustees to increase investment in government debt and high quality, low yield bonds. This recues the extent to which pension scheme assets might be available to support more speculative long-term investment.

43. Funded public service pension schemes such as the Local Government Pension Schemes are very large holders of assets which can be invested productively for the long term.

44. The Pension Protection Fund itself also holds a pool of assets which could be invested far more productively than it currently is.

Overview: defined contribution pensions

45. Following the introduction of auto-enrolment legislation in the Pensions Act 2008, the number of people saving for retirement through defined contribution schemes has increased sharply in recent years: total UK defined contribution assets are £71bn[6]. Assets will continue to accumulate as employees and employers make further contributions: £10.47bn of additional contributions were made in 2019.

46. The investment allocation of defined contribution pensions is decided by members, although the governing trustee boards determine the fund range on offer. In practice, 95%[8] of members are invested in a default investment strategy which is determined by the trustees: most often the default strategy involves a gradual shift in investments from growth assets (like equities) to capital preservation assets (like cash and bonds), as members approach retirement. With the introduction of new drawdown products, members might retain some equity holdings well into retirement. But on balance we expect the proportionate allocation to debt assets within defined contribution pensions to increase as the initial population of members ages and approaches retirement. This will stabilise as the auto-enrolment population reaches a steady state.

47. The expected introduction of collective money purchase schemes by the Pensions Schemes Act will mean another pool of assets available for productive long term investment.

Potential investment channels

48. There are a number of potential routes for institutional assets to be invested in debt or equity which would support economic rebuilding. Each route has certain benefits and drawbacks, and may be more or less important for the various institutions and individual firms, depending on risk appetites of individual firms.

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5 PPF 7800 Index as at 30 May 2020.
6 Pensions Regulator Scheme return data 2019
7 https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2019-2020#c105f465ce10435faaa359d561213e82
8 Table 2.13 https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2019-2020#c105f465ce10435faaa359d561213e82

Potential investment: purchase of new government debt

49. The level of support required to support economic rebuilding is expected to be high, given the unprecedented impact of COVID-19 on the UK economy, and it is anticipated that some of the additional spending will be financed through issuing additional gilts.

50. UK institutional investors are material holders of gilts, with defined benefit pension schemes holding ca. £725bn[9] and insurers holding ca. £320bn of the total £1,740bn nominal outstanding[10].

51. Given the trend towards de-risking observed in defined benefit schemes over the last 15 years and the continued pressure from the Pensions Regulator to move away from growth assets, it is likely that they would remain natural buyers of additional government debt issuance, assuming that the level of overall issuance were not such that it would adversely impact the credit assessment of the UK government.

52. In particular, both defined benefit pension schemes and life and health insurers are interested in index-linked gilts as a match for inflation-linked liabilities.

53. This appetite may be affected by the outcome of the current consultation[11] on changes to the RPI methodology. If as seems likely, Government switches the inflation measure used to set the coupon on index linked gilts from RPI to CPIH so significantly reducing the value of these assets, institutional trust in similar instruments may be undermined.

54. One issue for both sets of investors is the need for assets which match CPI-linked liabilities. There are very limited CPI-linked assets in circulation, so an approximate match is made by scaling holdings of RPI-linked assets. In this context, it may well be worthwhile considering issuance of CPI-linked debt to directly address an existing gap in the market for institutional investors. The UK Debt Management Office (DMO) issued a consultation on CPI-linked gilts in June 2011, and it was concluded that the government would keep the case to issue CPI-linked gilts under review.

55. Other non-conventional structures may also be worth exploring in more detail, such as government debt linked to GDP or tax revenues; these may also be considered in a relative risk/return context.

Potential investment: public-private partnerships

56. It may be possible for government agencies to partner with institutional investors in funding certain projects or services through public-private partnership (PPP) models. These type of co-operative arrangements can be structured to be attractive to institutional investors with long-term investment horizons.

57. A number of UK life insurers are already active in funding large-scale city regeneration and housing construction projects and investments in infrastructure are a familiar asset class to many defined benefit pension schemes. Key criteria such as yield level, index-linkage, contract length, level of engagement required in the design/build phases, and security over assets or government guarantees could be tailored to make PPPs attractive to institutional investors.

58. One method that could prove attractive would be to create a diversified portfolio of small/ medium sized projects, which could be aggregated in a special purpose vehicle which issues debt. This approach would allow insurers to underwrite exposures together in a pool of assets, with investors

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9 Derived from PPF purple book statistics

10 DMO, June 12th 2020

11 HMT and the UK Statistics Authority are, at the time of writing, consulting on the future of the RPI index, with a proposal to align it to the CPIH index, which adds owner occupiers' housing costs to the CPI index.

tailoring their exposure to their risk appetite and regulatory constraints. To the extent that yields are competitively relevant to risk (e.g. slightly above gilt yields if a government guarantee were offered), this could prove attractive.

Potential investment: investment vehicles

59. A further option may be to establish government-sponsored investment vehicles, perhaps managed by a centralised development corporation, which could issue long-term debt to institutional investors. One advantage of this approach would be that the development corporation could oversee a broad range of stimulus policies, and construct portfolios consisting of different underlying investments. For example, this could be a fund/ vehicle that financed infrastructure, or pooled small-medium enterprise loans. These could be financed independently through special purpose vehicle issuing long-term notes to institutional investors, where investors could tailor exposure their risk/return to their individual risk appetite; other investors (potentially the UK government) could hold the higher-risk equity tranches.

60. Such a structure might offer attractive flexibility in regards to eventual exit, as there would be an established route to wind-up, or to sell stakes in the future in a similar way to the UK Asset Resolution (UKAR)'s disposal of the government-owned assets from Northern Rock and Bradford and Bingley.

Potential investment: equity

61. Part of the economic rebuilding particularly in manufacturing, technology and bio-technology may well be funded entirely by the private sector using traditional equity structures. Long term institutional investors could be prime holders of diversified portfolios of such investments. This may require a new attitude to risk to be adopted by all stakeholders including Regulators. Any new risks and opportunities will need to be communicated widely.

Key investment considerations

62. Institutional investors need to consider a number of key factors when assessing the suitability of potential investments; these factors include:

    - duration;
    - risk and return – to both capital and income;
    - operational factors;
    - regulatory requirements.

63. On duration, both defined benefit pension schemes and life/ health insurers aim to invest to match the long-term nature of their liabilities, which can be measured in decades. Due to their specific regulatory requirements (described below), life insurers in particular require certainty over the timing of payments. This means that some common debt features, such as issuer calls or the ability to prepay can be unattractive. There are various ways to mitigate this, through securitisations or 'spens clauses'[12], but this would require additional operational effort on behalf of the investors.

64. In respect of risk, life/ health insurers and pension funds typically invest in lower-risk, investment grade securities. Again, insurers in particular are highly sensitive to credit risk, this has a direct impact on the amount of regulatory capital they are required to hold. To the extent that additional risk protections can be offered (such as credit enhancements, over-collateralisation, government guarantees), this may mitigate some concerns over risk.

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12 A provision to allow a borrower to repay debt early, but subject to early repayment penalty.

65. Depending on the risk nature and structure of the investment, investors may expect a return comparable to gilts (e.g. PPP contract with a government guarantee). In addition, for riskier endeavours, (e.g. direct lending to small-medium enterprises through a development corporation), a return in excess of corporate bonds would be expected.

66. Both pension schemes and insurers will need to do detailed due diligence as part of their regulatory risk management responsibilities. It may be upwards of 18 months from initial consideration of a new investment through due diligence, internal and regulatory approvals and governance through to execution of the investment. Given the resource involved to establish a new investment, the size of investment is usually required to be of material importance in order to warrant the upfront operational cost.

67. Institutional investors are typical run by specialist teams and advisors, and do not have the capacity to deal with large amounts of administration involved from underwriting large numbers of small exposure aggregates to a scalable investment. This would need to be outsourced.

68. Defined benefit scheme trustees use professional advisors to recommend strategic exposures to certain assets classes, whereas day-to-day management of assets is delegated to professional asset managers. It may be that pension schemes are restricted from investment by the existing mandate terms which may need to be revised.

Key regulatory requirements

69. Defined benefit pension trustees are required to act in the best financial interest of scheme beneficiaries, and have statutory power to invest in any type of asset. In practise this may be limited by the scheme's own governing documentation and will certainly be affected by Regulatory intervention.

70. Insurers are regulated by the PRA under the Solvency II framework. There are certain requirements within Solvency II that govern investments, including the Prudent Person Principle, which requires investors to invest only in assets where risks are properly identified, measured and monitored. This sets a high due diligence and ongoing risk management threshold for new investments.

71. In addition, the Solvency II Matching Adjustment is of particular relevance. The Matching Adjustment allows insurers to recognise a lower regulatory liability estimate if they invest in assets that meet strict eligibility criteria (governing quality and predictability of cashflows), and commit to holding these assets to maturity. The Matching Adjustment benefit is material to life insurers with annuity business, but it currently limits the ability of insurers to invest directly in certain types of assets. Whilst this can be mitigated by use of securitisation, this mitigation can be operationally onerous. A fit for purpose Matching Adjustment framework is needed to ensure that the insurance industry is well-placed to support the economy as the UK moves towards life post COVID-19[13].

72. We would urge Government to engage early with Regulators to ensure that economic regeneration is not hindered by access to institutional capital being blocked by regulatory intervention.

July 2020

[13] On 23 June 2026 the UK government announced plans to review the country's implementation of Solvency II; the Matching Adjustment is expected to be within the scope of this review.