think piece
Promoting debate and fresh thinking in the financial services industry

Risky Business and the Politics of Risk: Is the Insurance Industry Promoting Itself?

Jonathan Swift

Summary

- There is no question that the insurance industry does need to better promote itself, both to people considering a career in it and to the wider economy. Its benefits and value to the wider sector are still misunderstood.
- It could be argued that, on balance, the recession can have a net positive effect on insurance. While insurers will benefit from an inflow of new recruits that would otherwise have gone to banking, they should not be complacent about the financial crisis that largely centred on those banks and the impact on public perception.
- There is however the significant risk that the sector could fall victim to this public perception and the ensuing regulatory clampdown disproportionate to the risks involved. Such is the thinking behind the Insurance Industry Working Group (IIWG) report that aims to ensure the differences in risk characteristics between the sectors are recognised.
- This also ties in with what the IIWG describes as the 'virtuous circle'. For example, by being more transparent and pricing risks more effectively, so that gaps in coverage are reduced and consumers understand their protection needs better, the insurance industry will improve the customer experience.
- Despite the IIWG's limitations in terms of its recommendations which bring little substance or new thinking, the report offers a decent snapshot of where the industry is, and where it should be heading.

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CII Introduction: The UK insurance sector lies at a critical juncture in its long and eventful history. On the one hand, insurers are feeling the recessionary pinch in the form of a capital squeeze and a hardening market, but they can still benefit from escaping the contagion in the global recession. Despite this, insurance still risks exposure to wider financial services regulatory sanctions and the current effort is to avoid this. In this second article on the special RSA-Reform Thinkpiece series on risk and insurance, Jonathan Swift, editor of Post Magazine, explores this current situation, particularly the implications of the Insurance Industry Working Group report that many have viewed as a potential "first-round win" in this match.

Having written about the UK insurance industry for over a decade I have met and interviewed a host of the most senior figures in the market.

Time and time again I have asked them why they decided to work in insurance and it would be no exaggeration that in 99 out of 100 incidents the answer is that they "just fell into it". Whether it involved a disgruntled parent telling them they had to get a job or face being kicked out of home, or a graduate blindly taking the first job offered to them to clear their student overdraft, there are not many people who admit to have "chosen" insurance as a career.

A Sector in Need of Promotion

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There are many reasons that insurance is over looked by the most talented graduates or job seekers and they stem from the deep rooted problems the industry faces. Insurance has traditionally been seen negatively as something that you buy grudgingly to use in times of distress; many believe it represents little value for the financial outlay and thus is seen as fair game for opportunistic fraud or exaggeration when a claim is made.

Tellingly though, those who do fall into insurance, more often than not stay, because once exposed to the market they quickly become aware of its important role in keeping industry moving, in facilitating great sporting and music events that would not be able to happen otherwise, and the fact that it is offers dynamic, interesting and thought-provoking environment to work in.

The fact that many only find out about these benefits once they are exposed and immersed in the industry means it is missing a trick. Put bluntly it needs to promote itself better and educate people as to the benefits and value of its products, rather than be seen as a sector simply interested in flogging the cheapest car insurance possible on daytime TV.

Which is where the ongoing recession and a report by a grouping of nine leading insurers co-chaired by the UK Chancellor of the Exchequer fit in. Both have a role to play in ensuring the sector attracts the best recruits, focuses on its core business of underwriting risks and is proportionally regulated.

Insurance and the Banking Crisis

It is by no accident that the economic downturn has often been referred to as the 'banking crisis', as the companies that have been portrayed as the authors of the turmoil are the money lenders.

In the main the insurance industry has proven itself to be resilient in that the UK government has not had to bail out any of the leading players here. True, Royal Bank of Scotland-owned Direct Line, Churchill, NIG and Privilege were offered up for sale by the beleaguered bank, but tellingly the nationalised former financial services powerhouse decided to keep these businesses for the steady revenue and profits they provide, rather than simply selling them for a quick return.

With banks grabbing headlines ranging from tales of poor decision taking to bad risk management; from over-inflated bonuses to wholesale cost cutting, the industry no longer looks the safe, dependable and financially astute place to work it once did.

The collapse of Lehman Brothers, and government bailouts of Northern Rock and RBS in the UK, and Bear Stearns in the US, now means that the cream of the graduate crop may think twice about banking, investment or otherwise, as a career option. Instead they may consider other financial services-related opportunities which can provide just as much reward both for the mind and pocket, without the threat their employer is about to self implode.

A host of insurance bosses have recently remarked that there is an opportunity to be grabbed because the banking sector is cutting back on graduate placements and enforcing recruitment freezes. AIG executive director of UK commercial lines, Kelly Lyles, for one told me: "The [AIG] graduate scheme is more popular than ever this year, because a lot of banks are not offering them. We have seen a much higher standard and larger number of applicants."

The Recession Impact: Focus on Core Business

Of course the insurance industry does not exist in a bubble not impacted by the global recession. As a whole the UK insurance plc represents one of the largest institutional investors in the country and many insurers have reaped rich rewards in the past through their investment arms.

"The recession has given the insurance industry the perfect window to focus on its core business…"

Indeed these returns have masked the poor performances of some insurers in their core businesses. For example, accountancy practice EMB recently revealed every one of the UK's top 20 motor insurers lost money on their private motor portfolios in 2008 based on analysis of their Financial Services Authority returns. And this is nothing new, it has been happening for years.

However, these companies have been able to still make money through reserve releases and their investment arms, whilst paying out more in claims than they take in through premiums.

But things need to change and there are signs this is happening given the constant bleating by insurer CEOs during the recent half year results season that rates need to rise, reserves are running dry and investment returns are not what they to be.

The recession has given the insurance industry the perfect window to focus on its core business. Instead of propping up loss making underwriting ventures with money made elsewhere, firms should grasp this opportunity and keep hold of it for as long as possible, even when a semblance of normality returns to the stock markets.

The last time the sector had such a golden chance to do this was following the 11 September atrocities when stock prices again took a hit, but common sense ultimately gave way to unsustainable price wars.

I am not too innocent to understand that there will always be peaks and troughs in pricing as a consequence of the economic reality of a free economy. But if insurers concentrated on underwriting risks more for profit, rather than volume gain, the cycle could be smoothed and buyers would not be faced with such – to them illogical - steep premium rises every three to five years. The food industry may be able to explain to the public why a loaf of bread can cost 10% more and they accept it; when the insurance industry does it is seen as a bunch of money grabbing so-and-sos.

There has of course been one well publicised insurance failure as a consequence of the global economic downturn. AIG – once the largest insurance company in the world – was bailed out by the US Government 12 months ago after it returned massive losses. But these would not have been so potentially life threatening had it not been blinded by a quest to diversify into such complicated and potentially risky markets as insuring credit default swaps, which saw it badly burned by losses on derivatives linked to the US housing market.

Given the high-profile near-death experience of AIG there have been fears that the insurance sector could end up being the victim of a wider clamp down on the financial services sector, and that through little or no fault of its member companies, be subjected to much tougher regulation out of kilter with the risks involved.

"…it would be unwise to inflict the same proposals on the insurance sector as may be consider for other financial markets…"

Zurich's European general insurance chief executive Annette Court speaking at the time of the G20 summit earlier this year echoed the thoughts of many when she said it would be unwise to inflict the same proposals on the insurance sector, as may be considered for other financial markets.

"I don't think that is appropriate because you don't have the same systemic risks in insurance as you have in banking; they are not the same type of businesses. But I think it is inevitable that regulation will increase and so I am expecting that to happen. What we have to do - as far as possible [as an industry] - is to make sure it is proportionate."

This was echoed by the Association of British Insurers, which in its recent report *Restoring Market Confidence* warned of regulation 'contagion' and that any "lazy adoption of banking rules" for its members would ignore the sophisticated prudential regulation regime they work under, and the developments, under Solvency II, of modern, risk assessment modelling across the European Union.

Insurance Industry Working Group

It is thus with some relief that the Insurance Industry Working Group (IIWG), set up last year to map out a path for the sector for the next decade has at least acknowledged that one size certainly does not fit all. The group comprised of the CEOs of nine leading British insurers co-chaired by Andrew Moss of Aviva and Alastair Darling, the UK Chancellor of the Exchequer.

The Chancellor's remarks in the foreword of the IIWG's final report in July reflected the overall sentiment of the group and the wider industry: "I am glad that, while this report has been prepared against a background of financial instability, the Group have been able to reflect on the fact that the insurance industry has not experienced the sort of difficulties the banking sector has during the financial crisis."[1]

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As for the report itself, it contains some laudable proposals which support my thesis that the insurance industry has a great opportunity to prove that it is 'simply' not another faceless corporate pillar of the financial services market. And that by doing this – which brings me nicely to my original point - it will benefit not only by improving the quality of staff its recruits, but also by selling more products and cover once buyers, both personal and corporate fully comprehend what they are purchasing.

This also ties in with what the IIWG describes as the 'virtuous circle'. For example, by being more transparent and pricing risks more effectively, so that gaps in coverage are reduced and consumers understand their protection needs better, the insurance industry will improve the customer experience.

But the insurance sector cannot do this in isolation and the government has a role to play to help make sure society and industry manage their risks better, a point acknowledged by the IIWG. This has recently been illustrated by the concerns over the green lighting of property developments on floodplains, despite warnings from the Environment Agency, and *The Equality Bill*.

Bar the odd unavoidable bad headline about slow claim payments, the insurance industry did a good job of managing any media backlash during the 2007 floods, by going on the offensive and pointing out that the risk of a similar event happening again could be mitigated by greater investment in flood protection and better planning for new builds.

The ABI has issued guidance on insurance for new developments and its Director of General Insurance and Health, Nick Starling has rightly warned "without proper measures to reduce flood risk, these properties will be uninsurable, unsellable and uninhabitable".

Insurers understand they have a significant part to play in protecting property – hence the increasing role many are playing in the climate change debate – but every risk has a price and it would be unsustainable for the industry to continue to underwrite ones for which expensive claims are inevitable.

On the issue of the *Equality Bill*, the industry has stressed that imposing restrictions on the use of age would lead to costlier cover as companies would have to base underwriting decisions on insufficient information leading to a one price fits all approach.

Given the claims data held by insurers it would seem ridiculous that a 17 year old male should pay the same price for driving a sports car as a 35 year old women. The ABI has also disputed the claim one in five older people have trouble obtaining cover as it research showed 99% of older customers can obtain motor insurance, and 98% are able to buy travel insurance.

But does the report hold all, if any of the answers to this and indeed the other issues which the market faces?

On improving financial services literacy the IIWG recommends the development of a more "co-ordinated approach" and that consideration should be given to appointing a Financial Education Commissioner to act as central co-ordinating body. It also offers up the New Zealand Retirement Commission as an example of a successful body which since 1993 has played an active role in helping more locals plan for retirement.

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But the main problem here, as with a lot of the IIWG report, is that it brings little in the way of substance or new thinking, but often simply taps into initiatives which are already being run by the likes of the Chartered Insurance Institute, the Association of British Insurers, the Financial Services Authority, and suggests more of the same. See its advice on creating consumer trust (recommendation 4) or nurturing and attracting better skills (recommendation 11).

There is nothing wrong with seizing on successful initiatives elsewhere, but a lot of it seems to be

[1] *Vision for the Insurance Industry in 2020: A Report of the Insurance Industry Working Group*, 27 July 2009 http://www.hm-treasury.gov.uk/d/fin_insuranceindustry270709.pdf

simply piggy-backing on things already in progress.

Ultimately the IIWG could be seen as a missed opportunity. Indeed a source close to the process has spoken to me of their disappointment that the report has not offered up more in the way of hard and fast actions, and suggested that its aims were ultimately scuppered by budget constraints.

Others have, perhaps cynically, pointed to the fact that with Labour's hold on power looking precarious ahead of the 2010 general election the IIWG report was ultimately so half-hearted because there are little or no votes to be gained by helping reinvent the insurance industry, and that to win over the electorate there are more pressing areas for it to invest time and money.

Despite my reservations, I would suggest that the IIWG report is not simply tossed aside by whoever wins the next general election. For all its faults it offers a decent snapshot of where the industry is, and where it should be heading.

Once the issue of the next election, and for that matter whether the regulation of the insurance industry passes from the FSA to the Bank of England (as outlined by the Conservative Party) is settled, then the contents of this report could be seen as a major platform for change.

In the meantime, it offers a rough sketch as to where the insurance industry should be heading. Given more time and money it will hopefully become something that the sector is proud to hang its future on. There is a great opportunity out there now to be grasped. It would be a shame to miss it.

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Jonathan Swift has written about the insurance industry for over 11 years, the last four as editor of the highly respected paid-for insurance weekly Post Magazine. He has appeared on television speaking about topics as diverse as the insurance implications of Michael Jackson's death to the implications of consolidation on motor premiums; and is a past winner of the British Insurance Brokers' Association journalist of the year and Association of British Insurers general insurance trade journalist prizes.

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Risky Business: Insurance and Society ("Risky Business" Series No.1) by Andy Haste, RSA (Published 18 August)

> The insurance industry provides a long-standing and often forgotten role of helping people and business do things without the fear of catastrophic loss should something go wrong. How can this be achieved in a sustainable manner? In this first in a special series exploring insurance and risk entitled "Risky Business", Andy Haste, Chief Executive of RSA, gives the view of a major global insurer, and describes some techniques in place today and a few challenges confronting them.

Outsourcing: Continued Prosperity Despite the Economic Crisis? (International Series No.5) by Vanessa Rossi and Nora Burghart (Published 18 August 2009)

> Will outsourcing be a winner or loser from the global crisis? This sector has been a major beneficiary of the boom in business services trade since the mid-1990s, coinciding with the rise of emerging market economies. In 2001-2002, this growth survived and even boomed. But this time round it has been hit by the savage downturn in the global economy and the outlook for growth is less assured for a number of reasons, as discussed in this article.

Personal Accounts: Encouraging People to Save for Their Retirement, by Tim Jones, Personal Accounts Delivery Authority (published 6 August)

> As life expectancy increases so does the need for people to be well prepared for their retirement. However for many this will not be the case as the culture for saving in the UK has steadily eroded over time particularly for those on lower incomes. To counter this and help those not saving enough, the personal accounts scheme is being prepared for roll out for the onset of employer duties in 2012. In this article, Tim Jones, Chief Executive of the Personal Account Delivery Authority, provides background to the scheme, outlines the role of employer contributions and considers the investment strategies.

Women and Financial Advice: The New Model Financial Health Plan, by Carole Nicholls, FCII, FPFS (published 28 July)

> Carole Nicholls, former President of the Personal Finance Society, challenges the industry to evolve from the traditional 'product' driven offering to one based on 'outcomes' in this thinkpiece, suggesting a new model based on the massively popular WeightWatchers health plan. She highlights findings of recent CII research which show that women feel less confident and knowledgeable about making financial decisions than men, and recommends a model offering personalised financial plans to remedy this, making the connection between the product and the result in real-life terms.

Deflation Threats & Insurance Premiums: A Long, Deep Recession Means Greater Cuts?, by Vanessa Rossi and Nora Burghart of Chatham House (published 29 May)

> The property market has been hit hard by the current recession, and impacts of the decline have seen deflation reach new levels. Many assume that recovery is around the corner – but what will happen if prices continue to fall? Vanessa Rossi and Nora Burghart of Chatham House explain the serious implications of a prolonged recession, focusing on how insurance premiums, in particular, might cave in to ongoing market pressure.

ClimateWise: The Insurance Industry Challenging Itself to do More, by Andrew Voysey (published 15 April)

> In the second instalment of our climate change series, the ClimateWise secretary gives his personal view on the role the initiative and the industry more widely can play; and then explores some of the challenges confronting them.

Ageing and Migration Trends: Preparing for Change in the EU's Labour Market, by Vanessa Rossi and Nora Burghart of Chatham House (published 30 March)

> Analyses the changing age and migration trends in the EU labour market. Might the impact of ageing be reversed by raising the retirement age to 70? How important will migration be in picking up the slack left by a declining indigenous population? How ready is the insurance industry in dealing with these changes?

Pandemics – be Prepared, by Trevor Maynard of Lloyd's (published 18 March)

> Summarises the issue of pandemics and the insurance industry. His paper shows that the risk of a pandemic is ever present, despite the decline in media interest, and that contingency and business continuity planning is vital. Alerts of consequences of a global pandemic, the plans in place by governments, and highlights the need for insurers in particular to be prepared for all eventualities.

An Inclusive Approach to Financial Products, by Jane Vass, CertPFS of Age Concern (published 2 March)

> Examines the industry's approach to delivering products and services to older people. She argues that there are large gaps in the design of mainstream financial products and services, with many providers ignoring the changing physical, cognitive, social and emotional needs of their older customers, and calls for the industry to take a new approach shaped by principles of inclusive design.

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