Address by James Dalton to the JP Morgan European Insurance Conference: The general insurance industry in the UK: Changing and helping to manage change

31/05/2017

Introduction

Good morning. Thank you Edward for that introduction and thank you to JP Morgan for the invitation to be with you this morning.

I'm conscious that at last year's conference you heard from my colleague, Yvonne Braun about the challenges in the long-term savings market. In 2015, you heard from the ABI's Director General, Huw Evans, and the year before that you heard from the then ABI DG, Otto Thoresen. So although it may sound like the beginning of a bad joke about a German, a Welshman and a Scotsman walking into an investment bank's insurance conference, it may be a sign of the global nature of the industry that you have a Kiwi with you this morning. But what it certainly shows, is the long and collaborative relationship the ABI and J P Morgan enjoy.

What a difference a year makes. Since Yvonne spoke last year, the macro-political environment in the UK is profoundly different, not least because of the vote in favour of Brexit, Theresa May becoming Prime Minister here and Donald Trump becoming President in the US.

So in this ever-changing world, and in the context of an industry helping consumers and businesses to manage change and risk, in my remarks this morning I wanted to address three key questions in relation to the UK's general insurance industry: where have we come from, where are we now and where are we going?

Where have we come from?

Let me start with a confession. Like many I have met in this sector, I didn't grow up dreaming that one day I would work in the insurance industry. Having grown up in New Zealand, I started my career working for the Government there. I loved it. I played a part in developing policy affecting key industries, witnessed first hand decision-making at the heart of Government and worked on some of New Zealand's free trade agreements.

One of the things I learned during my time in New Zealand was how Government and business can work together. On countless occasions, I saw business coming to the Government asking for regulatory frameworks to be amended to remove barriers to them delivering meaningful change for their customers.

When I started working in insurance here, I was struck by the narrow nature of insurers' discussions with Government, characterised by a narrative based on "de-regulation", "light touch regulation" or "over-prescription". From my experience in New Zealand this was a narrative destined to fail. At best, it is seen by Ministers as self-serving. At worst, it is a way to exploit vulnerable consumers. In my experience, the more sophisticated discussion on regulatory philosophy is one based on the development and enforcement of high-quality regulatory frameworks; that carefully balance competing public policy priorities and are kept under review to ensure they continue to be fit for purpose.

In spite of – or maybe because of – my experience in the UK, I remain firmly of the view that regulation can act as an enabler of the outcomes that insurers want to achieve rather than something to be avoided at all costs.

And the insurance industry has increasingly seen the opportunities, that regulation can offer. For example, it is quite unusual for a market to want the competition regulator to investigate their sector. But that is exactly what the private motor insurance market lobbied for in the hope of addressing the problem of credit hire. That the industry then failed to coalesce around a sustainable regulatory model for the future was an important lesson learned for me.

Perhaps the most transformational project that the ABI has led over recent years, which involved extensive engagement on the underpinning regulatory framework, has been the establishment of Flood Re. In delivering this project with the Government, insurers have made a hugely important contribution to one of the biggest public policy challenges of recent years.

I have somewhat laboured the point about the importance of the more sophisticated discussion with Government about regulation but for good reason. Because the lesson to take from this engagement is that we are now seen as a more trusted partner by the Government and Ministers in solutions-focussed policy making. And that is a good place for any industry to be.

Don't misunderstand what I am saying though. The industry does not always get the regulatory frameworks from Government that are needed.

It's not my area of expertise, but the Risk Margin under Solvency II is probably the area where we would want to see change made most quickly. In thinking about young drivers, for years the ABI has demonstrated the overwhelming need for the introduction of a graduated driver licensing. Consistent Government inaction as a result of short-term, political considerations continues to cost young people dearly in terms of the death and serious injury they cause to themselves and others on the roads. And in terms of fire policy, it is a national scandal that there is no requirement for the mandatory use of sprinklers in newly built care homes and schools. The sad reality is that it will take a tragic loss of life and a public outcry before something changes. The real tragedy is that this loss of life is as inevitable as it is predictable.

Where are we now?

But it is to the present day that I would now like to turn. I have chosen three current areas of focus for the general insurance industry to discuss with you this morning: industry reputation; the Ogden discount rate; and finally, next week's election.

The reputation of the insurance industry

Just as the reputation of your industry is important for you, it is important for insurers to continue to address their poor reputation with consumers, the media and politicians.

Insurers are never going to overcome consumer resistance to the "grudge purchase" mentality. This applies equally in personal or commercial lines insurance. So if no one is ever going to enjoy buying insurance, as an industry we need to make sure customers can access the best insurance deal painlessly; ensure that the premium offered is fair and transparent; and make sure that the insurer is there in the customer's time of need. That's what customers expect. Customers also expect the industry to develop new and innovative products that respond to their changing needs and expectations.

And as the product offering of insurers changes, as an industry we need to get better at demonstrating and communicating the importance of the insurance sector to the wider UK economy. All too often, insurance is not seen as a unique industry but is but is viewed as just another part of the amorphous financial services sector. Our world-leading insurance sector continues to help Britain thrive. Insurance adds £40 billion a year to the UK economy, employing 300,000 people. Three quarters of these people aren't London-based, providing highly skilled careers in 145 towns and communities up and down the country. Not only is insurance the UK's third largest export industry, we are also a key enabler of trade by many other industries in the wider economy – from small textile companies to the UK's booming automotive sector.

As an industry, insurance is a UK success story and has much to be proud of.

Discount rate

That success has been hard earned but it can so easily be compromised by poorly thought through Government policy. Which brings me on to consider the debate around the Ogden discount rate which, as investors, I am sure you have been following with some interest.

In the context of my remarks earlier about partnership with Government, it was a carefully considered judgment to describe as “crazy” Liz Truss’ decision to reduce the discount rate from 2.5% to minus 0.75%. But crazy it was. The ABI tried through the Courts to get the Lord Chancellor to see reason but ultimately, we were unsuccessful. Her decision led to a £6 billion hole in the Government’s finances and it has been estimated that about that same cost again has been passed to motor and liability insurers, and ultimately motorists and businesses, through higher premiums.

The Claims Director of one insurer said to me that the decision was the biggest claims issue the industry has faced in a generation. And it is for that reason that we have been as vocal as we have been about a decision that resulted from muddled thinking, poor legal advice and intransigence. It is now widely accepted that the current methodology used to calculate the Discount Rate is fundamentally flawed. That the Chancellor, Phillip Hammond, met insurers the day after the decision was announced to discuss the industry’s concerns and that the Government has subsequently released on a consultation paper on how the rate should be set in the future, is a clear indication that the Government knows that it got it wrong.

So how should we fix the broken methodology for setting the rate and what should a new legislative framework look like? In our consultation response, we set out the principles for delivering a fairer system based on:

- Providing 100% compensation to claimants delivering neither under nor over compensation
- No link to one particular investment asset. The current link to Index Linked Government Securities (ILGS) is flawed as it fails to recognise the investment options open to claimants, and how they invest their compensation in practice.
- An allowance for the reality that claimants invest in a low-risk, mixed portfolio of assets which yield higher average returns than investing all a claimant’s compensation in ILGS. Where claimants want to minimise investment risk, they can choose a Periodical Payment Order; and
- A preference for replacing the current single rate with a ‘stepped’ dual rate to take into account the higher returns that can be expected for claimants investing over a longer time horizon.

Retaining the status quo is not an option. If delivered, our proposals will help keep down costs for motorists, businesses and taxpayers, while still delivering fair compensation to those who need it most. The new Government needs to grasp the nettle and quickly change the framework to ensure we have a system that is fit for purpose for claimants, insurance paying customers and compensators.

The general election

And so, all eyes turn to 8 June.

There are others more qualified than me to comment on the progress of the general election campaign to date. What is clear though is the Prime Minister's decision to call an election is an entirely rational piece of political decision making. As someone who works with the Government every day, what has been abundantly clear since the 2015 election has been the fragility of the Government's majority in the House of Commons, especially given the number of rebellious backbenchers.

So by calling an election, the Prime Minister must be hoping the result will enable her to exert more control over, but ultimately be less reliant for legislative support from, her own backbenchers. There is also no doubt that she is seeking to capitalise on Labour's recent polling weakness as well as catching them under-prepared for a full-scale, national election campaign. Finally, and perhaps most importantly from the Prime Minster's personal perspective, is that she wants her own electoral mandate. By winning her own election, the Prime Minister firmly sets the Cameron and Osborne era behind her and will have legitimacy in the eyes of those she faces across the Brexit negotiating table.

Ultimately, it remains to be seen if the PM's gamble pays off. As an apolitical trade association, representing a strong and stable industry, our job is to work with the Government of the day to deliver for the many, not the few – insurance customers that is. And we will do that whatever the result next Thursday.

Where are we going?

And it is to thinking about life beyond next Thursday that I would now like to turn.

Data and cyber

The biggest macro challenge and opportunity of the future is undoubtedly how insurers respond to the digital revolution. Digitisation is rewriting the rulebook for all elements of insurers' businesses. Colleagues from the long-term savings sector are seeing this as the industry works to deliver the hugely complex Pensions Dashboard project. And digitisation is delivering huge change in general insurance as well - from customer relationships to underwriting to marketing to claims.

Insurers need to get prepared for a customer base with very different needs and expectations. In particular, 'big data' and insights from Internet of Things devices can help insurers gain a better understanding of their customers than ever before and thereby drive innovation and change.

Mobile technology can help insurers put in place customer solutions in real time. And as part of this on-going process, the role of insurance is likely to shift, from being purely about financial risk transfer to being about preventing claims from arising in the first place, which is why the industry has played such a central role in facilitating the roll out of autonomous vehicles in the UK.

Insurers' ability to deliver against these changing consumer demands and expectations is fundamentally dependent on an ability to gather, process, understand and use data. More and better quality data will allow insurers to price risk more accurately than ever before. But this brings with it controversial debates about the fairness of risk pricing, especially when actuarial decisions are based on data relating to things that people may not be able to easily influence, for example, their flood risk, as opposed to things they can, such as their driving.

Insurers role is to price risk as accurately as possible. Insurers cannot decide on behalf of society what is fair, but we do have a significant role to play in assisting with the development of policy responses.

Data protection will, of course, remain paramount and is a significant focus of the industry's attention as Europe's General Data Protection Regulation is transposed. And cyber issues like the WannaCry ransomware attack earlier this month are an important wake up call for many Governments and businesses across the globe about the critical importance of effective cyber security. And, indeed, how cyber insurance can act as one of a number of tools in the toolkit of effective risk management.

InsureTech is helping significantly. There has been a fundamental shift in the relationship between traditional insurers and a number of new and emerging technology companies. Insurers recognise the benefits of collaborating and investing with these companies given that they offer ways of working that are more efficient for both insurers and their customers. InsureTech firms aren't trying to become insurers themselves given the significant regulatory and capital barriers. Insurers face significant challenges in changing on their own, not least because of legacy IT systems. So there is a positive inter-dependence between the industry and InsureTech that will continue for some time.

Diversity and inclusion

Just as the industry adapts and changes in response to changing consumer demands and expectations, the make-up and inclusiveness of the industry itself also needs to continue to adapt and change.

Female, LGBT, and ethnic minority representation at both Board and Executive levels across the insurance industry is low. Frankly, for an industry that serves a diverse breadth of customers and clients here in the UK and across the globe, it is a handicap if the leadership of the industry excludes large swathes of the population.

So we need to be doing more to increase the diversity of our industry. We can't just continue to congratulate ourselves when insurers sign up to the Women In Finance Charter; participate in the Dive In diversity festival or name their LGBT allies. We should be asking ourselves why a Charter, festival or allies are needed in the first place. Speaking as someone who will soon be away from the office on shared parental leave, we also need to be asking ourselves why women continue to be left at home holding the baby, why men spending time with their children is still seen by some as "career limiting" and how we can better facilitate parents – note: not mothers - returning to the workplace.

And like the rest of society we need to lean in to the challenges associated with ending the stigma attached to mental health. For all the talk about staff being an organisation's biggest asset, we need to remember that they arrive at work as individuals with a multitude of things going on in their own lives. We simply can't expect all that to be left at the door as they walk in every morning. Our staff are people, which is why I have never liked the term "human resources".

It will take leadership to deliver on the challenge of diversity and inclusion. And as the leading insurance trade body in the UK, we see it is an important part of our role to highlight and support the need for the industry to deliver change rather than just talk about it. And the industry will need to change if it is to retain and attract the best talent, especially when millenials are demanding inclusive, flexible workplaces with a balance between work and life.

Put simply: diversity and inclusion matter.

Brexit

And something else that matters – and my remarks on where we are going as an industry would be incomplete without a comment on it – is Brexit, undoubtedly the all-encompassing issue of the day.

With Article 50 having been triggered, the clock is now counting down to the 29th of March 2019. Clearly, the domestic political debate about retaining access to the Single Market has moved on. Insurers continue to have some high-level priorities in common with the rest of the business community – the status of our staff from the EU and continued access to the best global talent being obvious examples. But the key asks of the insurance industry are:

Firstly, to sort out what to do with existing contracts that have long-term liabilities beyond any phased process of implementation. The payment of a claim can only legally be done if you are authorised to operate in many Continental markets. Today, this is done easily through passporting. Post-Brexit, insurers could be left in a position where they have contractual obligations to customers which become legally impossible to fulfil. We need a solution that enables those customers to continue to be best served in the future. That requires both political and regulatory agreement, and work to get to that point needs to begin now. It simply cannot be left until the last minute.

Secondly, dealing with the policy issues raised by the Great Repeal Bill. Given the number and complexity of the issues involved, we see a major risk that the great repeal process will not be complete by March 2019. So, in order to minimise that risk, the Government needs to be open and transparent with affected industries and consult with stakeholders both formally and informally. There are some significant policy issues that it is important to get right including:

- The need for a standalone prudential insurance regulatory regime and the extent to which this should be allowed to deviate from Solvency II;
- The fact that the FCA's Handbook is an amalgam of EU rules and regulations supplemented by the FCA's own initiatives;
- The Green Card system which allows British motorists to drive in Europe.
- The future of the EHIC card which currently allows British travellers to be treated by the local health system as if they were citizens of that member state.

So the devil really is in the detail.

Finally, we need a post-Brexit regulatory relationship with the EU. Whatever the political framework that is ultimately agreed, the insurance market cannot work effectively without regulatory cooperation. From a UK perspective, and particularly for the London Market, insurance relies on a degree of sophisticated regulatory dialogue and cooperation. Part of the political agreement must allow our regulators to maintain a close and engaged relationship with their European counterparts.

Conclusion

So in closing, we have a world leading insurance sector in the UK. But, in the context of the significant change we continue to face, we cannot rest on our laurels. If we are going to continue to be the best, employ the best people and provide the best products to our customers, we need to speed up the pace of change across the industry, both now and in the future.

Thank you.

Last updated 31/05/2017

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e Value of Partnership Introduction Good morning. And thank you for that introduction. It's been si ars since I last spoke at the BDMA conference and it is genuinely a pleasure to be back with…

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ank you for the welcome and it's a pleasure to be here in Brighton to open the Convention today. e been asked to provide some introductory food for thought to get your brains working. And this…

mes Dalton speech to Verisk Risk Symposium (/news/speeches/2017/06/james-lton-speech-to-verisk-risk-symposium/)

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sponding to the news that the directors of nuisance call companies could be directly fined up to 00,000, James Dalton, Director, General Insurance Policy, commented: "Tougher…

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