



Insurance Institute of London; Lecture
'The City, Insurance and Society: Why 2012 Could
Redefine our Industry'
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26th January 2012

Check against delivery

Good afternoon everyone and thank you for inviting me to give today's Insurance Institute of London lecture.

'The City, Insurance and Society: Why 2012 Could Redefine our Industry.'

Our surroundings for my talk here in the Old Library at Lloyds, are certainly much grander than the school in North East Scotland, which I attended with our Chair, Dr Alexander Scott – or Scotty – when we were only teenagers four decades ago.

But the grand designs of this library, remind us of the rich history and critical role insurers have in Society.

Both on a micro level, as businesses whose products give our customers support when they have to deal with unexpected events in their lives.

And on a macro level, as an industry that invests and supports economic growth.

An industry that has grown steadily over more than 300 years, supporting the UK economy.

The Lloyds coffee house insured the risks of our nation's shipping industry from here in the Square Mile. I feel a close link with the origins of the industry – my father sailed as a Captain in the Merchant Navy.

But while we have a history we know we can be proud of, I'm going to use today's lecture to look forward.

Indeed, with the incidents of the last four years, everyone in this room knows that we are living through events which will shape the next five decades ...

...Affecting our customers, our businesses and our friends and families.

The global financial crisis of 2008 is our generation's Wall Street Crash.

And it is our role, to accept this reality and deal with the 'new normal', that has emerged from the crisis.

I'm going to talk first about what is shaping this new normal, and what it looks like.

Then I'm going to outline what the role of the ABI is within this challenging new world.

And why 2012 was always set to be a definitive year for insurers even before the events of the recent past.

The New Normal

So the first question is, what has led us to today's 'new normal'?

I think there are three core shifts that lie at its heart.

In recent years, globalisation has seen the emergence of the rising star of the economies of the Far East.

China in particular, continues to grow in influence, in marked contrast to the clouds over the UK, the US and the Eurozone.

The Economist's latest GDP figures illustrate a growing gap with China's year on year increase in GDP at 9%; India's at 7% and Hong Kong and Russia both well above the 4% mark.

Although China's GDP growth is slowing, prospectively, in the developed world we can expect growth rates closer to 1%.

With the threat of an extended period of flat-lining in Europe, with negative growth for the weakest economies.

These shifts in the power of global economies are joined by government austerity cuts, as a raft of deleveraging to reduce spiraling debt levels takes place.

Debt, which for decades was the engine of growth, is now the developed world's enemy.

For governments, businesses and consumers.

We currently are at the stage of trying to stop the growth in debt.

That will be followed by an extended period of debt reduction.

The UK alone will see at least seven consecutive years of spending cuts – an unprecedented fiscal position in modern British politics.

The Governor warned of the dangers of this week's ONS figures which show that Government debt has risen to a record £1trillion from £883bn only a year ago. And public sector debt is 64% of GDP – or £38,900 per household in 2011.

In December alone, the Government borrowed the equivalent of £220 for every person in the UK.

So the developed world has to reduce debt further – creating further headwinds to growth.

Added to these economic indicators of a new normal are long-term, world-wide environmental trends.

Global warming and global ageing.

Both are the results of some of man-kind's greatest achievements – economic growth, improved standards of living and better healthcare.

But both are threats which if not dealt with, could turn these great achievements into disaster.

Climate change is also affecting the timing and severity of natural catastrophe risks across the globe – and in the UK flooding and storm damage seem an ever present risk.

The independent Office for Budget Responsibility identified longer living as the biggest threat to Britain's long term fiscal sustainability – potentially pushing public spending, on pensions, health and social care, up by over 5% of GDP, or £80billion in today's terms.

The City and insurers are aware of these changes and society is feeling them too.

Inequality is widening and increasingly raising fundamental concerns about how society works.

Whether you are protesting as part of the Arab Spring, or across the street on the steps of St Paul's Cathedral at Occupy London; or if you are a shareholder involved in the debate on executive pay...

... In our new normal the gap between rich and poor is keenly felt; and was perhaps no more vividly brought to our doorsteps than during last summer's riots.

These political, environmental and social issues add to the mix to create the context within which insurers operate.

The ABI in the New Normal

From dealing with the effects of natural catastrophes to engaging on Board Effectiveness and Executive Pay.

From championing the Pensions Reform agenda to reforming the compensation culture.

From twin peaks regulation in the UK to dealing with the consequences of the UK veto in Europe.

The ABI's agenda is broad and deep.

2012 was always going to be a critical year, with Solvency II, the Retail Distribution Review, the approach of the end of the Statement of Principles on Flood Insurance and the creation of the FCA.

But just responding to these events is not enough.

On my first day at the ABI last April, I looked at the Business Plan.

It listed over 110 different things that we were currently working on.

While that list once served a purpose, in the new normal of tighter means and shorter deadlines, we need to prioritize and use our resources more wisely.

And become much more focused on outcomes – what we wanted to achieve by when.

We now prioritize our work based on what we call our ‘Principal Issues’.

I won’t list them all but I will cover a few of them today.

I know from thirty years in the industry, six of those as Chief Executive of one of the ABI’s biggest member firms, that what matters most is not that the ABI covers every single thing in the insurance space.

But that it covers our customer’s and industry’s definitive issues well.

We review our Principal Issues every month and at each ABI Board the list is challenged for relevance and progress.

The ABI has to add value: policy leadership, effective public affairs engagement and technical expertise.

General Insurance

I’d like to turn first, to our ‘non-Life’ work, or as we say, ‘General Insurance’, led by Nick Starling who joins us today.

Most of our current general insurance issues arise from the supply side.

General Insurance is our bread and butter. In the UK alone, last year, ABI members dealt with over 7 million motor and property claims – that's almost 20,000 every day.

Even if they are not a customer, every UK voter will know a friend or family member who buys general insurance products.

And everyone has an opinion – usually quite a strong one.

Recently, I was on my way back from an interview at the BBC on executive pay.

The interview had gone pretty well. I was feeling like I was getting to grips with this job.

Then my taxi driver lambasted me about the rising cost of his car insurance all the way from White City to Gresham Street.

And he is not wrong that we need to act to reduce the factors that are driving up industry costs in the general insurance space.

Our bread and butter offering is critical to our reputation.

Motor insurance is a compulsory insurance and driving a car is so often a necessity. And property insurance is an essential, particularly when there is a mortgage on the property.

Over the next twelve months, we have five key priorities to get costs down on the basic insurance essentials of life.

First, there is flooding, which is the biggest catastrophic risk facing the UK.

Our current flooding levels are set to become both more frequent and severe as the effects of climate change take hold.

We all remember the terrible 2007 floods which cost £3billion.

What you may not be aware of is that during the 2007 floods there was almost a much more devastating situation, when a North Sea surge of water came within millimeters of over-topping the East Coast flood defences.

This happened once before, in 1953, killing hundreds with devastating effects.

We absolutely must make sure we obtain a satisfactory way forward with the Government on the coverage of flood insurance.

The current agreement with the Government, the Statement of Principles, expires in mid-2013.

This agreement was a temporary 'sticking plaster' when implemented.

It results in a distortion of the market which cannot be sustained.

We want to see a free market with a support model financed through general taxation, and with Government as insurer of last resort – as happens across the world.

No other country in the world operates a free market which does not have some form of government intervention for people living in flood prone areas.

Second, we have to sort out the high costs of motor insurance.

These are driven up by excessive compensation claims, the poor road safety record of younger drivers and fraud.

Excessive compensation claims that are made as a result of personal injuries.

The bulk of these claims – 70% – come from whiplash; and a claim is made an astounding every minute of every hour of every day in the UK.

This area was recognised in the Transport Select Committee's report published earlier this month.

Over the next twelve months we will be working closely with our stakeholders and government to fix this broken system.

For younger drivers, the ABI has repeatedly called for the Government to take steps to lower their risks, so we can cut our premiums – and reduce deaths on the road, perhaps by introducing a curfew or stricter driving test.

Particularly pertinent to the 'new normal' is the link between unemployment and high motor insurance costs.

We simply should not have a situation, where, as the media have reported, young people are turning down job opportunities because they cannot afford to travel to and from work because of the high cost of their motor insurance.

One of the steps insurers have already taken to bring down costs for all drivers is through telematics schemes.

These black boxes, with a data chip, are fitted in your car, and record your route and speed.

They have helped to prevent 'crash for cash' scams and save lives through a more rapid emergency call-out.

Research has also shown they encourage drivers to behave more safely and responsibly on the roads.

Fraud is also a key priority – and one that affects all areas of general insurance.

We have set up a 35 strong specialist police insurance unit which launched earlier this month and has already seen success with 24 arrests and rising.

Insurers are footing the entire costs of this police unit spending £9million over the next three years.

We are also establishing the Insurance Fraud Register, to weed out fraudulent applicants and claimants.

And we are working with the Government to access the DVLA's database so that dishonest customers can no longer tell lies about endorsements.

A fourth priority in the G.I space is asbestos.

Asbestos is a vivid example of the long term nature of insurance.

Here we are dealing with the consequences of problems from the 1950s and 1960s which are not of today's making.

It's a clear example of changing standards and expectations of people – and how our long term insurance cover needs to be able to accommodate these.

Our priority for dealing reasonably with asbestos, is to ensure that people who contract this horrible disease, mesothelioma, can trace an insurer where there is one – and seek compensation quickly.

Fifth, on risk pricing, we need to make sure that crucial principle is adhered to and not interfered in by Government and Europe.

It is vital that we are able to price according to risk.

Risk pricing encourages consumers to improve their risk – like through telematics schemes for drivers – or by encouraging the Government to reduce their risk too, such as by building better flood defences.

On young drivers for example, the policy rates are high, but this is because the claims experience is very high.

Claims for the accidents of younger drivers can run to £20million with young males under 20, ten times more likely to crash.

Politicians suggest we – the industry – have a moral obligation to reduce premiums.

I would suggest that the industry and Government, together, have a moral obligation to society to tackle the cause of the problem – not merely foot the bill ex post.

General Insurance products are more relevant to society now than ever. But we must address the factors which could render these solutions too expensive or too exclusive for the majority of UK consumers.

Regulation

Closer to home are some of the developments in regulation both in the UK and Europe.

The European pipeline of regulatory change is a very full one, with Solvency II a key file.

We cannot pretend that the recent European veto made our lives any easier – we now face a situation where our European colleagues are more aware of anything we want to negotiate which could look like special treatment for the UK.

It is incumbent on us to maintain strong alliances and to make a strong case for change to those rule changes which could hinder rather than help.

We can't change our geography.

The European market is 330 million people sitting on our doorstep.

So we need to keep adapting to the challenges our neighbours face and ensuring we continue to be an active part of that community.

At the same time maintaining control of the levers which drive our economy – whether that relates to the level of capital we hold in banks or the taxes we raise on businesses and our citizens.

Turning back to the UK regulatory agenda, we have reorganized the ABI to create two regulatory divisions – our own Twin Peaks model.

Our prudential division faces the same concerns as Lloyds market members – on capital requirements, Solvency II and tax, and in this field the issues of our relationships with Europe loom large.

Our focus remains getting Solvency II over the finish line, and we are working hard with the FSA for internal models to be agreed on time, while making reasonable requirements on data.

There are still improvements to be made however, for example, on the calibration of the capital charge for catastrophe risk in the standard formula.

On tax, seeking a sensible outcome on the controlled foreign companies tax regime is also a key priority – one made ever more difficult against a backdrop of a tough government fiscal position.

A competitive, global UK insurance industry is an essential contributor to a viable UK.

Together the ABI and the London market can be a much stronger voice in achieving success for the industry and we will continue to work closely with Lloyds, the Lloyds Market Association, the Investment Underwriters Association and P&I Clubs.

On the conduct side, the creation of the Financial Conduct Authority, is another moment of truth for the UK financial services industry and the citizens of this country.

2012 will be the year when the debate settles and we see what kind of conduct regulation government has in mind for the UK.

Where in the spectrum do we want to land?

And what will the impact be in society and the industry?

This is a separate presentation in itself but I would like to make three points here:

- 1) This regulator must be about more than preventing negative outcomes for consumers. It must also be about supporting and promoting positive outcomes.
- 2) One of the most positive outcomes we need to see is that more consumers get better access for the financial products and services that they need.
- 3) And finally, for any industry to deliver it must be competitive. For any regulator to be effective, it must work towards the correct statutory objectives. Statutory objectives for the FCA therefore must emphasise effective competition.

All regulators should look not just to protect customers, but to get the best for customers.

And competition is an important part of making that happen.

Life, Savings & Protection

Next the life and pensions agenda, where I have spent most of my career.

Although this is not a feature of the London market, it is important for the ABI.

I said earlier that the great thing about my job is the diversity of the work.

And interestingly, on the Life, Savings and Protection work, unlike the supply side issues in General Insurance, the challenges tend to stem from the demand side.

I have studied some of these demand side issues in depth as part of my financial capability work.

Both as Chairman of the Personal Finance Education Group and as author of the Treasury commissioned Thoresen Review into generic financial advice.

However, improving levels of financial understanding among the public is only part of the problem.

The Life industry has big steps to take to gain peoples' trust.

This is particularly important in the area of retirement saving.

People are wondering if pension saving is really worth it?

We must persuade people that it pays to save.

And it pays to save with us.

We must address the fiscal imbalance created by ageing that the OBR highlighted.

And we have to start now.

Our Life and Savings priority is to get pension reform off to a good start when the first stages of automatic enrolment begin in October.

There is a real opportunity there to get saving into the public consciousness.

The new normal presents a much more difficult climate for the introduction of automatic enrolment than the Turner Commission envisioned.

The compulsion for employers to contribute adds pressure to their costs at a time they can least afford it.

For individuals, part of their discretionary income will be redirected when they are struggling to pay household bills; and the uncertainty of the economic outlook makes the argument for long term investment a hard argument to win.

But by engaging young people in long term saving; minimizing the risk in investment strategies; encouraging retirees to exercise their open market option; and making charging structures more transparent; we have a real shot at using this opportunity to start to address the UK's chronic under-saving.

50 years from now, the current situation where the State provides cannot apply given the competing demands on the State's resources.

This will be made tougher as more people age - I have already mentioned the OBR's predictions for the spending rise that will come with demographic change.

So as the Welfare State is cut back there will be opportunities for the industry to step in and fill the breach.

But we need to be clear about our role - first and foremost we are businesses, and we cannot meet the demands of Society, the City or anyone, if we operate at a loss for too long.

If return on capital is too low, capital won't be available, and if capital isn't available, capacity will be too low and the UK's dependency on state provision will grow and grow.

Investment Affairs

That leads me to the last piece in the ABI's work, our investment affairs arm.

I said at the beginning of this lecture that on a macro level, after our responsibility to customers, is the vital role of insurers' to support and drive wider economic growth.

Since 1995, there has been a systematic change in the make-up of ABI member's investments, away from equity to government and corporate debt.

In 1990, UK insurers and pension funds owned over 50% of the UK Equity market. Now it's less than 25%.

Successive waves of regulation have pushed down the appetite for risk in institutional investors.

So if we are to contribute to investing in UK infrastructure some things are going to have to change.

We have just started the work of the Insurers' Infrastructure Investment Forum which aims to help contribute to getting Britain's economy moving.

We want to work with the Government to create a new asset class of infrastructure bonds – that could see insurers invest in everything from railways to hospitals.

However, we face a big challenge here from Solvency II, which in its current form discourages investors from long term investments.

Then there is the significant and politically charged topic of corporate governance.

Here, the ABI is informed by our Institutional Voting Information Service, or IVIS, set up in 1993.

IVIS investors represent over 30% of the FTSE. It monitors all companies in the FTSE All-Share Index.

It looks at companies remuneration practices against the ABI principles of remuneration.

And IVIS looks at companies Board and Committee structures to see if they comply with the UK Corporate Governance Code.

It is the most respected advisory service in the UK and the only one that takes account of the views of real shareholders in the judgements it makes.

We do not give voting advice but instead highlight concerns through concise reports that red, amber or blue top a company.

Recently we amber-topped BSKYB, to highlight the need for an independent Chairman.

More recently, we red topped Mitchells and Butler, and Cairn Energy which has been in the news this week.

At 12%, red tops in 2011 were at their highest in recent years.

Our IVIS system gives us the robust evidence base from which to draw lessons that inform our guidance on corporate governance.

In particular, there is the role of shareholders and Boards, increasingly coming under scrutiny in the executive remuneration debates.

In the new normal, a stable economic growth will come from well run, sustainable businesses, and effective Boards are critical to this.

Our Board Effectiveness guide, mentioned by the Business Secretary in his ministerial statement on Executive Pay earlier this week, was published in September 2011.

The ABI Guide outlined detailed real life examples and practical ways for company boards to improve their diversity; succession planning; and engagement in oversight of strategy.

On executive pay more specifically, we welcomed the Government's measures, announced on Monday.

Taken overall, they will help shareholders establish stronger links between pay and performance, and tackle excessive pay for failure.

Investors want simpler pay structures, better accountability to prevent reward for failure and greater transparency on how rewards are calculated.

The task ahead is to work with the Government on getting the detail right on the complicated areas such as forward-looking votes and to ensure that the ambitious proposals announced this week become the standard practice of tomorrow.

And shareholders must fulfill their part of the bargain.

Properly engaging with company reports, exercising their responsibilities under the Stewardship Code and scrutinizing company strategy and management actions.

Conclusion

Ultimately, with all these demanding priorities to balance in the new reality, at times, I do find myself having to ask; what does it all mean?

And that brings me back to the micro and macro aims I said at the beginning.

How are we helping our customers to deal with the unexpected?

And as a whole, how are we supporting sustainable and responsible, long term economic growth?

Despite the need to come to terms with what can seem like an exceptional new reality, we have to manage what we can. And manage it as well as we can.

We must get debt down to manageable levels.

Spot the areas of economic growth and engage with them.

Plan for the effects of demographic and climate change.

Anticipate the needs of our customers and deal with them well.

Use long term growth as a driver of business strategy.

Increase levels of financial capability and encourage financial education in schools.

Invest in our people and their skills.

For six decades, none of us have known an environment like this.

But we can pride ourselves in the professionalism of our industry.

Something that Sandy Scott and the Chartered Insurance Institute have had a big role in developing.

I have mentioned already how compelling I find this role, but it has also given me the opportunity, for the first time, to work full time in London.

I've developed relationships across the industry, including with brokers and advisers, key players in the way the industry operates.

Coming to this remarkable City, this capital of insurance and global finance, has given me great confidence in our ability to adapt to the new normal and build success.

But the key for me is not to expect things to return to the way they were.

The new normal brings with it the chance to do things differently, to grasp new opportunities and to focus on some of those systemic issues we all need to address:

- We have the chance to redefine our relationship with our customers by helping them make good choices at a time when it is ever more important for them to plan and protect themselves.

- We can become partners of Government, driving growth through investment in UK infrastructure projects and contributing to the economy.
- And we can help rebalance the burden from the public balance sheet to the private by helping the Government to address the enormous challenges of an ageing population.

What is clear however is that it is incumbent on everyone from politicians to business leaders, bankers to insurers to start addressing the disconnect and disillusion of a public feeling bruised and uncertain about the future.

A clear appraisal of the challenge and positive steps to move forward is a start.

My father had a motto on the wall of his cabin in his ship.

‘Take time while time is, for time will away.’

The challenges we face as a society and as an industry in the long term are significant – but the sooner we start to take the steps we all know are needed, the better prepared our country will be to face them.