

# Insurance sector is well-placed to weather storm

The Times, 13 November 2008

Stephen Haddrill: Viewpoint

Having experienced a relatively stable few weeks after the turmoil of the autumn, now is a good time to reflect on the questions that have been asked of the insurance industry and its ability to withstand the shocks that have afflicted other parts of the financial services sector.

Only last month, the Bank of England's Financial Stability Review raised concerns about the implications for the insurance industry of corporate bond defaults and further large falls in the equity markets. It is more important than ever in the present climate to answer concerns openly and calmly, based on a clear understanding of how the insurance sector functions.

As the voice of the UK's insurance industry, the ABI's view is clear. The industry entered the crisis in a strong capital position and, as insurance companies do not lever their assets and liabilities are long-term, it is well placed to avoid liquidity difficulties and weather further shocks. Insurers are different from banks, with different funding arrangements and business models.

Since the 2003 stock market collapse, regulatory and capital regimes for insurers have been strengthened. But do not merely take my word for it — in a speech last week Sarah Wilson, the FSA's Insurance Sector Leader, said that the insurance industry “is better prepared to deal with stressed market conditions”. She pointed out that insurers were now required “to calculate the capital requirements that reflect their own business risks and hold capital commensurate with this”.

Even so, suggestions have been made repeatedly that the British life insurance industry is “next in line” to need bailouts. This is simply not the case. Over the past month, several of the UK's largest life insurers have made public the state of their capital and their exposure to potential further falls in bond and equity markets, demonstrating that their position is sound.

Given that insurers own or control about a quarter of the UK's capital, in equities, bonds and property, concerns are inevitable — but the industry has spent the past five years de-risking portfolios, reducing equity holdings greatly.

ABI members own less than 15 per cent of the stock market, compared with about 20 per cent five years ago, with greater investment in corporate bonds. For “buy-and-hold” investors (as insurers often are), bonds typically have provided a less volatile return and carried a lower risk than equities.

Insurers manage the risk of corporate bond issuers becoming insolvent, just as they do with equities. Where selling is taking place, it is being driven by technical pressure in thin markets, with a flight to government bonds and cash.

Yes, corporate bond values are falling at the moment, but let us be clear: insurers can and do withstand falls in the market price of bonds. Most of their liabilities - such as annuity payments — are largely matched by the bonds' income, which is not directly affected by currently volatile and unreliable market prices. Insurers do not become illiquid in a crisis; income continues to flow in before claims have to be paid. Even when, in the past, an insurer has come under financial pressure, it has continued to pay claims.

The FSA recently adapted some of its rules to give insurers more flexibility around their Individual Capital Guidance. This was done primarily to accommodate present dislocation in the markets, rather than because of any pressing concerns over insurers' long-term solvency. That flexibility means that insurers will not be forced to sell their bonds or equities unnecessarily, which would exacerbate current market difficulties.

We believe, therefore, that markets can have confidence in British insurers. So, too, can consumers, with the Financial Services Compensation Scheme covering 90percent of insured losses and annuities without any upper limit, and 100 per cent for any compulsory insurance taken out, in the event of an insurers' collapse.

I do not for a minute claim that the insurance industry is immune to global market events - investments have fallen in value and this remains a challenging time for the sector - but basic facts about how the industry operates, protects its business and looks after its customers' interests must not be ignored. Insurers remain well-equipped to deal with our challenging environment.

The UK insurance industry has a capital and risk management model that is explicitly designed and tested to cope with periodic hard times. Now is not a time for complacency, but neither is it a time for unnecessary and uninformed concern about a part of the British economy that is a world leader and is an immensely important part of our national infrastructure.

*The author is director-general of the Association of British Insurers*