ABI

#SecuringFutures

# Securing our future

How an effective UK insurance and long-term savings sector will help the UK succeed in an uncertain world

# Confidence through uncertain times

This decade is set to be one of transformation and uncertainty in the UK. After the global Covid-19 pandemic, this decade will see both the UK and the wider world navigate shifting geopolitical tensions, rapid technological change and the growing challenge of decarbonisation.

Confidence in uncertainty comes from understanding and managing risk. One of the key social roles of insurance and long-term savings has always been not just to protect people from risks, but to empower them to take them. To invest in transforming a home or business. To load a cargo for import or export. To retire from work with financial confidence.

Where excessive, precautionary saving or fear of unmanageable costs might otherwise stifle the dynamism of a society, insurance helps power it. Where retiring from working life might have meant economic uncertainty, long-term savings help make it a point of confident change.

This is a snapshot of a sector both undergoing rapid technological change and delivering on its historic social purpose to protect people and businesses and empower them to take the risks that help the UK succeed.

We think of capital as the key ingredient for growth and innovation. But risk management is often what unlocks the power of invested capital and entrepreneurialism and drives a society's sense of economic security.

Insurance and long-term savings are key to both.

Technological change and a world of evolving risks need new and smarter forms of insurance and long-term savings.

- The **data revolution** that is transforming the way in which customers can manage risk and plan for the future.
- The ways in which the UK insurance and long-term savings industries are reflecting on and adapting how they **communicate risk** to ensure that customers understand how they are protected and empowered.
- The ways in which more sophisticated risk measurement will enable UK insurers to actively engage customers in a two-way process of **risk management – and greater risk prevention** - in areas such as personal health and the low carbon transition.
- The ways in which UK insurers and long-term savings managers can be a vital pool of capital for critical **transformational investments** in the UK.
- The challenge of developing a new model for **insuring 'mega-risks'** – the unique class of disruptive events that strain the conventional model of private insurance and may need forms of public-private partnership to address.

# An historic strength. An asset for the future

The UK has the largest insurance and long-term savings industry in Europe, and the fourth largest in the world after the United States, China and Japan.

It insures policyholders against losses from a huge range of risks and pays tens of millions of pounds in claims every single day. It is the steward of more than £1.6trn in invested assets.

More than 900 insurers and over 330 long-term savings providers employ more than 300,000 skilled workers across the UK and contribute more than £30bn to the UK economy every year.

**£1.6trn** assets held and managed

**£0.86m** trade credit insurance claims daily

**£16m** property insurance claims daily

**£5.9m** liability insurance claims daily

**18.4m** individual pension policies

**£8m** business motor insurance claims daily

**£22m** personal motor insurance claims daily

**£1m** travel insurance claims daily

# Securing our economic future

## Confident risk takers

Insurance is so much a part of our lives that it can be easy to miss how fundamental it is to modern economies and societies. The fact that it is possible to limit our exposure to the cost of a motor accident, injury or ill health or ensure that a home can be repaired following a flood or fire allows us to remove what might be crippling forms of uncertainty or financial risk from our lives. Products like income protection allow individuals to rely on resources beyond the UK's relatively low levels of statutory sick pay should they be unable to work. Businesses being able to limit their liabilities, de-risk their pension costs and insure their physical assets helps them manage risks that might otherwise constrain their ambition.

One way of thinking about this is that it reduces risk – the risk that comes with a car accident, a house fire or a flooded business place or an unpaid trade invoice. Insurance protects us, and in doing so provides peace of mind. But we can also see it as enabling us to take risks. Every time we get in a car, put cargo on a truck or ship and invest in a property or a business we are taking a risk. For our society and economy this makes a huge difference. Our willingness to take these risks is fundamental to modern life. There would be no economic progress without it. One of the basic roles of insurance is to make these risks feasible.

Key to the way insurance does this is the way that that it assesses risk. Insurance is one of the most powerful tools for assessing risk that has ever been designed. When an insurer generates a premium for taking on a risk, it is putting a price on that risk. An insurance contract is not just an agreement on the cost of providing a policy and the peace of mind that brings. Calculated prudently and understood properly, it can provide both critical information on the risks a customer proposes to take, the effect these risks occurring would have and a vehicle for insurers to help their customer manage and reduce that risk. The power of insurance is in the way that it empowers us to make informed, confident choices about risk. In an uncertain world, it is one of our most important tools.

## Transforming our futures

Long-term savings serve as a risk management tool in a different way, but they are also closely linked to our economic confidence as a society. By providing for the costs of retirement over many years a saver ensures that they can plan to leave full time work confidently and in the knowledge that they will be adequately provided for. Long-term saving has a vitally important social and economic role. When we individually save for our retirement, we are both contributing to the wider resilience of our economy and society and creating a unique pool of capital for long-term investments. Channelled effectively, these savings are an important way of transforming and sustaining the country's physical infrastructure. At a time when that infrastructure must be overhauled to enable the digital and decarbonisation transitions, this pool of capital has never been more important.

Insurance and long-term savings have important roles to play in navigating the UK through a decade of uncertainty and change. They will help unlock the confidence and enterprise that will see the UK grasp the benefits of technological change, finance the transformation of the UK's infrastructure, and ensure that citizens close the daunting gap that has opened between what they save and what they will need to fund longer, healthier lives. In doing so, they will help secure our country's future.

# De-risking renewable energy

In 2021, renewable energy accounted for more than a third of UK energy generation. The UK already has the largest installed offshore wind capacity in the world with a further 6.117GW in construction. This includes the biggest offshore wind farm in the world at Dogger Bank (2.4GW, with an expected final capacity of 3.2GW).

This expansion would not have been possible without sophisticated insurance for this novel generation technology. Insurers were able to draw on the experience of insuring offshore oil and gas facilities and other complex infrastructure. They also needed to consider a range of unique features of offshore wind, including the capacity of the grid to support their integration and the uniquely demanding costs of returning damaged facilities to operational status quickly enough to ensure that they can play their vital role in energy supply.

With the Government's target of 1GW of offshore floating wind capacity by 2030 this challenge is set to evolve further. Commercial deployment of this new technology at scale will be much more difficult without an insurance market that can price the risks involved. If the UK is to fulfil its potential as a host for offshore power generation, this will be not only a triumph of technological innovation, but insurance innovation.

Scaling up offshore wind power will take more than just world-beating technology.

Insurers and pension companies have also invested their capital directly in UK offshore projects. Offshore wind facilities such as Hornsea 2, the world's largest offshore windfarm, have benefited from direct investment from UK insurers and pension companies. Insurers and pension companies are major institutional investors who can help finance the transformation of the UK's energy system. This provides developers with capital to expand the UK's renewable energy capacity, and provides reliable long-term income for insurers, pension companies and UK policyholders.

# Protecting digital innovators

The Covid-19 pandemic saw a dramatic expansion of the role of digital technology in everyday life. This accelerated a trend in digitalisation that was already well established. Business model after business model has been transformed by the potential to operate online or be supported by the infrastructure of the digital economy, especially for data storage and processing.

However, the rise in the incidence of cyber-attacks and the potential disruption they cause can leave businesses uncertain about digital transformation or exposed when they attempt it. The shift to remote and home working also needs to be accompanied by new ways of ensuring the cybersecurity of these 'disaggregated' workplaces. In 2021, the UK National Cyber Security Centre identified working from home as a material driver in a spike in cybersecurity breaches.

39% of UK businesses reported being the victim of a cyber-attack in 2021.

Only 9% of UK businesses have cyber-attack insurance.

A well-developed cyber insurance market can play a key role in enabling a transformation to a digital economy. It will do this both by developing forms of remediation and recovery from the effects of cyber-attack, but also by raising awareness of the risks, and sharing best practice on avoiding attacks. Insurers have an important role working with industry and government stakeholders, including the National Cyber Security Centre and the ICO, to raise understanding of the risks and to build UK resilience.

UK insurers have already created dedicated "working from home" insurance policies that offer remote workers cover for the full range liabilities they incur working from home. These can be tailored to each remote worker and provide for business equipment, professional indemnity and public liability.

# Supporting self-employment

The rise of self-employment and solo-working has been one of the most significant changes in the UK workforce in recent years. Despite a sharp drop during the pandemic, it has accounted for a third of all employment growth since the financial crisis and was a defining feature of the UK's economic recovery after 2009.

Self-employment can be a liberating and rewarding choice for many, and a source of innovation and dynamism for our economy. However, those moving into self-employment also need to plan and protect themselves in ways that those in full time employment may not.

Insurers and long-term savings providers have anticipated and responded to employer and employee demand by customising insurance options for remote workers and building solutions for retirement savings for those outside of workplace pensions. This includes:

- Creating a wide range of insurance products designed to make it simple for self-employed people to protect their incomes, access the protections of business insurance, or cover any liabilities that would be provided by an employer. This includes income protection insurance, public liability and indemnity insurance for the self-employed and a wide choice of policies that protect the tools and technologies an entrepreneur may depend on.
- Creating new savings products to provide retirement planning tools for the self-employed, or those who do not have the security of an auto-enrolment pensions. This represents a significant risk for governments and society, with traditional models of saving and preparing for retirement not keeping pace with changes in employment. Many UK long-term savings managers have developed products designed to meet this increasing need.

UK self-employment took a hit with Covid-19. Innovative insurance and long-term products can help it rebound.

# Innovative insurance for innovative investors

Although decarbonisation will deliver benefits for individual businesses, the upfront costs of transformation can be material. Insurers have developed a wide range of policies designed to encourage and support low carbon choices for UK businesses and investors. These include:

- Policies that provide project finance risk cover to renewable energy investors, guaranteeing them against the risk of non-payment. This helps to unlock finance for projects in solar, hydro and biomass power.

- Policies that cover the risk of damage to, or operational failure of, energy efficiency assets to guarantee the energy cost savings against which finance for such investments is often secured.

Innovative insurance can help companies and investors bet on low carbon change.

- Policies that guarantee the replacement of damaged goods have been expanded to replace like-for-like replacement commitments with the option of replacement with more sustainable products.

- Policies that guarantee revenue from bioenergy and circular economy projects where revenue is temporarily impacted by design or engineering issues.

- Policies that protect investors in low-carbon projects against changes in any tax incentives attached to such projects.

- Policies that insure a purchaser of carbon offsets against the possibility that an offset purchased does not ultimately deliver the level of sequestered carbon expected.

- Policies that provide third party liability cover for the decommissioning and removal of offshore assets used for the extraction of fossil fuels.

# Data-driven opportunity

Insurance and long-term savings involve making complex assessments of risk and important judgements about the future. Insurers incorporate a wide range of information into sophisticated calculations of the factors that might produce an insurance claim. Calculating an annuity involves similar assessments of how much income someone is likely to need in retirement and how long they are likely to live for. Insurers and long-term savings providers have always sought to incorporate new forms of data and analysis into the way they do this.

Over the last twenty years, the rapid transformation in data gathering and data processing has provided huge new scope for refining assessments of probability and risk and helping customers understand their risks better than ever before. The possibilities for customising insurance coverage and long-term savings products much more precisely for individuals and businesses are very positive.

For the customer this can, and should, transform the way they understand risk in their own lives in many positive ways. Given the necessary control over their data and the tools to interpret the growing volume of data about their risk profile, customers have more scope than ever before to make informed choices, to understand their life-time income needs, to manage their risk and to help their insurers and long-term savings providers make genuinely customised assessments. In Section 3 we consider how data can turn more data into more power to manage risk.

## Data sharing

An important step in unlocking the power of data is to give customers control over their data where it matters. When an individual has control over the data on their health or lifestyle choices, they can then choose to share that data with insurers or other providers. This will in turn encourage insurers to compete to provide more bespoke products and calculate premiums that better reflect the risk profile of an individual.

The ongoing work on Pensions Dashboards in the UK is an early example of how the potential benefits of better data sharing will be realised. Pensions Dashboards will enable UK citizens to see all their pension assets in a single consolidated online dashboard – and thus make more informed judgements about their current provision for retirement. But the scope for innovation goes far further. One of the challenges in the years ahead will be to ensure that individuals have safeguards that empower them to safely share their data. This means having the ability to share it in a timely way with

insurers and long-term savings providers where they choose, underpinned by a robust framework of personal data protection. To make an informed choice, they will need to have adequate transparency on where data about them is being used in risk calculations and in what ways.

It will also be important to consider the ways in which customising an offer to a client's risk profile could trigger regulatory obligations, such as where this constitutes investment advice. Investment regulation rules should not disincentivise customers to seek more bespoke products or providers to offer them.

## Responding to better risk pricing

This more sophisticated data picture can be a force for insurance inclusion. Where sharing personal data can establish that a customer does not in fact present the risks other aspects of their profile might predict, this can help individuals secure affordable insurance cover that may not have been available before. We already see an example of this where younger drivers, who as a group are more likely to be involved in road accidents, share their driving data via a mobile phone or a 'telematics' device, in order to reduce the cost of motor insurance.

However, one implication of a better understanding of risk is that the cost of insurance for some individuals or businesses could also rise in line with a clearer understanding of their risk profile. In many respects, this is insurance working as it should: assessing a risk objectively and expressing that risk in a premium for insurance. This is what enables the market to objectively understand risk, and a customer to potentially take proactive action to reduce it.

Nevertheless, this shift will represent a challenge for some customers. Should this lead to the development of a small pool of individuals for whom insurance becomes prohibitively expensive based on their risk factors – in some cases factors beyond their control – this would raise questions of equity and may need targeted solutions.

There are already examples of action being taken, either in legislation or voluntarily by industry, to ensure certain customers are not unfairly disadvantaged. For example, the law already prevents insurers using sex as a factor in risk profiling, despite, for example, the clear difference in road safety outcomes between men and women. The UK industry has developed its own Genetics Code to define the limits of what is acceptable in terms of using personal genetic data to model risk.

In the years ahead, these questions are likely to be raised in a range of areas as the datasets used to build personalised risk profiles become more detailed and predictive of future outcomes. Regulation will need to strike a balance between access to insurance and pricing driven by legitimate measurements of individual risk.

## Artificial Intelligence and Machine Learning

AI/ML is at the heart of the data revolution. As the volume of data available to customers, insurers and long-term savings providers expands, the potential power and value of AI/ML in interpreting it advances in parallel. AI/ML raises a range of legitimate questions about the ways in which human judgements might be substituted by machine reasoning.

The regulation of algorithmic processing, including Machine Learning and Artificial Intelligence, is of importance to authorities and regulators around the world. The UK is developing its own approach as part of its National Data Strategy. This needs to blend awareness of the risks with a willingness to let the market explore the potential of the technology.

As a first step, we should determine where the use of AI/ML is already covered adequately by existing regulatory frameworks for consumer protection and risk management, in insurance and financial services more generally. Only where this is not the case should new rules be necessary.

The questions around fairness, bias, transparency and explainability that AI/ML raises in insurance are also raised in similar ways in other services, including banking and healthcare. Often data generated by an individual's interaction with one sector will then be used in another, as already happens when someone shares access to their banking data to an authorised service through 'Open Banking'. Consistent and coherent regulation will be needed across industries, which can then be adapted to specific sectors.

In the years ahead, both approaches will need to be part of a comprehensive evolving UK National Data Strategy. Building around the Data Protection Act, the established track record of the UK insurance and long-term savings industry for robust data protection, it is important that the UK continues to be at the forefront of the data revolution with a blend of commercial innovation, customer empowerment and regulatory sophistication.

# 2. Communication and trust

Trust is fundamental to insurance and long-term savings. In insurance, a customer must understand the risk that they are insuring and the redress that would be available to them if that risk occurs – and the customer and the insurer must, of course, have the same understanding of this. Customers that entrust their financial futures to long-term savings providers need to understand the choices they are making and the risks they are balancing. For this reason, the regulation of insurance and long-term savings rightly places such emphasis on clear and effective customer communication.

The UK Financial Conduct Authority's new Consumer Duty will further embed this focus on consumer outcomes in UK regulation and practice. But it is not simply a question of regulatory duties. The Association of British Insurers (ABI), together with leading insurance and long-term savings firms, has joined forces with Plain Numbers, to help people who struggle with numeracy to better understand customer communications. Plain Numbers works with firms to help their staff present and explain numbers as clearly and simply as possible to help improve customer understanding.

The Public Trust Index of the Chartered Insurance Institute has emphasised that customers routinely report that quality of service is more important than price. In this respect, the new UK Consumer Duty merely converges regulatory expectations with commercial best practice.

The challenge for insurers and long-term savings providers is to continually adapt their practice to ensure they meet this duty as technology, society and the economy evolve. In part, this is about proactively explaining the changes in the way the industry assesses risk and ensuring that customers understand the implications of inflation, investment turbulence and longer lives. But it is also about a basic commitment to designing products and writing policies that are clear, unambiguous and simple to understand.

## Explainability in AI/ML

Insurers are already adopting forms of AI/ML to help price risk and evaluate claims. Consumers have always understood that the price of insurance will change to reflect the risks they propose to take, and the extent to which those risks can be measured and quantified. As underwriting judgements are increasingly driven by more detailed datasets and advanced analytical techniques, it will be important to ensure that these can still be explained clearly to customers and are subject to the necessary forms of accountability.

Assessments used to price an insurance policy or design an appropriate pension will always have to try to identify the things that predict higher or lower levels of risk. However, both customers and regulators will need to be assured that these judgements are genuinely objective and risk-driven, and do not incorporate unintentional bias, not least with respect to protected characteristics.

To do this, ensuring that compliance teams are involved in every aspect of model design is important. Technologists in the industry are actively seeking ways to embed transparency in models that use AI/ML and working to build governance models that ensure that AI/ML models are fully understood by the managers and business teams that use them and can be clearly explained to customers.

## In long-term savings markets impacted by inflation, investment turbulence and longer lives

The context for long-term savings in the

UK is changing in ways that will have important implications for customer communications. After a relatively benign period for global stock markets and inflation, savers and those reliant on investment income are now facing lower returns. Inflation raises the costs of living for those living on savings and erodes the value of those savings. It can eat away at the real value of annuities for those dependent on them. It can disincentivise those of working age to save for the future.

People are living longer lives, especially those who enter retirement in good health. But the UK is also characterised by increasing inequality in life expectancy and healthy life expectancy. This means retirement savings are often having to work harder for longer to support longer lives, and that people are having to make increasingly complex judgements about their own needs and provision from mid-life to potential care needs.

Understanding how to fund a pension and transition pension savings into a form that will generate stable and reliable post-retirement income are key life choices. Alongside tools like the developing Pensions Dashboards, long-term savings providers are actively working to ensure that customers are in a position to make better informed choices.

## Covid-19 and business interruption insurance – lessons learned

In March 2020, the UK Government took the unprecedented step of requiring many businesses across the country to either close or reduce their operations. Despite massive efforts to sustain their liquidity, the disruptive effect on many companies was inevitably serious.

Many firms were understandably concerned to find that their business interruption insurance policies did not cover the impacts of public health measures that forced them to close or sharply limit their commercial activities. While some policies did cover this eventuality, many explicitly did not. Most importantly, some were unclear. In these cases, the courts were ultimately asked to provide a definitive interpretation of the obligations captured in these policies.

### The uncertainty over business interruption insurance during covid reinforces some important lessons.

Our member firms supported the fast-track legal process that helped define the obligations in some business interruption policies. Once a judgment was secured, impacted insurers moved quickly to start settling claims, and now expect to pay out more than £2bn in compensation for Covid 19-related closures, alongside hundreds of millions in travel, liability and other claims.

Insurers recognise that this process has produced some important lessons. Even where policies were clear that they did not cover business interruption of the kind experienced during Covid-19, the fact that policyholders did not understand this means insurers needed to do more. Too many insurance brokers were not fully equipped to explain the scope of coverage. This is why initiatives like the ABI's partnership with Plain Numbers are so important.

# 3. From risk measurement to risk management

Insurers want their customers to take risks – if they did not there would be no need for insurance policies! But this is not the same as saying that insurers want their customers to behave irresponsibly. Insurers have every incentive to encourage their customers to manage the risks they are taking – and this risk management can and should be reflected in the price customers pay.

When it works as it should, this model offers the potential to make insurance not simply a policy you buy, but a process of conscious risk management. Where an insurer can reliably identify factors that might improve a customer's risk profile, they can then incentivise the customer to address those factors through the level of cover offered. Effective insurance relationships will be built on close relationships between insurers and customers in which policies will be tailored to customers more accurately than ever before.

These approaches allow customers to manage their insurance needs not just by comparing providers, but by working with providers to tailor the cover provided in a way that reflects good risk management. Instead of reducing cover to reduce costs, this approach enables customers to get better value for money from their insurance by managing their risks. As customers get better at managing risks and incur fewer losses, the cost of providing insurance can fall. Where this improvement in risk management translates into things like fewer illness or accident-related work absences, there is even a wider social and economic benefit.

Insurers have long offered vehicle insurance policies that adapt a premium to how often vehicles are driven and to their capabilities and safety features. In home or commercial property insurance, policy costs will often reflect the installation of security features.

Now, data-driven devices offer the potential to take this model to a new level of customisation. Sensors in vehicles (either 'telematics' devices or by using mobile phone apps) and in buildings can provide data that insurers could use to calculate premiums. But they also help to manage risk – by identifying unsafe driving or undetected damage in buildings.
As well as allowing insurers to suggest changes that would reduce the risk, these devices can also identify claims earlier and thus reduce the harm or damage. Not only does this reduce the frequency of claims, but it can also reduce their costs and the length of time taken to begin repairs. This reduction in claims costs reduces the cost of providing insurance.

## Encouraging better health outcomes

The increasing sophistication of data gathering and risk assessment in healthcare has enabled insurers to take this model to a new level of customisation. Not only are customers able to use their growing body of personal health data to help insurers measure their underlying risk in a more specific way, but they can then work with insurers to maintain behaviours that keep them as healthy as possible – and to see this reflected in their premium costs. Many insurers now use incentives for healthy behaviour in health insurance policies and use various forms of wearable data gathering devices to inform customers of behavioural choices such as gym visits or levels of daily activity.

In the years ahead this model will continue to evolve. In principle, it offers a very

positive opportunity to make the decision to seek health or life insurance that actively contributes to personal wellbeing. But insurers also recognise that it comes with a sensitive and important debate about requiring customers to wear devices that monitor their health and lifestyles in real time. Customer data protection is critical. But so is a wider debate about the right balance between data sharing and customisation in insurance – not least because customisation will identify higher risk customers as well as lower-risk ones.

## Facilitating the low-carbon transition

This model of iterative risk management potentially comes into its own when we consider the huge challenge of the low carbon transition. Insurers clearly have a role to play in developing insurance policies capable of managing some of the risks linked to climate change, including weather events or coastal flooding. As institutional investors and as savings providers, they have to consider the risk climate change poses to the value of assets. Some estimates suggest that there are many trillions of pounds worth of assets globally exposed to climate change.

Insurers have had to actively consider and revise their risk analysis models to account for rapid change in the incidence of extreme climate-related events, and to consider the possibility that currently valuable assets could become 'stranded' if subject to increased costs or legal changes designed to reduce society's reliance on carbon-intensive industries. Some insurers are already excluding certain types of hydro-carbon intensive businesses from some forms of coverage. Where prices for insuring carbon-intensive assets are rising, this is insurance working as it should.

Insurers also have a proactive role to play in working with clients to drive the transition. This will involve adapting the models used to assess risk quickly when new technologies or business models that can reduce emissions come to market. Insurers are already working closely with new sectors, such as Carbon Capture and Storage, which will be critical to the Net Zero transition, to ensure their risk profiles are understood and they can access suitable cover as soon as they come operational. Insurers can also help people switching to electric vehicles or installing energy efficient devices with tailored policies that cover battery outages or connection wires, in addition to the risks traditionally covered by motor or home insurance policies. They can also help reduce their customers' carbon footprints by offering recycled or repairable parts when repairing a vehicle or replacing damaged goods.

Long-term savings providers have also sought ways to support customers to engage actively with low carbon choices. The allocation of their investments is one way they can do this. Many UK providers are already providing tools that enable savers to assess the ESG profile of their portfolios and make conscious decisions about which types of businesses they invest in. Some providers are also moving the investments in their 'default' funds towards businesses that are committed to reaching the Paris climate change goals.

With the UK poised to make big societal choices in the next few years on the speed and effectiveness of its heat and energy strategy and the roll out of electric and autonomous vehicles, insurers need to play an integral role in the way government plans to incentivise these transitions. ABI members want to work with government to ensure that changes in industry practice such as offering customers more sustainable product choices as part of replacement policies are coordinated with other government incentives and the capacity of the UK to meet demwand for new technologies. It is also important that public policy helps to support the industry in encouraging customers to accept recycled, refurbished or repaired goods as part of insurance settlements.

# 4. The mega-risk challenge

Insurance is generally based on the assumption that unfortunate things can happen to almost anybody some of the time. However, events that affect whole communities simultaneously have always raised a particular challenge. To be managed through insurance alone, they would need to be part of a sufficiently large portfolio or diversified through reinsurance in a way that can absorb such large highly concentrated risks. The Covid-19 pandemic confronted us with the reality of risks on this scale.

Catastrophe risk is not new in insurance. Natural disasters have always presented a unique challenge for private insurance markets because of their highly localised, and often highly destructive nature. A conventional response to this problem has been to create a pooling of risk that combines the resources of both the public and private sector to make insurance feasible and affordable.

The OECD estimates that since 2000, around 40% of all economic losses due to floods, storms and earthquakes have been in markets or regions covered by catastrophe risk insurance programmes in which the state participates alongside insurers to enable affordable coverage. The UK has two examples of this kind of public-private collaboration in operation, the Flood Re scheme that allows homeowners in high flood risk areas to access affordable property insurance, funded by an annual £135m levy on property insurers and the Pool Re scheme that holds £6.5bn to cover claims linked to acts of terrorism. Both of these schemes are industry funded but enabled by a Government guarantee.

Similar forms of public-private partnership between insurers and the Government exist overseas. Examples include the National Flood Insurance Programme in the US, New Zealand's Earthquake Commission, Spain's CCS catastrophe insurance programme and France's CCR, which undertakes a similar role. In each of these cases, governments have shared risk to help create a market for affordable insurance.

Several areas potentially raise similar issues. These include:

- The risks attached to another pandemic like covid-19, requiring similar restrictions on economic life and business disruption.
- The risks attached to systemic disruption resulting from large scale, or targeted but widely disruptive cyber-attacks or other damage to the UK's critical infrastructure, especially for electricity on which much of its digital and other infrastructure depends.

The risks in both cases differ from conventional natural catastrophe insurance in an important way. Most natural catastrophe insurance is written on the basis that businesses will be physically damaged and must be repaired. In contrast, pandemics and cyber-attacks threaten business interruption and consequent financial losses – what is generally referred to as non-damage business interruption.

The UK's national resilience arguably depends on finding workable solutions to these 'mega-risk' challenges. A holistic view of the scope and strength of the insurance market should be part of the UK's national resilience strategy. Insurers should be actively engaged in the development of the National Risk Register and the work of the Civil Contingencies Secretariat. They also have an important

role to play in supporting their customers in developing their own resilience through business continuity planning.

It is also important to debate and define a possible role for government in supporting the underwriting of risks on this scale and with this degree of correlation. No market in the world currently produces affordable, widespread pandemic insurance. This is because the costs of paying out simultaneously on highly correlated risks are much higher than income from even the highest premiums. Only by offsetting some of this cost to large reinsurers or governments can it become feasible. If we want that sort of cover in the UK, it will be a partnership between insurers, reinsurers and the state.

Should we see longer, healthier lives as a mega-risk for our societies?

## 'Ageing society' as mega risk

Most of us would not regard living a long life as a risk. But from the perspective of retirement savings, living longer than you had expected can in fact represent a serious strain on your financial resources. In some cases, this risk is borne by an annuity provider or defined benefit pension scheme – or the state through the state pension. But for those funding their own retirement through drawn down funds or defined contribution savings, living longer than expected can present serious challenges. This challenge can be compounded by a period of high inflation, that can eat into the real value of savings for individuals with limited capacity to refresh them through earnings. In our sector, this is known as 'longevity risk'.

What makes this 'longevity risk' a mega-risk is the way in which life expectancy has improved widely across UK society. A man or woman born a century ago in 1922 could expect to live less than 60 years on average and faced serious health risks both early in life and as they aged. Improvements in immunisation, health care and diet saw life expectancy steadily increase across the second half of the twentieth century. By 2019, and despite some slowing over the last decade, a man or woman could expect to live around 80 years on average in the UK. Men and women who enter retirement in good health will often live much longer. This profoundly good news is also a profound challenge for our society.

Working lives are now much shorter as a proportion of retirements, which are now routinely double or more what they were four decades ago. Making provision for these longer retirement strains traditional pension funds, including state pensions, and requires considerable discipline from savers wanting a comfortable retirement. Some calculations of the UK's savings gap for retirement projects that by 2050 it could be as large as £25trillion. This problem is compounded by the gender pay gap that leaves women saving for later life with a 'gender pension gap' at retirement. In both cases, the challenge for long-term savings managers is to reach and educate more people on the need to plan properly for longer, healthier lives, and help them to provide for this financially.

# 5. Investing for the future

Insurers that provide long-term savings and life insurance products ensure they meet their long-term liabilities by investing the premiums or contributions received into different types of investments. The long-term profile of these liabilities can make them uniquely suited to investments in the UK's future – from holding government debt to investing in infrastructure development or the green transition, across multiple yield profiles and multiple asset classes.

ABI members hold £1.7trn of assets. Analysis conducted by Boston Consulting Group for the ABI suggested that these members alone could support around a third of the UK's necessary investment in infrastructure and energy transformation for meeting the targets contained in the Climate Change Act between now and 2035.

Insurers and long-term savings managers have been early movers in committing to make their portfolios of investments carbon neutral. Many have set and implemented targets for exiting carbon-intensive sectors such as coal. But there is more that insurers and long-term savings managers could do over the decade ahead to power the country's transformation.

Much of this is a question of active and engaged stewardship from savings managers under the direction of engaged savers. Investor demand for long term investment opportunities is strong and growing, and savings managers are developing their capabilities in assessing and managing investments in infrastructure, housing and other long-term assets.

Maximising the capacity of the insurance and long-term savings sector to invest in the UK's long-term transformation requires close collaboration between the sector and government. Even with monetary policy tightening to reflect sustained inflationary pressure, the current low-interest rate environment can make long term investments in infrastructure an attractive option for insurers and long-term savings managers. However:

- Supply of potential projects in the UK is lagging investor demand.
- Asset classes such as green bonds or green gilts that are potentially highly attractive for insurers and long-term savings managers are still under-developed, although the UK has clear potential to be a global leader in their development.
- The taxonomy and reporting standards around green investments is still in the early phases of development, something investors will demand so they can demonstrate to investors that they align with long-term targets and aspirations to address climate change.
- Pooling premia and contributions in transformative asset classes can still be constrained by liquidity requirements and matching adjustments.
- In order to provide investors from our sector, whose ultimate responsibility is to guarantee to customers they can pay claims and honour pension commitments, the Government should provide clearer signals on how they can 'de-risk' investments in the short-term, through co-investment or government guarantees, so that our sector can then support the UK's energy security strategy.

Collaboration between our industry and Government can unlock long-term investment.

# Solvency requirements – why do they matter?

Solvency requirements are broadly the amount of funds that an insurer must hold to ensure that they have the resilience to survive the most extreme losses they might be expected to face. In the UK these are defined in the Solvency II regime. This regime includes a 'risk margin', which attempts to capture the cost of transferring an insurance commitment to another provider. Insurers are required to hold this margin in assets. Solvency II also defines the kinds of assets that are judged to adequately offset long-term liabilities like pension savings – a framework known as the matching adjustment.

UK insurers hold of hundreds of billions of pounds against their risk margin obligations and as part of their matching adjustment portfolios. Over the years ahead, it will be important to ensure that UK regulation consistently strikes the right balance between the prudential buffer created by these rules and ensuring that resources are available for investment in the things that will secure the UK's future. To illustrate the potential value of this capital, consider:

- £10bn pays for more than the entire 3.6GW capacity of the three phases of the Dogger Bank offshore windfarm – one of the largest in the world.
- £10bn is around four times the investment in Carbon Capture, Utilisation and Storage infrastructure included by the UK government in the North Sea Transition Plan.
- £10bn pays for more than a million UK homes to be retrofitted for full energy efficiency at the £10,000 average cost projected by the UK Committee on Climate Change.
- £10bn pays for five years of the annual private investment in energy efficiency for commercial properties that the UK Committee on Climate Change estimates is required to help meet the UK's net zero targets.
- £10bn pays for West Yorkshire's planned new transformational mass transit system linking Leeds, Bradford, Halifax, Huddersfield and Wakefield five times over.

Every pound will count in the work of transforming the UK's infrastructure

# Working with government to secure our future

Insurance and long-term savings empower and protect us as we plan for a secure future for the UK and take the bold steps that get us there. It is also committed to delivering on many of the Government's key priorities: economic dynamism and productive investment and innovation; economic resilience; financially secure and happy lives; necessary transformation in the way we impact the environment.

This report has focused on the forces changing insurance and long-term savings and the challenges the sector must address. Some of these are huge opportunities for better insurance and savings products. Many pose important questions and even dilemmas. In the years ahead insurers and long-term savings providers want to work with government and regulators to:

- Ensure we have a framework that sustains the strengths of the UK's existing data protection regime while handing individuals greater power to control and use their personal data, whilereflecting carefully on the growing use of AI/ML.

## Securing our future will be a public-private partnership

- Work together to align the ways in which insurers can build incentives for better health, safer businesses and greener choices into risk management tools with policies adopted by government in the same area.
- Build a strong partnership on mega-risk that sits at the heart of the UK's national resilience strategy, recognising that some risks will need a public-private partnership to manage.
- Collaborate on ways to ensure that the hundreds of billions of pounds stewarded by the insurance and long-term savings industry are channelled into a steady stream of long-term transformational investments in the UK's future digital, energy, housing and transport infrastructure.


This report was produced by the ABI in collaboration with Global Counsel.
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