Association of British Insurers

# A BRAVE NEW WORLD

## The Changing Landscape for Insurance and Long Term Savings

# Foreword

## By Huw Evans

**Huw Evans**
Director General

**In 2013, for the ABI's last Biennial Conference, I wrote 'Identifying the Challenges of a Changing World' – an analysis of the key changes likely to impact the industry between then and 2030. A contention of that document was that the world is not only changing, but doing so at great speed. This has been exemplified in at least two key areas since – the seismic shift in the UK political environment encompassing the rise of UKIP and the SNP as well as the extensive reforms to the pensions system announced by the Chancellor in his March 2014 budget.**

The document speculated on political instability, the speed of digital innovation, changing customer behavior, globalisation and changing regulation of the industry – themes that have been ever present since. This publication updates that analysis with nine think pieces from the ABI's Head of Strategy, Matt Cullen and five ABI Board members, interspersed with segments from the original document that are still relevant. These opinion pieces focus in on a range of future challenges and questions for our sector. I am particularly grateful to Paul Evans, Barry O'Dwyer, Andy Parsons, Gary Shaughnessy and Maurice Tulloch for giving up their time to contribute their insights.

'A Brave New World' is intended to be thought provoking, not definitive. It begins to confront some of the key forward-looking policy challenges the ABI will be taking a lead on over the coming months – a key aspect of our role as your trade body. I hope that it generates debate at the conference, and beyond, on issues which may not always be front of mind in the day-to-day operations of insurance and savings firms, but which are nevertheless vital to the long-term sustainability of our industry.

# About the lead author

**Matt Cullen**
Assistant Director,
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**Matt Cullen is the ABI's Assistant Director, Head of Strategy. In this role he provides thought leadership on the long term strategic challenges and opportunities facing the insurance industry, and works with policy and executive colleagues to incorporate this thinking into planning and policy development. Much of the last year has been spent building the ABI's policy agenda and public profile in three key emerging areas: technological change and data, cyber risk and climate change.**

Matt joined the ABI in September 2010 as Policy Adviser, Flooding, and became Manager, General Insurance in 2013. In these roles, he spent most of his time leading the development of the Flood Re concept, building stakeholder support for the model, working on its negotiation and agreement, and leading the project team implementing the scheme.

Matt began his career in the UK and US nuclear industries – with roles at the Nuclear Decommissioning Authority, the Department for Energy and Climate Change, and the US Department of Energy - after reading Geography and then Management at Fitzwilliam College, Cambridge.

Throughout the document this icon indicates an excerpt from Challenges of a Changing World.

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# Introduction

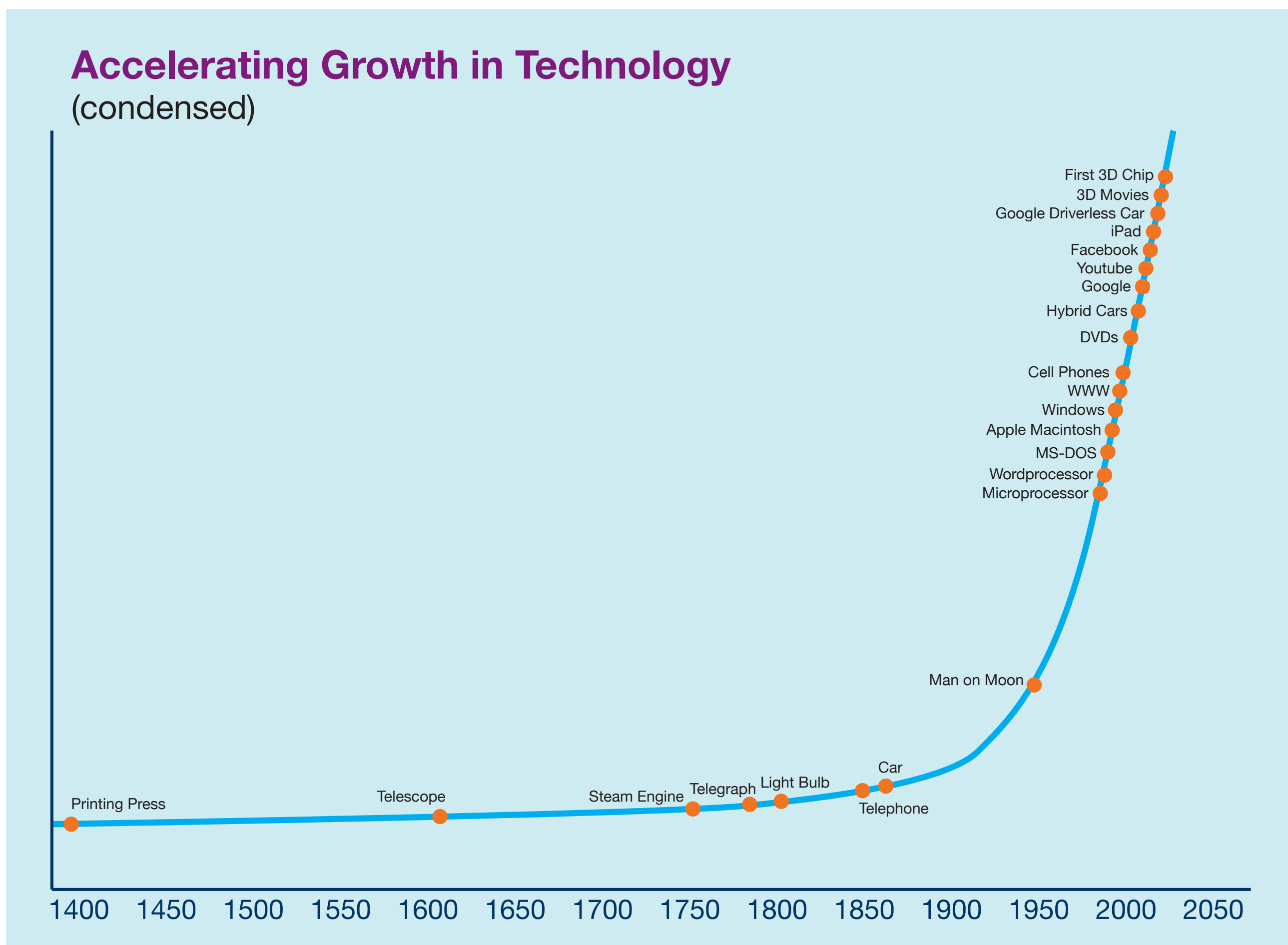
**In recent years it has become increasingly clear that providing, and consuming, insurance and savings solutions in the future will be profoundly different to doing so in the past.**

Many of the trends identified in Challenges of a Changing World are now significantly more visible than they were even two years ago, and rapid, relentless and disruptive change has been further embedded as a defining feature of modern society, in five broad areas:

## Technological change

- An explosion of 'big data' and the growth of the 'internet of things' are beginning to fundamentally shift the way in which insurance and savings firms operate.
- Significant cyber attacks forewarn us that the biggest catastrophic risks our industry faces long term are likely to be virtual, not physical.

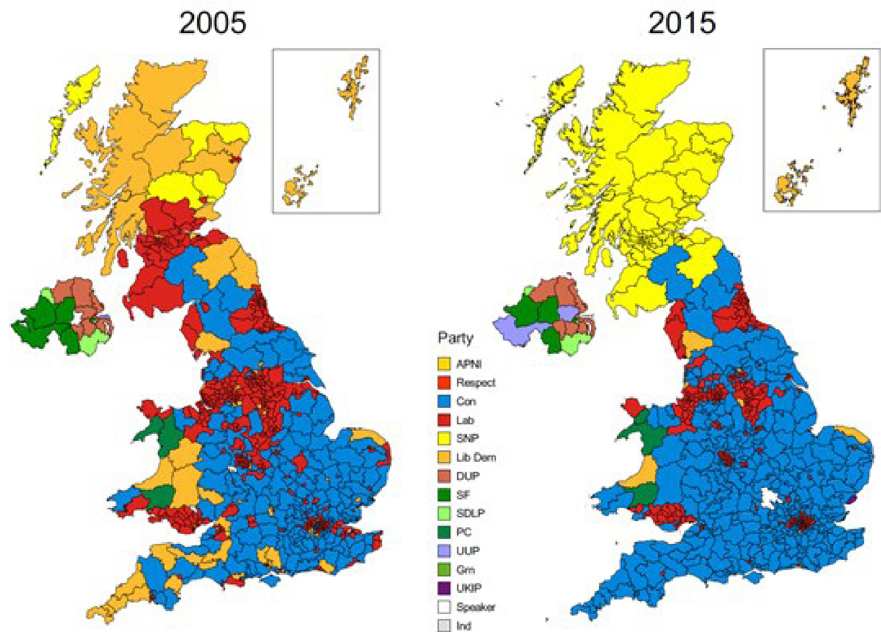
**Graph highlighting the proliferation of technologies and tech services in recent years.[1]**



## Political change

- The 2015 UK General Election result – a thin Conservative majority enabled by the meteoric rise of the SNP in Scotland, when some polls suggested a Labour-led coalition government – shows that traditional political trends and expectations can no longer be taken for granted, reinforced by the unexpected Labour leadership result that followed.
- EU negotiations and the In/Out referendum expected within the next two years have significant implications for the future of the British insurance industry.

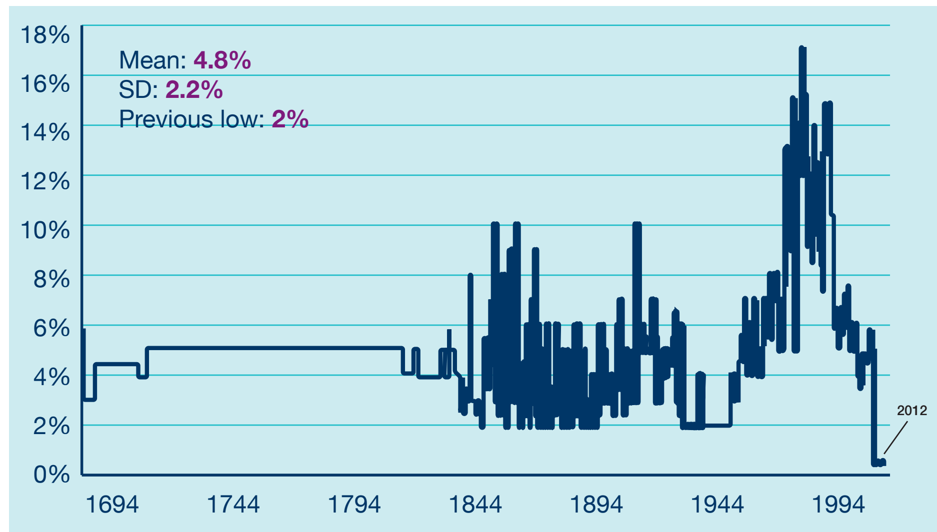
**Maps showing the shift in the UK political landscape between the 2005 and 2015 general elections[2]**




## Economic change

- The low interest rate environment which emerged during the financial crisis appears to be here to stay, shifting the basis on which insurers invest, and the long-term products customers buy.

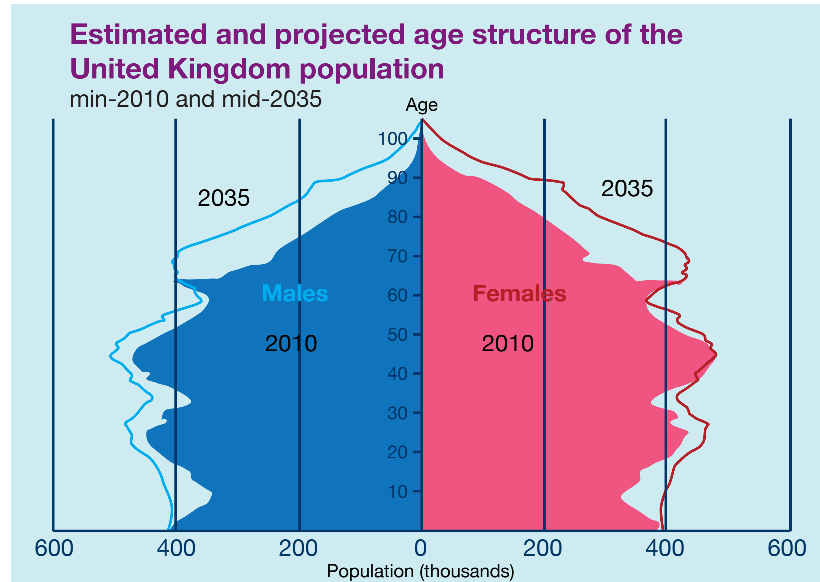
**Bank of England graph showing the official BoE base interest rate over 300 years. And the record low since 2012.[3]**



## Social change

- UK life expectancies continue to rise, as do predictions for the speed of the trend. In 2013 the ONS estimated that female life expectancy would reach 100 by 2062; in 2015 this estimate was revised to 2057, making ever more acute the long term challenge of managing and funding the ageing society.
- Instant access to information and the growing power of social media increasingly balance information asymmetries between individuals, authorities and companies.

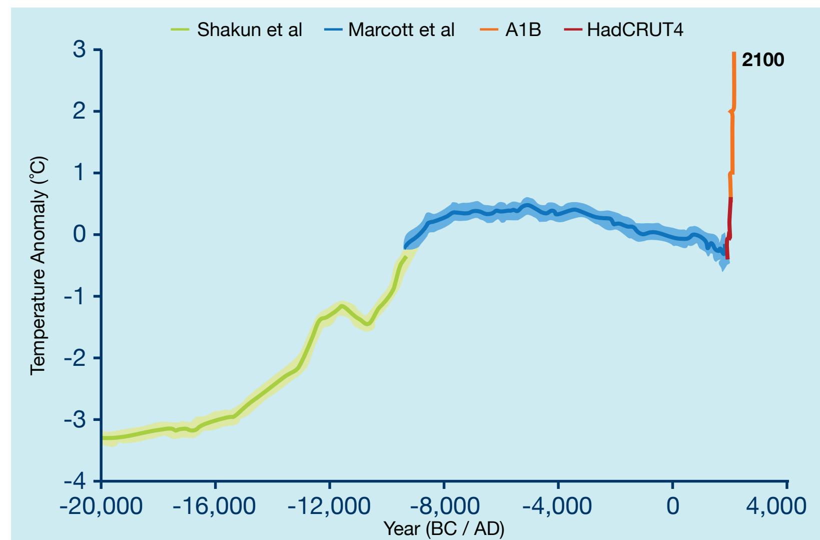
**The UK population 'pyramid' in 2010 and 2035, showing the significant proportional increase expected in the population over 60.[4]**




## Environmental change

- The 5th Intergovernmental Panel on Climate Change (IPCC) report[1] solidifies consensus that the Earth's climate is changing faster than it has ever changed before.
- The UK winter floods of 2013/14 reinforce perceptions of an increasing number and severity of extreme weather events as a result of climate change.

**Long term average global temperatures, relative to a 1990 baseline. An anticipated 3.5°C difference through this century would be the same difference as between 1990 and the last ice age 20,000 years ago.[5]**




**This document builds on the key trends identified in Challenges of a Changing World, and offers nine distinct think pieces on what this highly disruptive future will, and should, mean for insurance and long-term savings. The think pieces may appear disparate, but they are drawn together by this thread – they reflect a world changing faster than it has ever changed before, socially, economically, politically, environmentally or technologically.**

**Like 'Challenges', this document is not official ABI policy, but simply thinking out loud about some of the changes most likely to affect firms significantly in the coming years. If A Brave New World helps to provoke thought, stimulate challenge and encourage debate across the industry on how best to meet these challenges, then it will have been a success.**

# Themes drawn from ‘Challenges of a Changing World’:

1. Rapid technological change – the ‘digital revolution’
2. Global convergence: an increasingly inter-connected and balanced global economy
3. Political challenges
4. The ageing society and paying for life after work
5. Welfare reform
6. Industry reputation
7. Insurers, risk assessment and the availability of insurance
8. Insurers’ role in sustainable economic growth

# Theme: Rapid Technological Change – The ‘Digital Revolution’

**Between now and 2025, the exponential growth in computer processing capacities should mean individuals routinely having access to computing capacities in excess of 64 times that available today, through mobile phones, tablets, laptops and television.**

Feeding this processing power will be a huge jump in both the production and consumption of data, with consumer internet traffic predicted to increase by 24% each year to 2017, chiefly led by video and mobile data and with the capacity to transmit this data grow even faster thanks to recent advances in fibre optic cable technology. If these advances alone were the only consequence of the digital revolution, it would be life-changing; taken together with the potential growth in cloud computing, additive 3D printing and autonomous robotics, we can begin to comprehend how different these advances will make the world of tomorrow feel.

For insurance customers by 2030, empowerment through technology will be a central fact of life, underpinning the most basic and most sophisticated of daily tasks through the use of small, portable devices that could easily replace the wrist watch. At the heart of this empowerment will be constant access to information, much of it tailored to the individual’s requirements and available through a variety of channels. As a result, customers will view it as the norm to interact publicly (through social media and other online communities) as well as privately with their insurer to provide feedback about their experience and to have complaints resolved swiftly.

# Think Piece 1: Disruption through Digital – The Impact of the Digital Revolution on the Insurance Business Model

Matt Cullen, Assistant Director, Head of Strategy, ABI


## Summary

- The digital revolution will disrupt all aspects of insurers' businesses in the coming years.
- In a connected world insurers will need to become 'risk consultants', using 'big data' to help their customers manage their risks and giving them the flexibility to insure their lives in the way that works for them.
- Incumbent insurers are in a good position to adapt and thrive in the digital world, but competition will come from agile firms, totally comfortable operating in a connected environment.
- This is just the start. The exponential development of technology means that in the longer term, the possibilities are endless.


**We are, undoubtedly, in the midst of a digital revolution. In recent years society has entered an unparalleled period of technological change, fuelled by exponentially increasing computing capacity and the hyper-connectivity enabled by the development of the internet and smartphones. To give a flavour of the scale and pace of disruption, consider the fact that the biggest taxi company in the world doesn't own any vehicles and that the biggest hotel company doesn't own any hotels[7]; rather, both Uber and Airbnb are digital businesses created in the last decade, with completely different business models to their established competitors.**

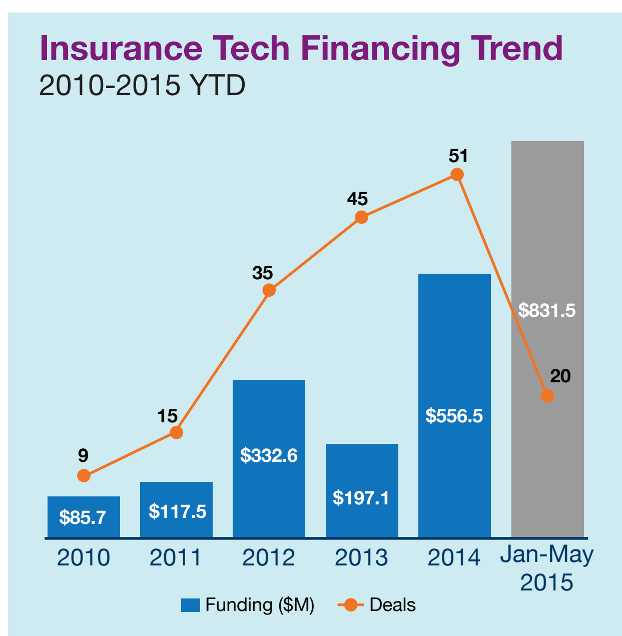
This digital revolution has more scope than any other megatrend to disrupt all aspects of the way insurance and savings firms operate – pricing and underwriting, customer engagement, product development, marketing, claims management, etc. will all work differently in the future to how they have worked in the past.

Many incumbent firms have now grasped the need to work with these disruptive forces, but others continue to sit back and watch. It's time for the late sleepers to wake up and smell the coffee. In the coming years, a firm maintaining a status quo that was built in the pre-digital age will inevitably be left behind, with little hope of ever catching up again.

## Disruption on the way

While the first period of the digital revolution has seen significant innovation in the insurance market – most visibly through the rise of the comparison websites and the gradual emergence of telematics in motor insurance – insurance has nevertheless not been the most agile sector in recent years. Indeed even within financial services, insurance is typically considered one of the areas where the adoption of innovation has been the slowest,[8] reflected by recent research suggesting that, for insurers, customer satisfaction with their online experience is far below average, with only estate agents and telecom firms scoring lower.[9] In part this may be due to relatively limited threats to the incumbent market from new entrants – whether insurance start-ups or firms from other sectors moving in. This is now beginning to change, signalling a far more disruptive business environment in the coming years.

Companies employing innovative new approaches are starting to gain traction. The Netherlands' fully digital insurer InShared, the USA's innovative health insurer Oscar and the UK's peer-to-peer motor insurance service Guevara are three examples of new insurance providers using fundamentally different, digitally enabled, business models to the mainstream markets. It is fair to say that few of these have genuinely scaled yet, remaining relatively niche, but they are growing, and scale will come in the next few years driven by a likely explosion of venture capital funding. The graph below – showing almost $1.4bn venture capital funding for insurance tech businesses between January 2014 and May 2015 alone - fits with the venture capital curves seen in other industries in recent years, and suggests the moment is fast approaching when Silicon Valley throws everything at scaling an innovative insurance business to the mass market.

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Perhaps it is thanks to the emergence of such companies, and the hype around their potential despite their small size, that we are also starting to see many incumbent firms in the UK insurance market ramping up their transition to the digital age. Firms are actively disrupting their own businesses as they fight to be fit for a customer base with wholly different needs, methods and expectations. This is a huge cultural challenge, as well as a technical one.

Firms are actively disrupting their own businesses as they fight to be fit for a customer base with wholly different needs, methods and expectations.

Amongst the most significant cultural barriers for incumbent firms is the reluctance to fail. Technology is built on the back of failure - testing multiple ideas in an agile way, continually iterating and adapting in small steps rather than in radical leaps, with an eye to long term goals rather than short term gains. Too often fears about regulators and policymakers become roadblocks to even starting a project, rather than challenges to be overcome by presenting tested and innovative models which genuinely work to the benefit of consumers. Insurance executives need to be willing to take risks on unproven ideas and technologies. They should be willing to 'move fast and break things' as per the Facebook motto, while, of course, maintaining robust policyholder protection.

### What will the insurance company of the future do?

Over the coming years the digital revolution will lead to major shifts in the behaviour and offerings of insurance companies, of which the four set out below are key. In the longer term, we could see even more revolutionary disruption to the market.

**Revolutionary Disruption of Insurance, by Matthew Griffin, Futurist, CEO of the 311 Institute**

The pace of global disruption is accelerating, driven by new waves of digitally savvy entrepreneurs backed by powerful new technologies and simpler, faster access to funding, resources and global markets. Factors that have reduced the cost of building and scaling a business over a thousand fold.

Due to the exponential nature of technological progress, over the next 100 years society won't witness 100 years of technological progress, but 20,000 years' worth. The Internet of Things, Smarter Cities, Connected Homes, Connected Vehicles and Telehealth are just the beginning. Moving forward, the 'on demand' and 'sharing economies', combined with emerging technologies like Blockchain will tip the entire insurance industry on its head at a pace never witnessed before.

Game changing entrepreneurs, who've seen their funding increase nine fold in the last year alone, will continue to find new ways to leverage technology for competitive advantage and disintermediate the incumbent industry giants. The new generation of insurance Unicorns are starting to emerge.

But every new technology has two sides and today's insurers are increasingly getting caught in the middle of a new turf war. Criminals will increasingly use technology for less noble causes. Already, hackers have shown the world how they can take over an entire fleet of driverless cars through the OnStar system, turn off pace makers from anywhere on the planet and affect a plane's operational performance using an Android phone.

Today's insurers will need to constantly adjust and readjust their risk models, their business models, products and services, to stay ahead of the competition and to keep pace with the enormous number of new variables and threats that the interconnected, technology dominated world creates.

**1. Flexibility and personalisation in the customer experience**

Probably the single biggest opportunity presented to an insurer by the digital revolution is the prospect of a more engaged relationship with its customers, with more touch points, more information flows, and increased flexibility as a result.

Firstly, the interfaces between insurers and their customers will continue to evolve, with more seamless engagement encompassing desktops, smartphones, tablets and wearables. This will facilitate a simpler, user friendly relationship between insurer and customer, which will in turn help drive useful real time interactions between the two.

The existence of such interactions is likely to encourage insurers to adapt their propositions to be much more flexible and personalised – both when a customer buys insurance or starts to save, and throughout their time as a customer. Popular insurance products are likely to be delivered through a much more 'open source' approach where, to the extent that they wish it, many of the parameters within an insurance policy are manipulated by the customer. Similarly, platforms used for long term savings and wealth management have flexibility and personalisation at their core – this market is growing and increasingly aimed directly at customers. There is also appetite for industry and government collaboration to make customers' information about their savings available and useful to them, for example through a pension dashboard.

**2. An evolving product base**

The product base will evolve as a result of the transition to a digital, connected world. Cyber insurance will become a crucial part of the toolkit for businesses and, longer term, individuals, to protect themselves against the cyber risks they face. The trend toward increasingly automated vehicle technology will uncover as yet unanswered questions about the future of the motor insurance market.

**Automated vehicle technology - five key insurance challenges**

- Managing the gradual transition to automated vehicles over an extended 20-30 year period
- Establishing where liability sits as new car models become increasingly autonomous
- Spotting new risks and safety issues as they emerge in a fast-changing road environment
- Developing the technical expertise to handle claims caused by system failures instead of driver failure
- Managing the data protection risks caused by handling large volumes of vehicle and driver behaviour data

However there are also likely to be more fundamental product shifts. As our world becomes less based on ownership of assets and more based on access to assets through the growth of the sharing economy, the insurance sector may struggle to maintain an insurance environment built on the relatively static concept of asset ownership. In this more transient world, we may begin to see the emergence of genuinely multi-line insurance offerings, which do not look to insure a person in the context of a specific car, home or pet, but which cover the individual against a wider range of risks.

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**3. A shifting distribution environment**

The channels used by customers (retail customers in particular) to access insurance have already been disrupted significantly in recent years. Thirty years ago the telephone began to eat into business models built on door-to-door sales. Fifteen years ago the internet began to challenge the telephone. Now, both online direct models and price comparison websites are coming to dominate the UK personal lines insurance market, and are increasingly tailored for mobile devices as well as desktops. In this context, it is possible, though not desirable, that the traditional high street insurance broker will, for retail customers at least, become virtually redundant in the coming years – or at least have to evolve hugely in order to survive - with the new generation of consumers operating almost exclusively through the web for savings and retirement online. Online forms of regulated financial advice are developing, both so-called robo-advice driven by algorithms, and simply more efficient customer-driven fact-finding processes. Such a shift does, of course, raise important questions about the treatment of older or more vulnerable people for whom this model is less likely to be appropriate.

But a shift in the balance of traditional distribution channels and approaches is just part of the story; genuinely original methods of comparing, buying and selling insurance are also beginning to emerge. Websites are beginning to emerge delivering a more holistic set of comparators than just price, for example Trip Adviser style reviews on www.smartmoneypeople.com, or customer service ratings on

www.fairerfinance.com. Peer-to-peer and group buying insurance are also gaining traction, facilitated by the normalisation of financial transactions through social networks[11] - the question is whether they will grow to the extent that there is a genuine impact on the scale of the mainstream market.

**4. A shift towards more actively managing risk, as well as carrying it.**

The core role of an insurer is to give their customers financial certainty by carrying their financial risk in exchange for a premium. Given the inextricable link between physical risks and financial risks, insurers have always had an interest in their customers mitigating risk in order to minimise financial losses, but until now have not often been in a position to help.

The connected world will change this, allowing insurers to become 'real time risk consultants'. Through 'big data' and the increasing prevalence of connected sensors in our lives – the 'Internet of Things' – customers and insurers will be able to constantly share insights with each other that simultaneously:

- Provide customers with information or warnings about their risk (you are skipping red lights when you drive, left your front door unlocked this morning, or are developing a potentially dangerous medical condition);
- Help insurers set prices that accurately reflect their customer's individual risk, reducing the reliance on less granular information, and take account of that risk when it shifts;
- Pre-warn customers and insurers about faults and events likely to cause loss, allowing them to be rectified in advance far more cheaply.

## Winning in this world

The ability to deliver the activities set out in this think piece will be vital in determining success for an insurer in the digital world. But will these successful insurers be the same incumbent insurers we know in 2015, or will agile new entrants come to the fore?

This is not a question that can be answered with any certainty at this stage, but it is fair to say that both incumbent and new entrants have some trump cards to play:

| Incumbent firms | New entrants |
|---|---|
| Existing customer base and brand strength | Organisational culture born in the digital age, not adapted to it |
| Existing scale and capital strength | Ability to develop systems and processes for the connected world in a 'green field' environment |
| Expertise in pricing and analytics | |
| Historic claim data | |
| Significant regulatory barriers to entry | |

Ultimately, for those dominating the market today, future success is likely to come down to having the appetite to actively disrupt currently successful business by doing things differently, and being prepared to fail in order to succeed.

## Think Piece 2: The inexorable rise of cyber risk

By Matt Cullen, Assistant Director, Head of Strategy, ABI


### Summary

- Cyber risk is growing rapidly, which presents a massive market opportunity to the insurance sector.
- Insurers will look to meet rising demand, but with regulators watching closely, must also ensure that their understanding and management of the exposure they take on is robust.
- As cyber risk continues to grow, the ability of the private market to operate without some form of public-private support is uncertain. Unfortunately we may not find out for sure until after a 'big one' hits.


**Only a few years ago hacking, data theft and cyber extortion would be most commonly encountered as exotic concepts explored in film and literature. In the real world these were 'things that happened to other people'. Today, with the 'digital revolution' inexorably shifting our personal and commercial activities into cyberspace, any individual or business which uses the internet is part of the story – subject to a multitude of cyber related risks.**

Some of the most significant public facing cyber incidents have occurred in the last two years:

- 2013: a cyber attack on US retailer Target results in the loss of tens of millions of customers' credit card and personal information. Target's $100m cyber insurance was not nearly enough to cover their loss[12].
- 2014: the infamous 'Sony hack' results in thousands of employees' and celebrities' personal details being made public.
- 2015: extremely sensitive personal information for over 30 million customers is stolen from adultery website Ashley Madison. Subsequently, criminals use the stolen information to extort money from users of the site, and people looking for information on their partners.

The insurance sector is doubly impacted by the rise of the cyber threat, with both operational and underwriting risks to consider. In this context, it is no exaggeration to assert that cyber risk will be one of the most critical issues for insurers to get on top of in the coming years.

The UK insurance sector is well placed to play a major role, both at home and globally, but there are challenges to overcome if we are to see a sustainable cyber insurance market long-term. The four challenges considered below stand out as particularly important industry-wide problems to overcome.

### 1. A rapidly growing, and varied, set of risks

'Cyber risk' is often visualised simply as theft of information, or the shutting down of systems, by hackers. But as the table below from a recent joint report by Marsh and the UK Government shows, the suite of risks covered under the 'cyber' banner is wide.

| | Loss category | Description |
|---|---|---|
| **A** | Intellectual property (IP) theft | Loss of value of an IP asset, expressed in terms of loss of revenue as a result of reduced market share. |
| **B** | Business interruption | Lost profits or extra expenses incurred due to the unavailability of IT systems or data as a result of cyber attacks or other non-malicious IT failures. |
| **C** | Data and software loss | The cost to reconstitute date or software that has been deleted or corrupted. |
| **D** | Cyber extortion | The cost of expert handling for an extortion incident, combined with the amount of the ransom payment. |
| **E** | Cyber crime/ cyber fraud | The direct financial loss suffered by an organisation arising from the use of computers to commit fraud or theft of money, securities, or other property. |
| **F** | Breach of privacy event | The cost to investigate and respond to a privacy breach event, including IT forensics and notifying affected data subjects. Third party liability claims arising from the same incident. Fines from regulators and industry associations. |
| **G** | Network failure liabilities | Third party liabilities arising from certain security events occurring within the organisation's IT network or passing through it in order to attack a third party. |
| **H** | Impact on reputation | Loss of revenues arising from an increase in customer churn or reduced transaction volumes, which can be directly attributed to the publication of a defined security breach event. |
| **I** | Physical asset damage | First-party loss due to the destruction of physical property resulting from cyber attacks. |
| **J** | Death and bodily injury | Third-party liability for death and bodily injuries resulting from cyber attacks. |
| **K** | Incident investigation and response costs | Direct costs incurred to investigate and "close" the incident and minimise post-incident losses. Applies to all the other catergories/events. |

[13]

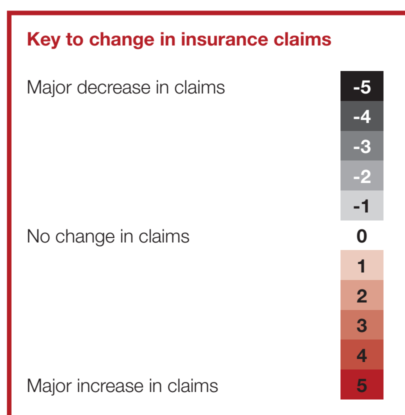
Furthermore, these risks are getting more severe, and affecting an increasing number of businesses over time (including insurers). Each year PwC conduct an extensive survey on information security breaches on behalf of the Government. The 2015 survey shows 90% large businesses and 74% small businesses experiencing a breach in the last year, up from 81% and 60% in the 2014 report[14]. Less than a decade ago in 2006 (when the survey did not distinguish between large and small organisations) the figure was only 52%[15].

## 2. 'Accidental' cyber exposure

While cyber-specific insurance policies have been on the market for a number of years, and are now showing significant growth, they remain a relatively niche purchase for UK firms. This is still a low penetration market.

However, with such a range of cyber related risks which link in multiple ways to existing lines of insured business, 'accidental' cyber exposure – where claims may arise under policies where cyber risk is not an explicit cover, but not an explicit exclusion either - is a significant concern. In many cases, insurers may not be aware of their 'accidental' cyber exposures or price them into their premiums. For example, insurers may not have considered physical property damage as a result of a cyber attack within property insurance policies.

One process that might start to drive change in this space is the PRA's 2015 General Insurance Stress Testing[16], which requires insurers to analyse their most significant stress scenarios. In complying with this stress testing, UK insurers have had to analyse their cyber exposure across the lines of business they write (i.e. not just cyber-specific policies), and assume significant losses unless they have clear and consistently applied exclusion clauses in place. Simultaneously, the PRA asked insurers to complete a specific cyber risk questionnaire, incorporating both operational and underwriting cyber risks faced by the firm. Could these processes lead to improvements in insurers' holistic understanding of their cyber exposure and, in turn, to a significant crystallisation of wordings and exclusion clauses?




## 3. Systemic aggregated risk

Cyber insurance presents significant aggregation risks – both between lines of business and between policyholders - which in some cases could become systemic. The excellent Lloyd's 'Business Blackout' report[17] from July 2015 sets out a scary yet credible scenario that demonstrates the systemic nature of cyber risk for insurers. The report analyses a cyber event knocking out much of the US power network and generating simultaneous insured losses from many thousands of firms directly or indirectly affected, and includes the diagram below estimating the impact of such an event across a wide range of classes of insurance.

| Class | Line of business | |
|---|---|---|
| **Property** | | |
| | Personal lines/ homeowners | 0 |
| | Personal contents | 2 |
| | Commercial combined | 5 |
| | Construction & engineering | 1 |
| | Commercial Facultative | 4 |
| | Binding authorities | 0 |
| **Casualty** | | |
| | Worker's compensation | 1 |
| | Directors & officers | 3 |
| | Errors & omissions | 3 |
| | Financial Lines | 3 |
| | General liability | 4 |
| | Healthcare liability | 0 |
| | Professional lines | 1 |
| | Professional liability | 2 |
| **Auto** | | |
| | Personal lines | -1 |
| | Commercial & fleet | -2 |
| **Marine & Specie** | | |
| | Cargo | 0 |
| | Marine hull | 0 |
| | Marine Liability | 1 |
| | Specie | 1 |
| **Aerospace** | | |
| | Airline | 2 |
| | Airport | 3 |
| | Aviation products | 1 |
| | General aviation | 1 |
| | Space | 0 |
| **Energy** | | |
| | Downstream | 5 |
| | Energy liability | 5 |
| | Onshore energy & power | 0 |
| | Upstream | 0 |

| Class | Line of business | |
|---|---|---|
| **Speciality** | | |
| | Accident & health | 1 |
| | Aquaculture insurance | 0 |
| | Contingency – film & event | 4 |
| | Equine insurance | 2 |
| | Excess & surplus | 0 |
| | Surety | 0 |
| **Life & health** | | |
| | Life insurance | 0 |
| | Health insurance | 2 |
| | Income protection | 2 |
| | Death & disability | 0 |
| | Hospital cover | -3 |
| **Pension and annuities** | | |
| | Standard annuities | 0 |
| | Variable annuities | 0 |
| | Enhanced annuities | 0 |
| | Life settlements | 0 |
| **War & political risk** | | |
| | Kidnap & ransom | 0 |
| | Political risk | 2 |
| | Political violence & terrorism | 1 |
| | Product recall | 3 |
| | Trade credit | 4 |
| **Agriculture** | | |
| | Multi-peril crop | 0 |
| | Crop hail | 0 |
| | Livestock | 0 |
| | Forestry | 0 |
| | Agriculture | 1 |
| **Cyber cover** | | |
| | Standard data breaches | 1 |
| | Advanced property | 5 |

The Lloyd's report estimates total insured losses in this scenario of up to $71bn. That is more than the insured losses from Hurricanes Sandy or Katrina. In this context, it is no exaggeration to suggest that the most significant risks the industry covers in the future, and its biggest losses, may be virtual not physical.

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**4. Paucity of data**

Adding further to the difficulty of ensuring a sustainable cyber market is a lack of data on cyber events. Individual insurers are generating data from claims, but as a relatively new risk with relatively low insurance penetration, this remains quite limited information. Insurers' own data will get them to a position of strong evidence in time, but if we want to turbocharge this process then imagination and collaboration will be required. Is there scope for the industry to agree to pool anonymised data on cyber insurance claims, without overly compromising the commercial advantage that insurers get from their own data? Is there scope for a robust database of cyber incidents created by government and other stakeholders – potentially building on the information currently generated through the Cyber-security Information Sharing Partnership (CISP), and licenced to any insurer who wishes to use it? One or both of these would help cyber underwriting a lot, but neither would be simple to deliver.

### So where are we likely to end up in the coming years as we tackle these key challenges?

First, cyber events are likely to become higher profile, more regular and more costly with each passing year. This, in combination with potentially more stringent regulatory requirements on UK firms as a result of the forthcoming EU General Data Protection Regulation and Network Information Security (NIS) Directive, should increase firms' understanding of the cyber risks they face and their desire to manage that risk through insurance. Market growth is a massive opportunity for the insurance sector that UK insurers are in a strong position to exploit.

Second, in order to achieve market growth sustainably, the industry needs to accelerate discussion with itself, and with the government, to find a way of expediting the existence of a robust set of aggregated data about cyber incidents, without compromising competition law or insurers' ability to gain competitive advantage through their own experience.

Third, as cyber risk and the cyber insurance market grow, individual policyholders' and insurers' overarching Probable Maximum Losses (PMLs) for cyber risk will be pushed higher. This will put pressure on insurers to access huge levels of reinsurance capacity, particularly if they want to be able to offer policy coverage limits that are fit for purpose for the most exposed businesses. It is unclear whether there will ultimately be enough capacity in the market to meet demand without some form of public-private support.

There has already been some talk within the industry about potential reinsurance solutions to this problem. In early 2015 a CEO steering group overseeing the UK Government / Marsh report agreed that now is not the time to push forward with an arrangement bringing industry and government together akin to Pool Re (the UK terrorism reinsurance pool, backed by government). This is absolutely the right position to take in a relatively nascent market, where insurers are able to meet demand and are eager to grow in this area, and a government focussed on austerity is unlikely to be readily motivated to provide any form of backstop. But while now is not the time, some form of public / private partnership is fairly likely to be required longer term if businesses (and indeed potentially individuals) are to be protected from the financial shocks that cyber risk can produce. So while the brunt of the work in this area is likely to be some way off, it is nevertheless important for the industry to maintain a conversation with the government during this Parliament, to lay the political groundwork for a potential scheme longer term.

Finally, there is nothing like a crisis for spawning a paradigm shift. If the first truly catastrophic cyber event were to take place in the next couple of years, might we see things move much faster – an explosion in demand, a market keen to keep up but facing rapidly escalating risks, data sharing agreements to rapidly get on top of those risks, State involvement to avoid potential market constraints? Such an incident would exemplify the kind of catastrophic event that the insurance sector aims to shield society from, but may also be the signal that this is a risk of such magnitude insurers cannot carry it alone.

# Theme: Global Convergence: An Increasingly Inter-Connected And Balanced Global Economy

## Economic Convergence

**We will see the fastest economic convergence in the history of humanity, the process of 'globalisation' which encompasses the dynamic effects of the digital revolution, the relative opening up of the Chinese and Indian economies, the growth of giant trading blocks such as the EU and NAFTA driving economic liberalisation, the fall of Communism in Eastern Europe and the exponential effects of increasingly educated populations in developing countries. Two caveats are important here. Continuous globalisation is not a certainty; protectionism will flare up at times and could threaten the trajectory of change described here, with the losers of globalisation increasingly challenging mainstream politics. Secondly, convergence may further aggravate the plight of the world's poorest nations as the effects of climate change and rising commodity prices disproportionately impact them.**

In this new economic environment, capital will flow - in many cases irreversibly – to the prosperous and fast-developing countries of Asia, South America and some parts of Africa where there will be very significant demand both for investment in infrastructure and in providing insurance products to the burgeoning middle class population.

The growth of the consuming classes, primarily in China and India, will fuel much of this capital flight. As recently as 1990, only 20% of the world's population had the financial capacity to make discretionary purchases beyond their basic economic needs, mostly in the US, Japan and Western Europe. Yet by 2025, an estimated 4.2 billion people from an estimated global population of 7.9 billion will be able to do so.

## International Regulation

**Some core international standards covering capital, systemic risk, resolution and supervision will be established by 2030, although it is far from certain that the agreement of such standards will be effective in helping tackle future crises even if a degree of harmonisation between the EU, US and Asian regulators can be agreed. However, with new economic centres emerging and sophisticated financial interconnections between all parts of the world, considerable amounts of effort will be expended on making structures work and on designing and agreeing practical fixes to problems as they emerge.**

Those regulators exerting the most influence will be those able to work with other countries and regions to find common ground and execute a workable plan, at the same time as demonstrating thought leadership to the broader systemic questions. One effect of this will be to increasingly take regulatory leaders away from their own countries as they focus their efforts on protecting their home economy and institutions from contagion, yet the pressure will remain formidable for them to revert to being national cheerleaders at times of difficulty.

# Think Piece 3: Growth and Regulatory Disruption in a Globalising Insurance Market

Andy Parsons, Finance Director, Insurance, Lloyds Banking Group & ABI Prudential, Financial and Taxation Committee Chairman

Steven Findlay, Prudential Regulation Policy Adviser, ABI

## Summary

- The pace and scale of regulatory disruption for the insurance and long-term savings sector is unlikely to slow down, even after the implementation of Solvency II.
- As the macro-economic focus shifts from financial stability towards growth and competitiveness, there is a significant opportunity for the sector. Specialisation or scale are likely to be required to take advantage of this.
- The tension between the harmonisation of capital standards and their local implementation will make a truly level playing field unlikely – both across Europe and globally. Protectionism is also likely to place some limits on the free flow of capital and risk.
- In the context of such a globally uneven playing field, it will be important for regulators to retain a strong focus on the competitiveness agenda of their jurisdictions.

**In recent years, insurance and savings firms have faced significant economic and regulatory disruption. Low interest rate environments in developed economies have now been coupled with uncertainties over the Eurozone and regarding the growth rate in developing economies – the summer rout of the Chinese markets, and global volatility that followed, provided a timely reminder of this.**

On the regulatory front, the implementation of Solvency II ahead of January 2016 has been a key strategic priority for insurers across Europe. It has been a focus of management time and driven changes in areas including governance, asset and liability management, business models, systems and data, reporting and disclosure. According to recent estimates by the UK Government, the one-off implementation costs across the UK will reach £2.7bn, with

### Solvency II: Five years on

By 2021, the long and winding road developing and implementing Solvency II, the EU-wide insurance capital standard which comes into force at the start of 2016, will be well behind us. It will have taken time to bed down and the first few years will have been awkward and choppy as national regulators and EIOPA, the pan-European insurance and pensions authority, slowly converge but not fully. With so much actual and political capital having been invested by a wide range of stakeholders, it will have been declared a success by regulators. And with reference back to the overall objectives of enhancing policyholder protection and modernising supervision, this claim will not be unfair.

However despite being a 'maximum harmonising' supervisory regime, the playing field may not be truly level. The rules of the game may now be the same – but with different referees in different jurisdictions, there will be divergence. The balance of influence between EIOPA and national supervisors will be critical here. A strong EIOPA will be required for convergence – and industry will need to develop close links with EIOPA, in addition to the national supervisor.

Given the protracted negotiations required for Solvency II, there will not be the appetite for a sequel, although a review of sorts is scheduled for 2018. Instead, clarifications and refinements will continue to be made, leading to some friction between national regulators, national governments and European institutions.

annual ongoing costs of £200m. In parallel, significant product regulation changes, such as pension freedoms and auto-enrolment, are underway. Regulatory disruption will continue on a variety of fronts and become the new norm.

These economic and regulatory dimensions will crystalise into two separate but interrelated strategic challenges for the industry:

1. Delivering growth in a turbulent economic environment
2. Constantly adapting to major regulatory developments at an international, regional and local level

## Delivering growth in a turbulent economic environment

Global economic growth and rebalancing from West to East is continuing, although the pace of rebalancing will slow. A recent World Bank report suggests the recovery in advanced countries is gathering momentum, whilst there is a broad-based slowdown underway in developing countries (although it should be noted their growth rate still remains more than double what is seen in the West).[18] A separate report by the accountants PwC points to a doubling of the world economy by 2037 and tripling by 2050. However, growth in emerging economies, particularly China and India, is to moderate after 2020 towards advanced economy norms.[19]

### The need for the West to remain competitive

Driven by the need to ensure the West remains competitive over this time horizon, we are beginning to see increased emphasis from governments on economic growth and competitiveness, compared with the unrelenting focus on financial stability and soundness following the 2007-2008 global credit crunch. This will shape many government initiatives in the coming years, both national and European, including the EU's "Europe 2020" growth strategy.

We are beginning to see increased emphasis from governments on economic growth and competitiveness.

This is welcome news for UK companies – and those who have strategically positioned themselves will be able to take advantage of it. In particular, this is an opportunity for the insurance and long term savings industry, given the important role it plays in boosting economic growth by facilitating the transfer of risk and capital around an economy, and supporting the consuming middle classes. The UK government recognises this role, as well as the sector's contribution to GDP and the tax base, and has in place a dedicated growth plan for the medium-term with the aim of strengthening the sector's competitive position and enhancing the UK's position as a global leader.

### But there is only so much that policymakers can do

A desire for firms to be well placed to be a part of the growth story and to operate efficiently within the regulatory environment will incentivise scale, resulting in a continuation of merger and acquisition activity that has been seen recently. Such scale enables firms to reduce the frictional cost of regulation, have the capacity to take on more volatility, and benefit from diversification across product lines and geographies. This will also help to alleviate the margin squeeze that will otherwise be felt by mid-size firms from other players in the distribution chain – such as brokers (themselves consolidating) and online aggregators.

Such M&A activity as well as less formal alliances between insurers could result in a very different landscape: One that is dominated by specialist players who have carved out a niche in the market and continue to innovate but are constrained by regulatory capital requirements; and larger insurers – perhaps even mega-insurers - operating across multiple products and geographies, applying their own economic capital models on a global level, flexing them accordingly to calculate solvency under a variety of regimes.

An excess of capital in the markets is seeing more capital flow into the insurance sector, available for insurers to trade risk with, both as traditional and alternative forms of reinsurer capital. It will continue to flow from sources such as pension funds and hedge funds, seeking yield and diversification benefit, and offering cheaper funding than the more traditional sources of equity or retained earnings. The result could be rock-bottom reinsurance rates for insurers and a maturing alternative risk transfer market for insurance-linked securities. The broker Aon Benfield, in their latest 'Aggregate' report of the reinsurance market, noted continuing strong growth of 28% in alternative capital and observed that, as with primary insurers, reinsurance consolidation is underway as companies seek scale and diversification.[20] In a report for the London Markets Group, management consultants the Boston Consulting Group also identified embracing the rise of alternative risk capital as an opportunity to enhance and retain London's status as a global insurance hub.[21]

In addition to the insurance side of the balance sheet, there will be growth on the asset side. After the financial crisis, assets were moved by insurers towards safer classes such as bonds, leading to a prolonged period of low investment returns, with firms deploying more diligence to their underwriting to partially off-set this. Continuing low yields will see firms working their assets harder, with more sophisticated choices of assets in order to optimise their return for a given level of risk – this is likely to include investment in infrastructure and securitisation. This will align with EU initiatives, including the flagship Juncker Plan, to stimulate economic growth. A similar opportunity was identified by Insurance Europe in its report, Funding the Future, highlighting a role for long-term savings firms to invest in the real economy through long-term lending by stepping into the gap left by banks because of reform to their regulations. Oliver Wyman, the management consultants, estimate this opportunity could increase the aggregate market value of European insurers by €200bn, of which €50bn is attributed to UK insurers.

### The reaction of regulators

However whilst flows of capital and government initiatives can play a role in helping the insurance and long-terms savings sector to grow and support economic growth, this may not be embraced as warmly by the regulators, with their primary objective of economic stability and soundness. It is vital that messaging from both the Bank of England and government is consistent to avoid uncertainty for firms. Senior officials at the Bank have already publically stated the need for care when considering turning back the overall regulatory dial or trying to trade off the risk of financial instability for short-term growth[22]. Ambivalence has also been expressed regarding their approach to new asset classes, such as infrastructure.

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## Constantly adapting to major regulatory developments at an international, regional and local level

Beyond the European Union's Solvency II, recent years have seen efforts from international bodies to lay the foundations for the harmonisation of insurance regulation on a global level. The International Association of Insurance Supervisors – which counts both the PRA and FCA in its membership – has, under direction from the G20's Financial Stability Board: established its Insurance Core Principles; identified nine global systemically important insurers (G-SIIs); and developed its Common Framework (ComFrame) relating to the supervision of Internationally Active Insurance Groups (IAIGs). The nine insurers designated as 'global systemically important insurers' (GSIIs) have a series of additional policy measures to be implemented, including Systemic Risk Management planning and Recovery and Resolution planning. Other insurers are keeping an eye on these developments as they are likely to influence national or regional policy.

Continuing regulatory disruption – not just prudential but also increasingly with regards to conduct – will become part of business as usual. It will require early industry engagement to shape the emerging regulatory landscape, and significant resources and management time from firms to operate and optimise within it. In the 2015 edition of their annual global survey of CEOs, the accountancy firm PwC found that 88% of insurance CEOs believe regulation will be a disruptive trend for the industry over the next 5 years – higher than for any other industry. More still, 91% of insurance CEOs, see over-regulation as a threat to their growth prospects over the next year, also higher than any other industry and an increase from the previous year.

### The principle versus the reality

Whilst the goals are certainly laudable, practicalities and politics will lead to slippages in timelines, fragmentation in application and inevitable compromise. Solvency II is an obvious case study here: achieving significant regulatory reform is difficult, involving protracted negotiations, extensive resources and costs. The accountants KPMG, who interviewed leading regulators and insurance CROs to inform their Evolving Insurance Regulation report, found that whilst both industry practitioners and regulators saw value in greater international consistency and harmonisation of insurance requirements, they also raised concerns as to whether this could be achieved in practice.[23] Achieving such international harmonisation with a low cost of implementation is even less likely.

The sector and a range of other interested parties will engage constructively as the debate and developments around international standards move forward over the next ten years. There will, however, be some concern from industry, based on past experiences, that the supervisory community uses this as a further opportunity to raise capital requirements regardless of how sufficiently capitalised firms already are, despite senior PRA officials speaking at ABI events seeking to bust this myth in the context of Solvency II.

**Global standards, local interpretations**

Another tension which will surface is between national supervisors and governments, wishing to ensure regulation is appropriate for the specificities of their society and economy, and international efforts to harmonise regulation with a 'one size fits all' approach. How local requirements will coexist alongside international standards will be a focus for much further debate.  Neither the Americans nor Europeans will be embracing of wholesale change to their respective regimes. A likely compromise is therefore global capital standards which are principle-based, and which are implemented through more detailed and varying local and regional standards, by national supervisors maintaining control of direct supervision.

Geopolitical issues will add to this pressure and add more practical challenges to the harmonisation agenda. Referendums on independence and on the European Union; the politics of identity; anti-immigration sentiment in Europe in response to crises in the Middle East are just three examples. These factors could lead to protectionism as societies turn in on themselves, even as companies become more multi-national, and this public sentiment could be reflected in government policy and action. Governments may be unwilling to surrender too many levers of control over their financial services sectors to supra-national bodies. Amongst other effects, this will restrict the fungibility of capital across borders, even when staying within the same set of regulatory standards.

**A level playing field?**

Paradoxically, efforts to harmonise standards which are then implemented and interpreted locally by supervisors, will bring into sharp focus material areas of divergence between jurisdictions. This will create regulatory arbitrage opportunities for firms. Branches and 'passporting' will be used by firms to optimise their group structure.

Efforts to harmonise standards which are then implemented and interpreted locally by supervisors, will bring into sharp focus material areas of divergence between jurisdictions.

Bold decisions and strong enforcement action will be required at an international level to resolve this tension of global standards which are global only in name due to the politics and practicalities of local implementation. Strong and centralised institutions with a powerful mandate to directly supervise would be required to act as a counterbalance to the diverging interests of local institutions. These will not materialise overnight; instead, this will be a long-term and iterative journey.

### Challenges - and opportunities

The coming years will be ones where economic turbulence causes challenges, but a focus on growth from both policymakers and government brings opportunities too. A patchwork of overlapping and inter-relating local, regional and international standards, with differing interpretations, will create a complex landscape for insurers to navigate, but this again presents competitive opportunities for firms that can adapt to it.

# Theme: Political Challenges

**Politicians in the 2020s will face formidable challenges of structural change, demonstrable relevance, the capacity to act effectively, and the pressures of short-termism.**

The structure of the EU and the UK will have evolved from today, whether through giant steps or small ones. In Europe, the institutions and power structures of the European Union will have adjusted profoundly to reflect the realities of a large trading block with marked differences of economy, culture and possibly, currency. Its framework will have been established by the realities of banking union, the consequences of a UK decision to either remain or leave and the differing appetites for integration within an EU made up of at least 27 states. Institutionally, this is likely to mean greater power for an ever-more politicised European Parliament at the expense of the Commission, with the EU-wide regulators (especially in banking) increasingly influential, not least as a point of EU continuity in the rotation of presidencies, commissioners and MEPs. However, these authorities will also have to battle even more for power and influence with national governments, which can deprive them of their authority by sidelining them or increasingly ignoring them altogether.

Within the UK, the structural foundations of the United Kingdom will probably have evolved, irrespective of whether Scotland has voted to leave the Union either in 2014 or in a subsequent plebiscite. Structurally, the trend will continue towards increased devolution towards the constituent parts of the UK with Wales and Northern Ireland having ever greater autonomy over their own fiscal decisions with inevitable consequences for insurance. Short-termism and capacity. Increased short-termism is a natural consequence of the speed of this political environment in which hard-to-reverse critical judgements can be formed in a matter of minutes. Power spread thinly between a range of governments and institutions and the constant threat of legal challenge will also constrain ministers wanting to effect major change. In the UK, this may mean more EU-style of policy making with openly speculative policy development eventually narrowing down into concrete legislation, compared to the Executive-driven top down governmental policy making framework we have traditionally had.

For insurers, as for other sectors of the economy, all this will change the dynamic with central governments. Insurers will be under almost constant pressure to help develop and, critically, implement public policy given the reduced policy instruments and smaller public finances these governments are likely to have. This is an opportunity to help frame public policy in a way that enables insurers to manage liabilities effectively in the public interest, but it brings with it the big risk that the industry is viewed as an alternative source of public funding with the industry constantly pressurised to spend resources on preventing risk rather than managing it, while still blamed by governments when things go wrong.

# Think Piece 4: A New Kind of Politics and Its Implications for Our Sector

Seth Williams, Assistant Director, Head of Public Affairs, ABI

Matt Cullen, Assistant Director, Head of Strategy, ABI

## Summary


- The era of stable party politics is over. A new kind of politics is emerging – less certain and more reactive.
- In this new political world, government policy is likely to be harder to plan around and may require innovative approaches to deliver.
- The ABI and its members need to be prepared to adapt to this new reality if they are to remain relevant in the public policy arena, whilst ensuring the market thrives.


**An altered relationship between politicians, the media and the public, increasing distrust of the mainstream political parties, the rise of new and often anti-establishment parties, and a new distribution of power across the country is changing the UK political environment. This will affect the ability of governments to plan or retain broad ideological underpinnings to their policy. This has already impacted, and will continue to impact, the drivers behind public policy development which will have ongoing implications for the insurance and long-term savings sector.**

We can expect less long-term planning in government with more reactions to external factors, less of a set agenda for our industry and more self-regulation due to current parliamentary arithmetic.  Engaging with this process in the future will require a fresher and more nuanced mindset for the ABI and its members than it has in the past, ensuring that we demonstrate our relevance to public policy priorities and innovative approaches to delivery.

### Key Events Since 2013

The 2014 referendum on Scottish independence energised passionate debate and, despite resulting in a relatively narrow 'no' vote, emphasised a huge shift in Scottish politics. The referendum had other consequences, with the UK Parliament quickly moving to promote 'English Votes for English Laws', leading to proposals for further devolution of powers to Scotland, and the potential for other constituent parts of the UK to gain greater autonomy in the future.

The 2015 General Election resulted in a narrow Conservative majority, very significant losses for Labour and the Liberal Democrats, and the SNP becoming the third party in Westminster. Despite avoiding a hung parliament, which most commentators and polls had predicted, the election has led to new challenges for each party. With its slim majority in the House of Commons, and with no majority in the House of Lords, the Conservative party faces new challenges in asserting legislative authority and will need to be imaginative in how it drives change. Meanwhile, the Labour and Liberal Democrat parties prepare to regroup under new leadership.

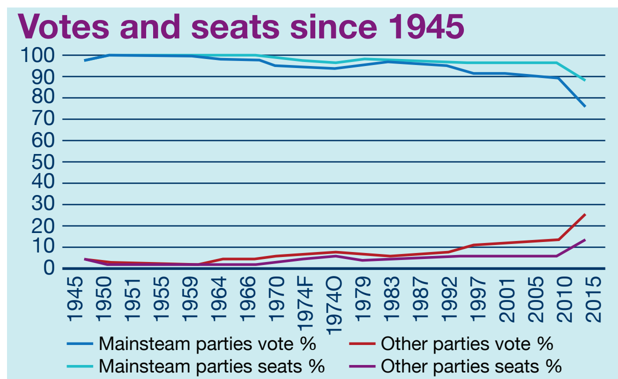
A further outcome of the General Election is the confirmation of a referendum on Britain's membership of the EU, which will take place before the end of 2017. The referendum was a key element of the Conservative party's manifesto, with David Cameron continuing his efforts to renegotiate the position of the UK in the EU ahead of the referendum. Whether the EU referendum campaign will energise the debate in a similar manner to the Scottish referendum remains to be seen, although it will almost certainly dominate UK politics over the coming years.

## The changing structure of party politics and an end to the 'age of deference'

The political, social and economic elite were once instinctively trusted by the public. This 'age of deference' has been in decline since the 1960s, but has been accelerated by the digital revolution. Nowhere was this more embodied than during this year's General Election. The election saw the rise of insurgent parties such as UKIP and the SNP that energised voters in a way that mainstream politicians struggled to. They offered 'anti-consensus' policies – leaving the EU, Scottish independence and abandoning austerity - in the face of what the public often saw as identikit politicians from the mainstream parties.

Relatively similar policies offered by party leaders from similar backgrounds increased many voters' disconnect with the traditional two, and more recently three, parties that have dominated UK politics. Indeed in Scotland this happened years ago with the rise of the, now governing, SNP who look on course for another victory in next year's Holyrood elections. The SNP in Scotland and the insurgent parties' leaders across the UK didn't seem to the public as though they were part of this traditional elite and were refreshingly real to many, both in their policy offering and authenticity. A similar outcome can be seen in the election of Jeremy Corbyn as Leader of the Labour Party, who appealed to people, particularly younger voters, thanks to his authenticity and views that differed from the mainstream candidates.

This is not a UK phenomenon; anti-establishment parties are gaining popularity across Europe and creating instability to the long-standing political order - Spain's Podemos, Syriza in Greece, the Front National in France, the Sweden Democrats and the Austrian Freedom Party to name a few. Clearly these parties do not offer a single ideology, and of course vary in their levels of what are deemed 'extremist' policy solutions. However the root cause of their rise generally lies in their appeal to many who feel they have missed out on the benefits of rapid globalisation (in particular the ease with which capital and labour can now move from one country to another), resent the inequality of wealth distribution that it has brought (and in many cases the austerity now being imposed on much of Europe by its leaders), or fear a loss of their cultural identity as a result.

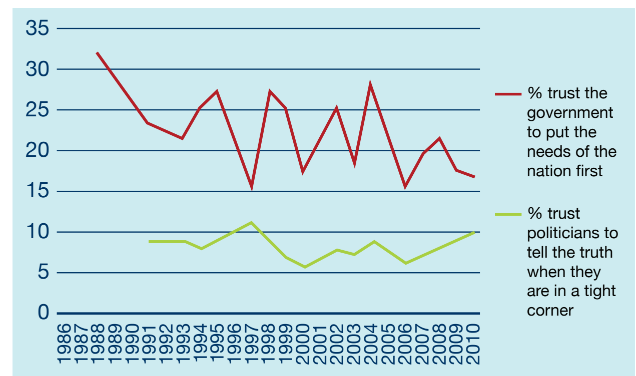



Source: UK Election Data[24]

Time will tell whether these parties are here to stay in the UK, but during the course of this UK Parliament the new parliamentary arithmetic will affect the environment in which the Government operates. It will likely be more reactive to these parties' proposals, perhaps at the expense of its ideologies and policy priorities. Certainly in the short term, as a consequence of this year's General Election, we face a generational decision about our future in Europe, questions about the future of the Union and increased devolution across the UK and in English cities and regions – uniquely all at the same time.

## The changing nature of public engagement with politics

The UK General Election also highlighted the changing nature of the public's engagement with politics, in part due to the significant media developments in recent years. It was the first 'social media General Election' - in which social media provided a key platform for politicians, activists and commentators. As with the Scottish independence referendum eight months earlier, news often 'broke' on social media and it complemented traditional media, such as during the television debates when viewers gave their reactions on Twitter as events unfolded.




Source: The British Social Attitudes survey [25]

For the political parties' campaign strategists, chasing Facebook 'likes' and Twitter 'followers' has never felt more important. Pre-election, the parties had good reason to focus on this. Research showed that among those aged 18 – 24 social media was ranked only second to TV debates in terms of influencing their decision on polling day.[26]

The internet has altered the way we digest information, adding to the decline in public deference. Where previously we were comparatively passive consumers – we received information that traditional media provided us with – we can now create our own content. Social media has become a platform for the public to undermine and challenge politicians' carefully stage-managed campaigns and announcements. An immediate consequence compared even to election campaigns of a decade ago is the decline of election press conferences and fixed poster launches.

Consequently, few situations now arise in which politicians engage with the public in an unscripted way as party spinners seek to control every aspect of their leaders' public image through stage-managed performances. Any supposed 'gaffes' are quickly jumped on by campaigners – indeed Ed Miliband had barely unveiled his party's tablet of stone before the hashtag #edstone was trending on Twitter. The ability to satirise or ridicule politicians has been democratised; previously the preserve of the media elite, now anyone can do it.

The rise of social media has also led to what many see as 'Echo Chambers' in our views - we follow those on Twitter and choose to read articles by people we share views with, removing opposing opinions. Some argue the hype around crazes like the social media 'Milifandom' created a bubble that removed the Labour Party from wider opinion, although polling companies clearly played a far more significant role in this. Interestingly, analysts looking at social media interaction by the main parties and their leaders predicted largely similar election results as the polling companies[27], demonstrating that tweets don't make votes. Indeed the wider question is whether social media does influence people's views or just reinforces existing biases.

Traditional and social media have also become powerful weapons to force government policy changes. The U-turn on what would be dubbed the 'pasty tax' of 2012 following a sustained media campaign, which was able to galvanise public support at an extraordinary rate, exemplified this. Freedom of Information requests have also empowered journalists and the public to access damaging, or at least embarrassing, information that can be used to quickly discredit a public figure or organisation.

## Less long-term planning in government

This new set of political norms generates a less stable and less certain policy environment for the industry to engage with and operate within. In spite of the current parliamentary system supposedly giving more stability, politicians now have less control of the news agenda, less public trust in them and less opportunity to brush away the more radical views of the challenger parties. This creates a situation whereby planning for five days', let alone five years', worth of policy is increasingly difficult for all industries. But what does this mean for the insurance industry?

This new set of political norms generates a less stable and less certain policy environment for the industry to engage with and operate within.

### 1. No set agenda for the insurance and long-term savings industry

The 24 hour news cycle, the rise of social media and the ability for government policy to be almost instantly discredited by campaigns has inevitably heightened a sense of reacting to external developments rather than sticking to one plan and ideology set out at the start of a parliamentary term. This is not a new trend but it has accelerated significantly. A shift of the major parties' ideologies towards the centre in recent years also means they have less distinct ideological underpinnings and are more pragmatic in reacting to issues, developments and markets.

An advantage of this majority government should be an end to agreements on policy behind closed doors with coalition partners and no longer having to guess possible red lines in negotiations between parties. Historically we would therefore expect more clarity for industry on what policy to expect based on the party's manifesto. However all parties' manifestos were written with coalition negotiations in mind and even without this factor, nowadays they can rarely be used as a clear indication of likely policies affecting our sector. Indeed some of the key public policy decisions affecting our industry during the last and current parliament, such as the pensions Freedom and Choice agenda, Flood Re and the consultation on pensions tax relief were not in either of the governing parties' 2010 manifestos or in the Conservative Party's 2015 manifesto. These were in many ways a reaction to a particular set of circumstances including external events, market behaviour and media attention.

So, we can expect less of a set agenda for the industry with less clarity than previously on how policy affecting the insurance and long-term savings industry will be developed by parties. Businesses of all sectors can't necessarily assume that a particular government or party will be its friend or foe.

### 2. Less legislation, more regulatory solutions

The Fixed Term Parliament Act theoretically gives more stability and allows business, and indeed the Opposition, to plan around five year parliaments rather than facing the prospect of snap elections. However with a very small majority in the Commons and no majority in the Lords, this UK Government will effectively have to function as a minority government with the threat of backbench rebellions and significant amendments by the Lords to any legislation.

For the insurance and long-term savings industry this is likely to mean less legislation and more non-legislative means from the government to drive through policy proposals, including through the regulators, and by encouraging the industry to self-regulate. The industry is well-placed to respond to this and will need to take a pragmatic and flexible approach to working with government and the regulators, delivering good outcomes for the industry and consumers while making industry red lines clear.

**3. Actively partnering where the agenda is clear**

The ABI and our members have demonstrated many times in recent years that we can be an effective partner of government. Over the last five years alone we have worked with the government on a range of societal challenges, including helping to deliver the first phase of the Freedom & Choice pension reforms, developing and negotiating the Flood Re scheme, the development of MedCo, the audit of charges and benefits in legacy defined contribution workplace pension schemes, the development of the prototype for PensionWise, and enabling over £1 billion in reduced motor premiums to be passed on by insurers to customers following a Downing Street summit hosted by the Prime Minister in 2012.

The insurance and long-term savings industry must find ways to support the government's agenda to demonstrate our relevance and positive contribution to local, national and global growth.

Looking ahead, where government priorities or challenges facing society are clear – for example deficit reduction, supporting SME growth, increasing exports and productivity, climate change – the insurance and long-term savings industry must find ways to support the government's agenda to demonstrate our relevance and positive contribution to local, national and global growth. Within this context though, we will need to make it clear that not everything is tradeable and that partnering must take place within the context of a thriving market that offers consumers the choice that they value, and delivers attractive returns to investors.

**4. Reputation – demonstrating the role of the industry**

The power of media campaigns has meant that what could previously have been a day's worth of negative press for the industry can now become a prolonged campaign that results in regulation of the sector. The media may find them dull compared to negative headlines, but as an industry we must work harder to highlight the 'good news stories' of the millions of positive outcomes delivered for customers every day to help act as a buffer for any future media campaigns, including with more transparent data on claims paid/ declined. More widely the industry's commitment to apprenticeships, support for SMEs looking to grow or export, the employment created by the industry across all parts of the UK and its investment in UK and global infrastructure are just some examples of the role of the insurance and long-term savings industry in society. Consistently and in new ways demonstrating to the public, and to governments, this value of the industry to society will be more important than ever before.

**The changing political landscape will affect the ability of the insurance and long-term savings industry to plan around government policy. In response, the industry will need to be flexible in adapting to this new environment and work hard to demonstrate its relevance to public policy priorities, while continuing to remind elected politicians of its primary responsibilities to its customers, regulators and investors.**

# Theme: The Ageing Society And Paying For Life After Work

**While the world's population will continue to grow dramatically over the next two decades, our own society is ageing and our ratio of workers to retirees is falling. This makes the current pensions system increasingly unaffordable. But ageing also brings with it challenges for which our society is financially unprepared; the impact of dementia on our health system, the household economics of living for 30 years post-retirement and the need to fund care in later life either at home or in residential facilities.**

This will make radical reform of our welfare state a pressing concern over the next decade; while the Beveridge reforms of the 1940s envisioned a basic safety net for all with additional benefits for those who contributed to them during their lifetime, recent decades have seen the contributory element diminish while the overall level of welfare has increased. This has left a system mismatched for modern requirement which will have to radically reformed to become more affordable and be better aligned to wider society.

The ageing society will pose its own economic challenge for the UK and the West, increasing demand for more flexible housing, driving growth in the residential and private care sectors, stretching the welfare state's ability to fund dignity in retirement and potentially creating a new labour force of the semi-retired. For insurers, the most obvious challenge will be to innovate to help fund a range of solutions to long term care provision in a way that meets shareholder, political and regulatory approval. But potentially an equal challenge will be to develop flexibility in retirement solutions to reflect the financial requirements of the semi-retired and to adjust to a labour market with fewer younger workers and more older part-time employees.

# Think Piece 5: Personal Responsibility – The Tension at the Heart of Pensions Policy, and How to Resolve It

Barry O'Dwyer, Managing Director, Corporate, Retail & Wholesale, Standard Life & ABI Long Term Savings Committee Chairman

Matt Cullen, Assistant Director, Head of Strategy, ABI

## Summary


- The Government's emergent personal responsibility narrative sounds attractive, but generates significant tensions in practice.
- Not least is the ability of society as a whole, long term, to fund the retirement of an 'elderly society' – this would be a huge burden for the State, but equally a huge challenge for employers and individuals.
- If individuals are to make a success of personal responsibility, many of them will need help, and in this context ensuring that responsibilities are clear, advice is accessible and incentives are in place, is critical.


**In February 2015 the ABI published Retirement 2050[28] - an extensive report on the future of long term savings and pensions in the context of an ageing society and significant upheaval in the pensions market. This think piece focuses on one aspect of this upheaval - the emerging narrative of 'personal responsibility' in savings and retirement policy, why this presents a challenge and what the Government and industry can do to strike the right balance of responsibility to enable customers to make the most of their long term savings.**

Despite the political commentary, transferring responsibility from the State to the individual is not straightforward. There is a tension between the desire for personal responsibility on one hand, with a popular narrative that it's 'your money, your choice', and on the other hand a societal expectation that people will have a minimum standard of living in retirement. Moreover, auto-enrolment, with its reliance on inertia to engineer retirement savings, and the pension freedoms are arguably at odds with each other. In this tug

### Key Events Since 2013

The medium term changes anticipated in 'Challenges' have happened in waves of rapid activity since then in the UK. The Budget of March 2014 brought sweeping reforms as the Chancellor decided that those in defined contribution pension schemes would no longer be required to choose between an annuity or income drawdown, but could take their money out and spend it as they wished. Alongside these 'Freedom and Choice' reforms, the Budget announced a free government service, Pension Wise, to offer guidance and help people understand their options at retirement.

Shortly after the Budget, the Government confirmed a charge cap of 0.75% for those automatically enrolled into a default pension scheme. The cap includes all administration costs associated with the scheme but excludes transaction costs as a result of the buying, selling, lending and borrowing of investments. These measures were announced at a time when workplace pension charges are at their lowest level in history and ABI members are focused on improving the transparency of charges on all pension products.

The final Budget from the Coalition Government in 2015 announced that the Freedom and Choice reforms of the previous year would be extended further with the introduction of a secondary annuity market by April 2016. This would enable people who purchased an annuity before the Freedom and Choice reforms to sell their annuity to other investors for a cash lump sum. However, in the Summer Budget following the General Election the timetable for implementation was delayed until 2017 to ensure the right regulatory structures are established to protect consumers.

of war between giving people flexibility and ensuring they have security, there are two crucial factors for policy-makers to consider:

- The ability of the State and individuals to fund adequate retirement outcomes;
- Driving adequate behaviour through incentives, financial capability and access to advice.

### Ability of the State and individuals to fund adequate retirement outcomes

With an ageing population and constrained public finances, there is substantial pressure on Government's ability to fund tax relief on private pensions, but this pales into insignificance compared to the State Pension. If the State Pension remains triple-locked to increase each year by the highest of average earnings growth, inflation, or 2.5%, it will cost the UK around £438bn per year by 2062 in real terms, over four times what it costs today[29]. Arguably, the personal responsibility narrative now underway is a necessary precursor for Government to lay the cultural groundwork for difficult decisions on the State pension in the future.

Automatic enrolment into workplace pensions will make a vital contribution to starting people on the path to adequate savings for retirement, but the Government's own projections show that despite automatic enrolment, 11 million people are still under-saving. This trend is most pronounced in the income band between around £22,000 and £53,000[30].

> For many of today's young adults, with limited property equity to fall back on, their savings are likely to be all they have to fund a longer and more expensive retirement.

Moreover, in the long term we will have a retiring population who will be less likely to own property and more likely to retain an element of debt later in life. For many of today's young adults, with limited property equity to fall back on, their savings are likely to be all they have to fund a longer and more expensive retirement.

It is often suggested that leading fuller working lives is a solution to funding retirement needs in an ageing society, and indeed semi-retirement is already a reality for many. ABI research from March 2014 indicates that 51% of people who deferred a decision about accessing their defined contribution pension did so because they wanted to work[31]. There will be no shortage of supply of older workers, but the feasibility of this part of the labour market will also depend on whether the demand continues to grow in the long term. The current Pensions Minister and her predecessor have done much to promote this agenda, and the growth of demand for older workers from the mid-1990s has been linked to the increasing importance of interpersonal skills in the workplace as a result of the shift from manufacturing to services[32]. But in an increasingly fast-changing, digitised world, it feels hard to say with confidence that this trend will continue sufficiently for work to be a reliable source of income for many in later life.

### Driving adequate behaviour through incentives, financial capability and access to advice

It is therefore vital to encourage adequate retirement savings throughout people's working lives. There are two key factors that may help to improve, if not fully optimise, savers' behaviour:

**1. Incentives**

The industry was very pleased to see the publication of the Government's recent Green Paper on strengthening the incentive to save, having advocated a review since 2013. "Supporting personal responsibility" was one the Green Paper's principles for reform: any reform should allow individuals to take personal responsibility for ensuring they have adequate savings for retirement, and to save enough during their working lives to meet their aspirations for a sufficient standard of living in retirement.

The ABI response made clear that retaining the status quo is not an option as the current system is poor at incentivising lower and medium earners, and fiscally unsustainable as the roll-out of automatic enrolment continues to small and micro employers, and higher contribution rates are phased in through 2017 and 2018. Instead, the industry advocated a single rate of tax relief, topping up pension contributions at a rate between 25% and 33%. This would be simple and transparent for employers and savers and would help to target tax incentives towards lower and middle income earners. This single rate of relief should also be reframed to be more accessible, for example as a 'Savers' Bonus' or 'Government top-up' – making the State's contribution visible will act as a powerful incentive.

**2. Financial capability and access to advice**

However, financial capability and access to advice still remain very important. There is established evidence that people find it difficult to make decisions about the long term and are poor judges of their own life expectancy. Moreover, in the new, more flexible retirement market, more options on using those savings are available to more people. Drawdown, previously seen as a niche product available only to those with large pots, is now being offered to the mass market without advice by many providers. But the risks, such as the difficulty of recovering from losses while making withdrawals, are not easy to comprehend and have not gone away.

In this context, improving financial capability in both the savings and retirement phase has never been more important. Driving engagement with savings and retirement planning right through people's working lives, rather than merely towards the end of them, is vital. Free, impartial guidance from Pension Wise and the activities of the Money Advice Service will remain important, as will the development of user friendly tools and online dashboards allowing savers to engage more interactively with their savings projections and options throughout their working lives. Access to affordable advice for those with modest savings remains a major long term challenge, and the Financial Advice Market Review, being conducted by the FCA and the Treasury, presents a welcome opportunity to tackle this.

## What can policymakers and industry do to address these challenges in the future?

The drive for personal responsibility in savings and retirement presents many challenges, of which those above are just a few, but testing the balance and limits of responsibility sheds further light on how to navigate pension policy problems. The lessons are similar for Government, regulators and for our sector itself.

**1. Decide and articulate what a good outcome looks like and build policy and propositions around it**

This involves a value judgment, and should focus on quality of life in retirement. It should be possible to achieve a consensus view of what a pension is for and what minimum standard of living is acceptable, to give parameters for what makes a policy or a product acceptable.

**2. Work with human behaviour, understanding that people are different**

This could mean defaults for some, and better access to advice with prompts to take it up, but it could also mean more freedom and responsibility with accompanying risk for those who want it. It means better communication of concepts like tax incentives, seeking to engage all customers and acknowledging that people engage in different ways.

**3. View pensions policy challenges with a holistic and long-term mindset that engenders trust**

For policy-makers, this means joined-up policy not just across tax and regulation, but all aspects of saving and ageing, helping to build consistency and trust between Government and savers. There needs to be a more stable and certain policy framework established, with cross-party support and relative independence from the peaks and troughs of the parliamentary cycle. As set out in Retirement 2050, the establishment of an independent 'Retirement Commission' could play a key role here[33].

For providers, it means continuing to build trust by demonstrating a long-term commitment to customers and understanding their needs and responding to their aspirations. Where tensions such as that between personal responsibility and safeguarding adequate retirement outcomes do arise, the needs of customers will be best met by Government, regulators and industry working together to resolve them. Our work with industry bodies, regulators and Government towards a common language on pensions and retirement, to be used by all who deal with consumers at retirement, is one example of such co-operation.

# Theme: Welfare Reform

**It is hard to look far into the future and see the current welfare framework surviving into the 2020s.**

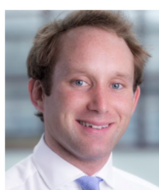
We are likely to see an increased focus on the poor and the vulnerable which may be forced on society rather than chosen by it. In contrast to the cultural norms in many of the emerging economies, the British state and wider society has sought to provide some form of basic welfare safety net since the Elizabethan era. If distribution of wealth in the UK continues to develop into an 'hourglass' shape, the scale of economic problems facing the bottom 20% and their relative lack of opportunity to escape them will have its own momentum and require a significant focus of welfare provision to prevent social breakdown and destitution and uphold the standards of protection for children and vulnerable people we now expect as a society. These problems will continue to become more expensive for the state as the cumulative effects of multi-generational unemployment and social exclusion build up and the barriers to work and economic productivity grow ever higher.

Change may come in small, grudging steps rather than through grand reforms, but change is inevitable. For as long as the old quip remains relevant that the British want Scandinavian standards of welfare provision with American levels of personal taxation, the challenge will be formidable to reform a welfare system that is increasingly strained by the tensions within it.

No less challenging will be attaining a measure of political stability and consensus among political decision makers and their opponents. [Partnering with government] will require a more proactive industry which is bolder in its thinking, setting a compelling but politically neutral agenda which politicians can engage with. This will never be easy to accomplish but it will be a necessary task to achieve reforms the industry can support and work with.

# Think Piece 6: The Shrinking State – Insurers' Growing Role in Workplace Welfare

Gary Shaughnessy, CEO UK Life, Zurich & ABI Protection Committee Chairman



Charlie Campbell, Protection and Health Policy Adviser, ABI

## Summary


- The State is likely to significantly reduce its umbrella of workplace welfare provision. It will increasingly shift more of the burden of responsibility onto employers, who it will ask to provide (both funded & sponsored) financial and back-to-work support for those unable to work due to sickness or injury.
- In recognition of the difficulty in changing individual behaviour, the workplace will become the primary marketplace for providing health services in order to minimise the severity of conditions and reduce the burden on state services.
- Employers will have a growing need to protect themselves and their employees with insurance that delivers a strategic response to employee risk management - protecting both the financial position of the business and the welfare of its workforce.


**In recent times welfare reform has been one of the policy areas towards the top of the public's list of concerns, with both the distribution and absolute levels of spending hotly debated – discussions which point, in the current political climate at least, to a shrinking State and the need for the private sector to fill the gap.**

This is the environment in which protection insurers have recently found themselves, working together to articulate the case for an increase in Income Protection insurance. Having identified the opportunity early on we are now in the optimistic position where government policy in this area is increasingly closely aligned with what insurers have been saying for a long time: that a greater role for insurance products such as Income Protection can deliver more for UK citizens and reduce the burden on the State. Having used the long run up to the last election to make ourselves heard, working with the Government, the opposition and civil servants about how protection insurance works and the benefits it can bring, the ground is now primed for the industry to take tangible proposals and solutions to Ministers. The challenge is to ensure that the case is robust, evidenced and well-articulated in the context of Ministerial aims.

It is clear that there is significant support across the UK for the government to live within its means and deliver 'more for less', legitimising a reduction in the absolute amount of welfare spending by the State. In the context of an austerity agenda, we can expect to see widespread reforms to the provision of welfare by a Government keen to stress that high spending is not, in itself, a measure of success in looking after the most vulnerable in our society.

## The insurance industry has a once in a generation opportunity to step up to the plate.

Using the private sector to undertake functions which up until now have been the responsibility of the State will be a key aspect of this process. On welfare specifically, the insurance industry has a once in a generation opportunity to step up to the plate and play a key role in ensuring that those whose health or personal circumstances make working difficult are not left to fall through the cracks.

What does this mean in practice for insurers? Following the 2015 Summer Budget, a number of themes are crystallising which should help us better understand the future of welfare provision, and assess the opportunities for insurers to showcase their worth to society in this area:

**1. £12 billion of reductions in welfare spending will be sought.**

There have been clear signs that the Chancellor intends to make good on his party's pledge to find the vast welfare reductions promised in the 2015 Conservative election manifesto. So far, cuts to tax credits and the removal of housing benefit to the under 25s have been announced, but it still is not clear where the remaining reductions will be found. One thing is clear – if the Chancellor wishes to reduce the deficit and run a surplus by the next election, as he has promised to do, whilst maintain a duty of protection to society's most vulnerable, he will need to find innovative remedies.

**2. A vision where prevention and intervention ensure the State is the last resort.**

It has long been the case that the Welfare State provided support to those unable to work and the NHS offered free healthcare when illness or injury struck. Although wide support for these basic provisions remains, a vision is now taking hold of a State that retains its duty to provide a basic financial safety net and free healthcare, but that encourages intervention through the workplace before State services are called upon. In July 2015, tackling employee sickness absence was announced as the Department for Work and Pensions' next big challenge - recognising that the workplace is well placed to provide immediate support for those beset by injury or illness. Meanwhile, the NHS hopes to reduce the use of its core services by focusing on prevention services that ultimately reduce the use of hospital beds and A&E.

**3. The moral obligation for worker welfare will be largely shifted to employers.**

Following the UK General Election, a number of initiatives have been established which begin to transfer elements of responsibility for worker welfare away from the State and on to employers. The abolition of the Employer Statutory Sick Pay Rebate, a living wage for all employees aged over 25 and cuts to tax credits are all good examples. With the Chancellor looking to boost productivity, a more altruistic role played by employers could help attract, retain and incentivise employees. But whilst employers providing more for their employees may save the State money, it will inevitably cost the employer more. They now need to pay employees more and shoulder the greater cost of sick pay and absence management, all of which is arguably a moral obligation for employers in the context of a shrinking state. The answers to these increased burdens can be largely fulfilled by insurance solutions, provided through the workplace, that enable employers to deliver to those obligations while minimising the uncertainty of the financial cost.

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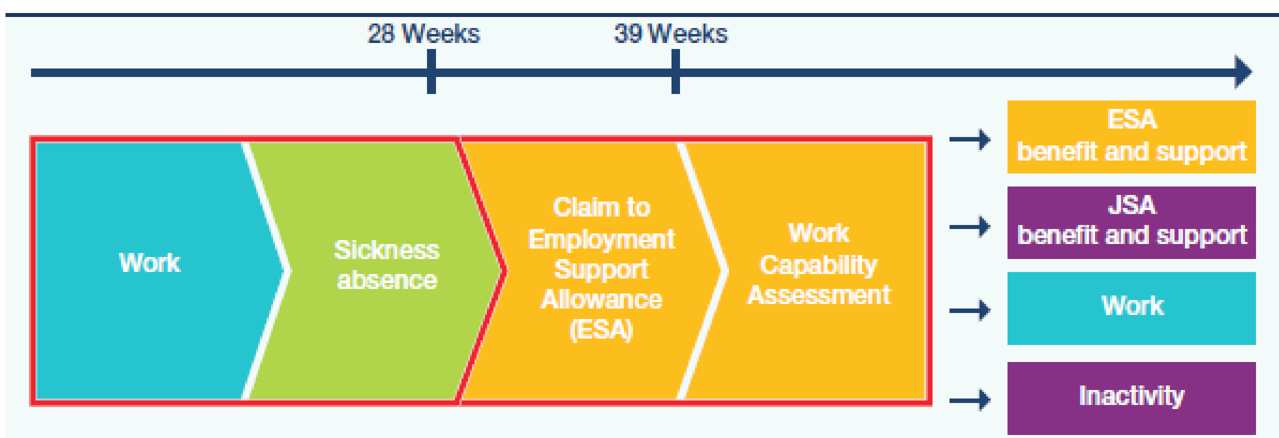
**The journey through occupational and State support** (Source: Black / Frost Review, 2011)



The themes set out above present significant opportunities for the insurance sector to fulfil a much more prominent role in workplace welfare, but for 'opportunities' do not read 'easy wins'. There are several big challenges that need to be overcome in order to make the most of them:

**1. Making the wider financial case to employers, individuals and the State.**

The benefits of Income Protection are shared between the individual, employer and the State. This spread is positive but points to a need to prove the benefits for all three parties - particularly the employers generally funding the premiums – not just the individuals who are the most obvious beneficiaries. So at a time when we are asking the Government to support and partially fund the wider uptake of Income Protection we need to demonstrate how it will not just benefit individuals and employers but also reduce reliance on the State, tackling sickness absence and boosting productivity. In this context, a government tax incentive would encourage a greater uptake of Group Income Protection, which in turn will deliver net savings overall, rather than just benefit those employers who already choose to provide the cover. For employers, the case needs to be made that the cost of premiums is a known cost, provides certainty and can provide the financial safety net for many employees that the State cannot.

**2. Evidencing the benefit of early intervention and back to work support services.**

The protection industry's products offer benefits beyond acting as a financial safety net. But whilst offering services that help individuals back to work sounds altruistic and far more effective than no intervention, we need to provide evidence of the difference those interventions make. How often do those services play a role? Would individuals have returned to work regardless of intervention? By how much does it speed up the return to work? The Government has shown that it believes in the value of early intervention, with the introduction of the Fit for Work[35] service, however the service does not provide access to rehabilitation services. Insurers need to evidence the tangible benefits of the rehabilitation services provided if we are to gain wider government support for the incentivising of insurance provision.

Insurers need to evidence the tangible benefits of the rehabilitation services provided if we are to gain wider government support for the incentivising of insurance provision.

**3. Ensuring products are robust and stand up to scrutiny.**

With a life in the spotlight come risks and challenges. If government sees a role for insurers as partners of the State in providing more for less, it will naturally want to better understand the products it is advocating. This kind of scrutiny when applied to pension products as a result of auto-enrolment brought with it tighter regulation of defined contribution schemes, and ultimately a charge cap. In Protection, small print has reduced, claims payouts have increased and more conditions have been covered over the last decade. Insurers make a real difference to thousands of people's lives each year (£3.44bn was paid in claims by the protection industry in 2014 for example). We clearly need to make sure that we continue to adapt coverage, ease of access and affordability as the needs of UK citizens change, to make sure we remain relevant to those needs.

**4. Taking steps to avoid confusion with Payment Protection Insurance.**

Finally, while it may seem a relatively minor issue for the industry, insurers should not hide from the current tendency for Income Protection insurance to be confused with Payment Protection Insurance. It is unclear whether a positive case for insurance solutions to welfare can maintain traction while this common, although incorrect, association remains. It asks the question, is this a terminology issue and, if so, should we be looking at broad new ways to reinvent and rebrand our services?

**Welfare reform is well underway, but the journey is just beginning. Likewise, insurers have a foot in the door with an excellent case to be made, but have some way to go to convince government, employers and individuals that they have worthwhile and workable solutions to providing workplace security. With the Government open to ideas in the early stages of this parliamentary term on how to deliver more for less, now is the time for the industry to pull out the stops to make the case for a growing role in workplace welfare.**

# Theme: Industry Reputation

**Tackling the poor reputation of the insurance industry is a key priority for the CEOs of the major UK insurers who do not believe insurers should be keeping politicians, bankers and journalists company at the bottom of public opinion surveys in the decades to come. No single factor holds the key but several matter:**

Insurers will continue to suffer from the collateral damage inflicted on the entire financial services sector by the banking crisis, a crisis in which insurers as investors played a contributing role and, in some cases, were linked by common ownership. This association is impossible to avoid and will not fully dissipate until the economy has recovered but the asset management arms of insurers have been at the heart of post-crisis governance reforms and insurers have had some success in establishing their distinctiveness in the eyes of key stakeholders.

A second factor is the industry's relatively poor consumer reputation. This is explored in more detail elsewhere in this document but insurers recognise that good customer experiences and swift resolution of avoidable complaints will increasingly have to continue to form the bedrock of a broader foundation of insurer reputation.

More difficult to change is the relative unpopularity of the core insurance product; a necessary but unglamorous 'grudge-buy' in an age where the zeitgeist is set by the exciting opportunities for entertainment and leisure provided by the technological innovations of the IT sector. Set against this, the fundamental dynamic of many insurance products is to provide security against the financial consequences of a risk a customer never hopes to confront, or provide income for future scenarios that customers would prefer not to think about. The bias of human beings will continue towards near-term gratification always, making it a challenge to crystallise the value of insurance compared to the entertainment gadgets made possible by the technology and connectivity of the future.

Insurers know the answer will partly come from providing undeniable value when the product is required; the bar for meeting customer expectations will always be higher for insurers precisely because the product may not be needed very often or because customers have paid in for many years to get the benefit of it. Given the anxiety which often accompanies a general insurance claim, the opportunity to change perceptions by offering first class service is an increasing area of focus for industry leaders. Equally the answer will have to come from being unapologetic in advocating the need for insurance in a fast-changing world where standards of welfare provision are not a given.

# Think Piece 7: Regaining and Strengthening Trust in the Insurance and Savings Sector

Paul Evans, Group CEO, AXA UK & ABI Chairman

Matt Cullen, Assistant Director, Head of Strategy, ABI


## Summary

- The UK insurance and savings sector plays a vital role in society – providing certainty and security, enabling saving and investing for the long term. Despite this, trust in insurance and savings firms is poor.
- Greatly improving the transparency and clarity of product offerings is a crucial step in regaining trust, by helping customers better understand what they are buying.
- Firms must also be prepared to leverage the 'internet of things' to increase their day-to-day role in their customers' lives. More touch points will mean greater opportunities to demonstrate value and trustworthiness.


**Our industry plays an integral and valuable role in society - we protect for today and invest for the future. Our customers can go about their daily lives without fear for the financial consequences when things go wrong, whilst we help them to save to build their future financial security. That is a compelling proposition - one which meets very obvious customer needs - and is**

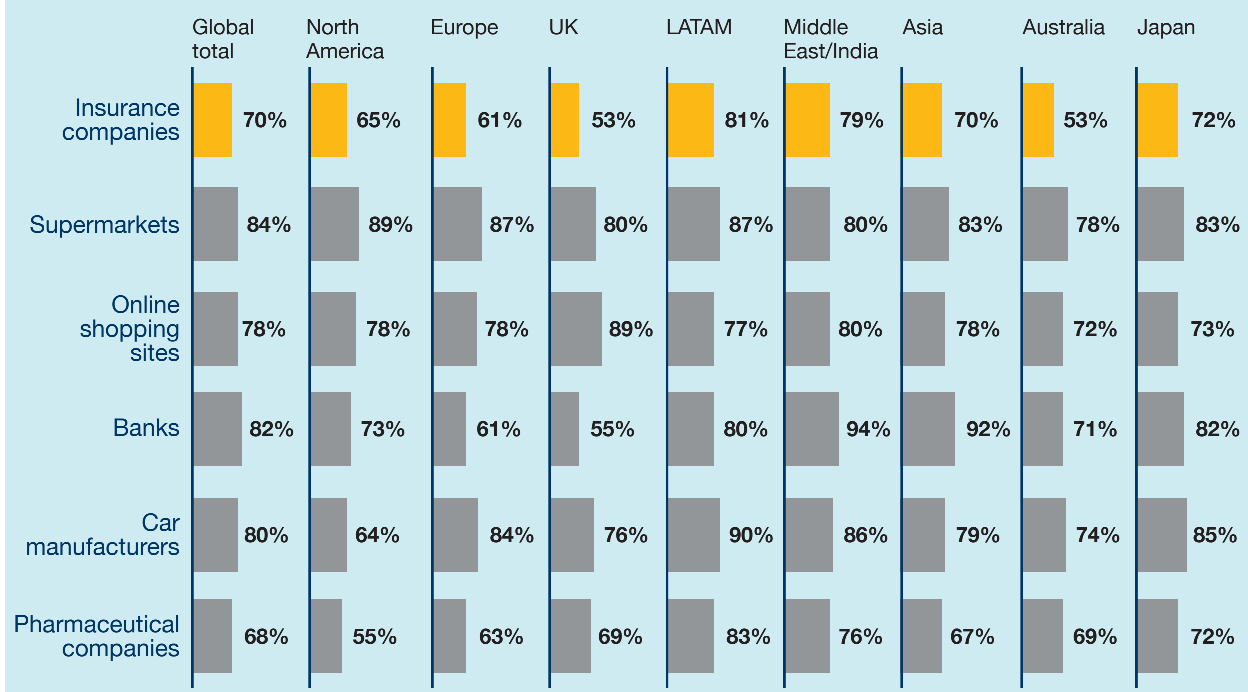
> Last year as protectors we paid £14.5 billion - that's £40 million each day - in motor and property claims

**delivered by an extremely competitive industry which is increasingly taking on different forms as new ways to serve customers' needs emerge.**

So we should not be bashful in showcasing the best of what we do. Last year as protectors we paid £14.5 billion - that's £40 million each day - in motor and property claims, £370 million was paid in claims to travellers who needed help, and £3.6 billion to provide access to private healthcare. For savers, we invested £1.9 trillion (equivalent to 25% of the UK's total net worth) – providing enormous fuel to the economy, and crucial funding for its necessary infrastructure[36]. These are remarkable figures which serve to highlight the positive contribution we make to society every single day – we are there when our customers need us most, both for tomorrow and for the long term.

Nevertheless, as the statistics below from the EY 2014 Global Insurance Survey show, levels of trust in the insurance sector

**Figure 1: Level of trust (% of consumers citing "complete trust" and "moderate trust") by type of business**




[37]

are relatively poor compared to many other sectors globally. This lack of relative trust is even more pronounced in the UK.

For an industry full of people passionate about making a difference for customers, it is extremely disappointing that the sector has so badly failed to secure their trust. In customers' moment of need, they worry that we will not be there for them; when they come to access their investments, they worry that the charges will have eaten away at their hard earned savings – that the industry will put making a profit ahead of meeting their needs.

There is a significant disconnect between the noble purpose firms strive so hard to serve, and the trust that is undermined by some of the ways they go about it. Overcoming this is the profound challenge, and opportunity, of our generation – adapting business practices to earn the trust of our customers and thereby forge deeper, more effective and ultimately more profitable relationships.

Two processes stand out as key steps for the industry to take over the next five years in order to regain and strengthen trust. First, radically improve the transparency of what we do, and second, deepen our relevance to, and day to day engagement with, customers by harnessing 'the internet of things' to become more akin to 'life consultants'.

**1. Radically improve the transparency of what we do**

It is a given that customers should be able to make an informed decision about the product they purchase – what is covered, and what is not? – what charges will be applied in given situations? – what is the reputation of the company in the eyes of its existing customers? Instead, unless a customer uses a broker or IFA, the tendency is simply to make the important purchase decision predominantly on price and perhaps brand perception, and in many cases without pausing to better understand the relative quality of the product chosen. Moreover, unlike other purchases, there is no immediate consumption – if you buy a new mobile phone you know, through immediate use of the phone, if you have made the right purchase. But with an insurance or savings product, whilst they provide intangible reassurance and certainty every day, the only tangible enjoyment is at the point of claim or withdrawal.

So when these tangible moments arrive, for example a household insurance claim or when a customer comes to access their savings, firms face a rare 'moment of truth' for reputation and trust – not only with the customer concerned, but with all of their peers who, in the absence of their own 'moments of truth', rely on the experiences of others – and of course negative experiences generally gain more visibility than positive ones.  Will the claim be covered, or will there be an exclusion in the small-print? Will there be charges the customer hadn't expected?

These are questions the customer should not be left wondering about in their moment of need. Over the years, rather than ease communication with customers, a combination of regulation and legislation has served to make the communication of what is really important less and less clear amid the fog of mandated disclosures. Furthermore, whilst in the retail sector customers can make purchasing decisions with reference to the online feedback of fellow customers, this is a relatively nascent concept in the insurance and savings industry.

To earn customers' trust we must work harder to make plain the key features of the product, its cover and its charges in a wholly transparent way.

To earn customers' trust we must work harder to make plain the key features of the product, its cover and its charges in a wholly transparent way; and share publicly the feedback of other customers' experience at their moment of truth.

- Online customer reviews are crucial if we are to persuade customers that the vast majority are delighted by their experience;
- Simple illustrations of every possible charge must be given if customers are to have confidence they will not suffer hidden charges;
- Clear information, at point of sale, on the circumstances where a claim will, or might not, be paid are key if a customer is to really understand how the cover will work in practice;
- Transparent disclosure of the percentage of customers who claim each year, and the proportion of those claims which were not paid, with illustrations of typical reasons; so that a customer can gauge value for money.

The firms that can do more to help their customers understand the products that they are buying, and be on hand subsequently to offer accessible guidance and help, will be making great strides towards building trusting customer relationships.

**2. Harness the 'internet of things' to become 'life consultants'**

The greater our relevance to our customers' lives, day in, day out, the stronger bond of trust we can form. Today, touch points are relatively limited – in simple terms 'I buy/invest'; 'I renew/contribute'; 'I change' and 'I claim/withdraw', and in general insurance it is not uncommon that a customer never needs to utilise the tangible benfits of the products they purchase. It is difficult to build deep trusted relationships when there are so few meaningful interactions.

Technology will offer opportunities to change that – connected cars, telematics, the connected home, health monitors, mobile apps, 24/7/365 online investment platforms, all offer the opportunity for firms to adapt their business models to become more relevant to customers on an ongoing basis. The statistics are staggering – where today there are roughly 8 billion connected devices, this figure will reach 50 billion by 2020, and a trillion by 2030[38].

The insights provided from connected devices, or the 'internet of things', will enable us to effect a radical repositioning – from a reactive 'we are there when you need us' to a proactive 'we are with you each day to help you reach your potential'. Not only are we there to help you when things go wrong, but we will also provide advice and insights to help reduce the risk of such issues happening in the first place. Not only are we there to enable you to save for the future, but we will also encourage and help you make the right decisions on saving, informed by the insights we have about you, and people like you.

So the internet of things creates an opportunity to reposition the sector's relevance to customers, through more frequent touch points and therefore more immediate and regular enjoyment of the customer's purchase. Delivered well, this can help to build trust. But crucial here will be how we access, gather, manage, protect and use the customer data to their benefit – getting this wrong could damage trust irreversibly.

**These are just two processes of many through which the industry can work to regain and strengthen trust. Everyone will have their own ideas about the most problematic reputational challenges insurance and savings firms face, and the most effective ways to re-establish trust with our customers. But hopefully everyone can agree that concerted efforts must be made, individually and collectively, if we are to preserve our privileged position in society.**

# Theme: Insurers, Risk Assessment And The Availability Of Insurance

**Insurance companies exist to serve society by managing its risk, yet the way in which insurers assess risk and the consequences of those judgements are already under increasing scrutiny and challenge. For general and protection insurers, the weighting and pricing of risk is at the commercial heart of their business. The science of doing so is core to the industry's professional standing and is an integral component of commercial success, especially in an era of low investment returns.**

For high quality risk assessment to remain at the heart of UK insurance, insurers will need… to be increasingly open and transparent about how they use risk assessment to deliver products that best meet customer needs and price limits.

## Risk assessment and pricing increasingly under scrutiny

There is no single reason why risk assessment and pricing is under more scrutiny than ever before. In part, it reflects the dynamics of the information-rich and increasingly transparent era we live; this encourages customers, the media and consumer groups to 'demystify' aspects of financial services they do not understand. Many insurers have responded to this trend, seeking to explain more fully what risk factors they use and how these can impact on the availability and cost of an insurance product. Linked to this search for information has been less consent from some customers about risk assessment decisions, empowered by the internet and social media to challenge the specific application of risk factors, their accuracy or relevance to the individual or their overall consequences. This has been most notable in the debates around young drivers, flood insurance and annuity pricing where customers have increasingly expressed strong views about how they feel risk factors should impact on the product and its cost.

Parallel to this has been increasing challenge from both UK and EU politicians and stakeholders to the use of risk-pricing. During the passage of the 2010 Equality Act, many UK parliamentarians called for the banning of the use of age risk factors for travel insurance, while the Belgian consumer group, Test Achats, was ultimately successful in 2011 in persuading the European Court of Justice to ban the use of gender in insurance pricing after it had originally been excluded from the EU's Gender Directive.

The biggest area of scrutiny, however, has come in areas where risk assessment has led to exclusion from insurance products either because of lack of availability of the product or because the cost is unaffordable for the customer. This has partly come to the fore because particular sub-groups of customers have found the risk-related price for their needs too high; especially young male drivers and high flood-risk households. In both cases, prices have undoubtedly gone up in recent years as the respective costs of compensating the victims of road accidents and the incidences of flood claims have risen.

# Think Piece 8: Sharing risk or smoothing bad luck – what is insurance really all about?

Matt Cullen, Assistant Director, Head of Strategy, ABI

## Summary

- As data and technology evolve, insurance pricing will become increasingly segmented, creating social justice concerns in some areas.
- Insurers must, however uncomfortable it may feel, accept that pricing as accurately as possible is not always going to be deemed 'fair' in the modern world.
- Solutions will only be possible with a level playing field, generated through working with government and / or regulators. Flood Re has shown that this is possible.

**What is insurance all about? A fundamentally important question which is increasingly pertinent across almost all insurance lines – is insurance pricing and underwriting a collective, 'all in it together' process often referred to as 'sharing risk', where to a greater or lesser extent those at lower risk cross-subsidise those at higher risk, or is it an individualistic process where the customer pays for the risk they bring to the table? Which of these is 'fairest'? And is what has appeared fair historically likely to be deemed fair in the future?**

## Pricing and underwriting – individualistic or collective?

Historically, in the UK at least, almost all lines of insurance have subscribed to the principle that a customer pays a premium commensurate with the risk that they present. This has been the principle; the reality has been, inevitably, that the premium is commensurate with the insurer's best estimate of the risk presented. This is vital because when the best estimate is relatively unsophisticated, the inevitable consequence is an element of averaging or collectivisation. So with a relatively unsophisticated understanding of who the low risk and the high risk customers are, their premiums are less differentiated, and those at low risk therefore informally cross-subsidise those at high risk.

So an oft-heard argument that "sharing or pooling of risk has always been a principle of insurance" misses the point. The principle has been about pricing as accurately as possible given the techniques available at the time. This was the case in the 18th century when the price of ship insurance from Lloyd's would vary based on destination or cargo, it was the case in the 20th century when rating tables were developed to help bring actuarial rigour to the pricing of general insurance products, and it is the case in the 21st century as highly sophisticated pricing models become widely used. But while a 'risk sharing' environment has never been a principle of insurance, it has been a historic norm created by a lack of granular risk information. In other words the collective nature of insurance pricing has been created and maintained by a fundamental asymmetry between the real distribution of risk in the insured population and the distribution of risk that can be reliably obtained or modelled by insurers.

While a 'risk sharing' environment has never been a principle of insurance, it *has* been a historic norm created by a lack of granular risk information.

But change is afoot. While this asymmetry will never close completely, it is shrinking. With each passing year insurers have access to new data and new techniques that allow them to home in on the 'real risk distribution' of a population. Where this real risk distribution is highly varied (i.e. there is a significant difference between the levels of risk of different customers), premiums will inevitably diverge, potentially creating affordability problems for those at the high risk end of the spectrum.

**Two areas where insurers may have a much more granular understanding of risk in the coming years**

**Genetic information – likelihood of illness or mortality**

Imagine a world where everyone has their genome mapped as a matter of course, and detailed blood-based health screening is widespread - making major health and mortality risks increasingly clear as a result. At present, in line with a 'Concordat and Moratorium' agreed with the UK government, life and health insurers do not use genetic information in pricing (except for Huntington's disease). But in a world where people could have their entire genome stored on a memory stick this is unlikely to be sustainable, without significant additional reform, due to the risks of adverse selection.

**Big data – likelihood of expensive motor claims**

'Big data' – the term used to describe the huge volume of varied, largely unstructured data in the world today, including information from social media, data from sensors in homes, cars etc. – presents an opportunity for insurers to uncover new correlations between customers' circumstances or behaviour and claims. In motor insurance a combination of analytics built on lifestyle information and increasingly sophisticated telematics data may give insurers unprecedented information about who the highest risk drivers are.[39]

UK flooding is a perfect example of this - a visible precursor to the challenges which could emerge in other areas over the coming years. Flooding is one of the first areas where insurers' understanding of what is a very varied, granular risk has caught up with reality, due to the rapid development of detailed hydrological flood models in the last two decades. Whereas in the past insurers would need to rely on a crude estimate of flood risk along the lines of, "Is the property near a river or coastline? Yes = higher risk; No = lower risk", now models such as the JBA JFlow hydrodynamic model[40] can help insurers accurately assess flood risk down to a five metre grid square.

The result of this process has been an increasingly segmented home insurance market over the last fifteen years, with an informal cross-subsidy between low and high risk homes, to the tune of £180m a year, gradually unwinding. The increasing affordability problems for those at high risk ultimately led to a debate in the UK about fairness – should those at high risk pay a premium to match, even if unaffordable, or should they be supported by cross-subsidy from the rest of the population? The ABI's decision to put forward, and the subsequent agreement with the Government to develop, Flood Re was hugely significant - it marked an ideological shift away from pure individualistic risk based pricing always being the right, 'fair' approach.

## Navigating the fairness challenge

In their excellent 2012 paper on "social justice and the future of flood insurance"[41] John O'Neill and Martin O'Neill set out three different concepts of fairness in relation to insurance.

1. 'Pure actuarial fairness', or the individualistic, 'pay for your own risk' approach.

2. 'Choice sensitive fairness', where an individualistic approach is only fair in areas over which the individual has choice or control.

3. 'Fairness as social justice', where insurance that is a 'basic requirement of social justice', is independent of individuals' risk or choices.

As insurers understand risk with increasing accuracy in the coming years, societal debates about the fundamental purpose of insurance, and which approaches represent fairness will be increasingly common and they will be hard fought.

It is safe to say that individualistic risk-reflective pricing – O'Neill and O'Neill's 'pure actuarial fairness' - does not always sit comfortably with the public or the media, however technically sound and 'economically efficient' it might be. Media coverage on older drivers is a case in point.

But dissenting voices generally shout the loudest, and many lower risk individuals benefit from increasing granularity and segmentation with less costly insurance. Increasing segmentation also has the benefits of better incentivising action to manage the risk, keeping average premiums lower (because less uncertainty overall results in a lower cost of capital for the insurer), and preventing adverse selection in the insurance market where products are only seen to be good value for higher risk customers and the market begins to shrink.

## Ultimately, decisions on fairness are for society to take, not the insurance sector.

Ultimately, decisions on fairness are for society to take, not the insurance sector, but it is important that insurers participate in the debate, offering logical and well-argued insights into the impacts of these decisions.

We must help society to understand the consequences of a segmented, personalised market. In many areas this will be productive, offer the right incentives, and create limited negative effects. In other areas (like those in the box above) the negative affects may be more widespread and have a more acute impact on those affected. These are the areas where deeper thinking is required to ascertain the right approach for the long term.

However these are also the areas where it would be most difficult for the insurance sector to intervene unilaterally, even if it were appropriate for us to do so. The impacts are widespread and acute precisely because the risk is highly differentiated, making compromising insurers' ability to use that approach a significant commercial disadvantage. Level playing fields that can only be delivered in partnership with government and / or regulators will be required if 'fair' social outcomes are to be achieved.

## Level playing fields that can only be delivered in partnership with government and / or regulators will be required if 'fair' social outcomes are to be achieved.

Returning to O'Neill and O'Neill's three fairness concepts, it is important to reiterate that no one approach to delivering insurance is likely to be right in all cases. If insurers wish to appear to the outside world not just as profiteering businesses, but organisations with a true social purpose in helping to manage risk, then they must be prepared to engage in finding solutions where social justice or choice issues have been raised. However, it is important not to over egg the pudding, and remember that individualistic, pure actuarial fairness works well most of the time. Windstorm, for example, is never likely to generate affordability or availability problems in property insurance because it is a relatively consistent, shared risk – so even as insurers' data and analytics develop we will not see the divergence in premium that comes with more granular risks.

So what is insurance really all about? Even when insurance is priced on a fully risk-reflective, individualistic basis, it is still the ultimate collective financial risk management process, where the claims of the few are funded by the premiums of the many. Or to look at it another way, those who suffer misfortune and have to claim are effectively subsidised by those who end up not having to. This collective cross-subsidisation on the claims side, which provides certainty in an uncertain world, is what insurance is really all about, irrespective of whether pricing and underwriting are cross-subsidised as well.

# Theme: Insurers' Role In Sustainable Economic Growth

## Economic Growth

**The modern insurance industry is indivisible from the major economic trends that have shaped the last 300 years of human history. It has grown out of the commercial and human needs of industrialisation; the enabling of trade, the protection of property and the provision of basic welfare. In doing so, the industry has built a scale and stake in modern economies that have made it vitally important in its own right as an owner and protector of assets, a major employer and tax contributor and source of macro-economic stability. At a time of unparalleled economic change, the question for the future is what role insurers can most usefully play in both the mature economies of the West and the fast-growing economies of the East, Latin America and parts of Africa, whether political and regulatory expectations are reasonable and how insurers can place themselves at the heart of the next period in human history.**

There are five areas where its role will be important:

i) Provision of capital
ii) Funding of infrastructure
iii) Exercising of stewardship and stabilisation of the economy
iv) Protection of assets
v) Maximisation of export strength

## Climate Change

**Debate on the scale and impact of climate change will be at the forefront of the 2020s, in particular whether 4°C warming will be reached by the end of the century instead of the predicted 2°C. The 2020s would be the last chance for sustained global action to prevent this 4°C rise, as irreversible tipping points were reached in areas such as the Greenland ice sheet and Amazonian rain forests.**

These changes will be just as relevant for insurers' asset management activities as their underwriting operations. If political leaders take sustained action to try and prevent 4°C warming, it would almost certainly lead to further restrictions on fossil fuels, reducing the value of reserves held by major energy companies in which insurers will be heavily invested. Meanwhile greater natural resource constraints, driven by both climate change and population growth could not just limit economic growth but, at worst, impact pension funds as assets deliver lower returns and costs rise against a backdrop of consistently rising commodity costs.

# Think Piece 9: A step change in green investment

Maurice Tulloch, CEO, Aviva UK & Ireland General Insurance & ABI General Insurance Council Chairman

Matt Cullen, Assistant Director, Head of Strategy, ABI

## Summary

- A strong, legally binding agreement at the UN Climate Conference in Paris would be a game changing 'signalling point', especially for the investment community.
- The reputational and economic drivers of green investment, and the reduction of regulatory barriers, will make a step change in investment behaviour not only feasible, but attractive.
- As a result, actively seeking opportunities to improve the sustainability of both fixed income and equity investment portfolios is likely to become a mainstream activity for all forward thinking insurance and savings firms.

**Climate change is one of the great challenges of our time. 20,000 years ago, the world's average temperature was around 4°C lower than it is today; the same four degree variation as the Intergovernmental Panel on Climate Change (IPCC) expects us to rapidly reach by 2100 if greenhouse gas emissions are not constrained[42]. 20,000 years ago we were in a different period of geological time – the Pleistocene – and the majority of the UK was under hundreds of metres of ice.**

A world with global average temperatures four or even six degrees higher than today would be a very different place, with increased thermal energy in the global climate system creating a more volatile and uncertain risk environment for individuals and for insurers. Sea level rises will threaten the viability of many of the world's most important population centres. With a one metre global sea level rise – not inconceivable over the next century - what would be a 1 in 100 year flood in New York today becomes a 2 in 1 year event – i.e. 200 times more likely[43].

In December 2015 leaders from around the world will come together at the UN COP21 Climate Conference in Paris to try and deliver a robust, legally binding global agreement on reducing greenhouse gas emissions. But while political agreement in Paris is vital in setting direction and providing certainty, it can only lay the groundwork – the transition to a low carbon world can only realistically be delivered with the help of trillions of pounds of private investment capital channelled in the right direction over many years.

The transition to a low carbon world can only realistically be delivered with the help of trillions of pounds of private investment capital channelled in the right direction over many years.

In this context, a step change in green investment behaviour by insurance and savings firms, which helps society to mitigate the risks of climate change, is vital if we are to transition to a low carbon economy and avoid this four degree world. Insurers have multiple incentives to do this:

**1. To manage the risk environment in which they operate, maintaining insurability in existing areas, and strengthening the prospects for growth in emerging markets**

Insurers' ability to act as carriers of climate related risk depends on that risk being maintained within acceptable levels of average annual loss, volatility, and uncertainty. Climate change will, in many geographies - particularly developing countries which are a key driver of future growth for the sector - create risks that are too volatile to capitalise effectively, or simply too costly to cover at affordable levels, rendering many people uninsurable before they have ever had access to insurance provision. To an extent, these problems are already locked in by inevitable climate change in the coming years, but they could become far more acute. Ultimately, the long term relevance of insurance across many parts of global society is linked to avoiding the exponentially increasing risk environment likely to be generated by global warming over 4°C.

The long term relevance of insurance across many parts of global society is linked to avoiding the exponentially increasing risk environment likely to be generated by global warming over 4°C.

### 2. To contribute to minimising the macroeconomic risks presented by climate change

While the first point is primarily relevant to those firms insuring risks physically impacted by climate change, all insurance and savings providers have an incentive to contribute to maintaining value and growth in the economy. Recent research by the Economist Intelligence Unit[44], sponsored by Aviva, uses an economic forecasting model to estimate the Value at Risk to the global stock of manageable assets, which estimates an average loss of value by 2100 of $4.2 trillion[45]. In the extreme 6°C scenario, the Value at Risk rises to $13.8 trillion – around 10% of the world total investable assets. These permanent macroeconomic impairments have significant implications for growth and prosperity in the long term.

### 3. To ensure we are on the right side of the fence reputationally

In the coming years climate and sustainability performance will be an important reputational driver for the sector, not least in the immediate period of political and media attention generated by the December 2015 UN Climate Conference in Paris. A worldwide survey on climate change involving 10,000 citizens across 79 countries found that 78% of respondents were 'very concerned' about the impacts of climate change, and nearly two-thirds said the world should do 'whatever it takes' to limit temperature increases to 2°C.[46]

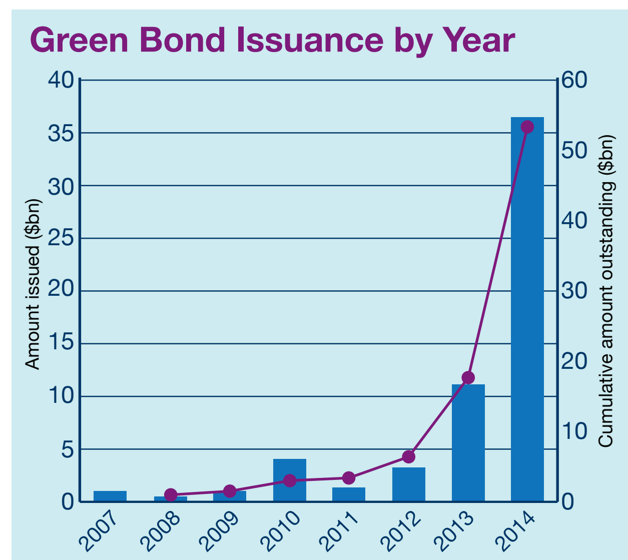
Leading insurance and savings providers are increasingly aware of these incentives, and are taking steps to align their investment behaviour to them.

### Aviva's five carbon pillars

In July 2015 Aviva published its Strategic Response to Climate Change[47], setting out the following five commitments:

1. **Integrating climate risk into investment considerations.** Ensuring that environmental, social and governance issues remain embedded in investment analysis and decision making.
2. **Investment in lower carbon infrastructure.** Targeting a £500m annual investment in low carbon infrastructure for the next five years.
3. **Supporting strong policy action on climate change.** Supporting policymakers in negotiating a credible outcome at the upcoming UN COP-21 climate conference in Paris.
4. **Active Stewardship on climate risk.** Actively engaging with companies to achieve climate-resilient business strategies.
5. **Divesting where necessary.** Divesting from highly carbon intensive fossil fuel firms where it is felt they are not making sufficient progress towards the engagement goals set.

Direct investment in low carbon infrastructure – in particular renewable energy infrastructure – and broader investment in the green bond market (which includes funding low carbon projects and also climate resilience infrastructure that can almost immediately have benefits for insurers' underwriting activities.) have begun to 'take off'. The graph below shows that global green bond issuance in 2014 was over three times greater than the previous year at $36 billion.

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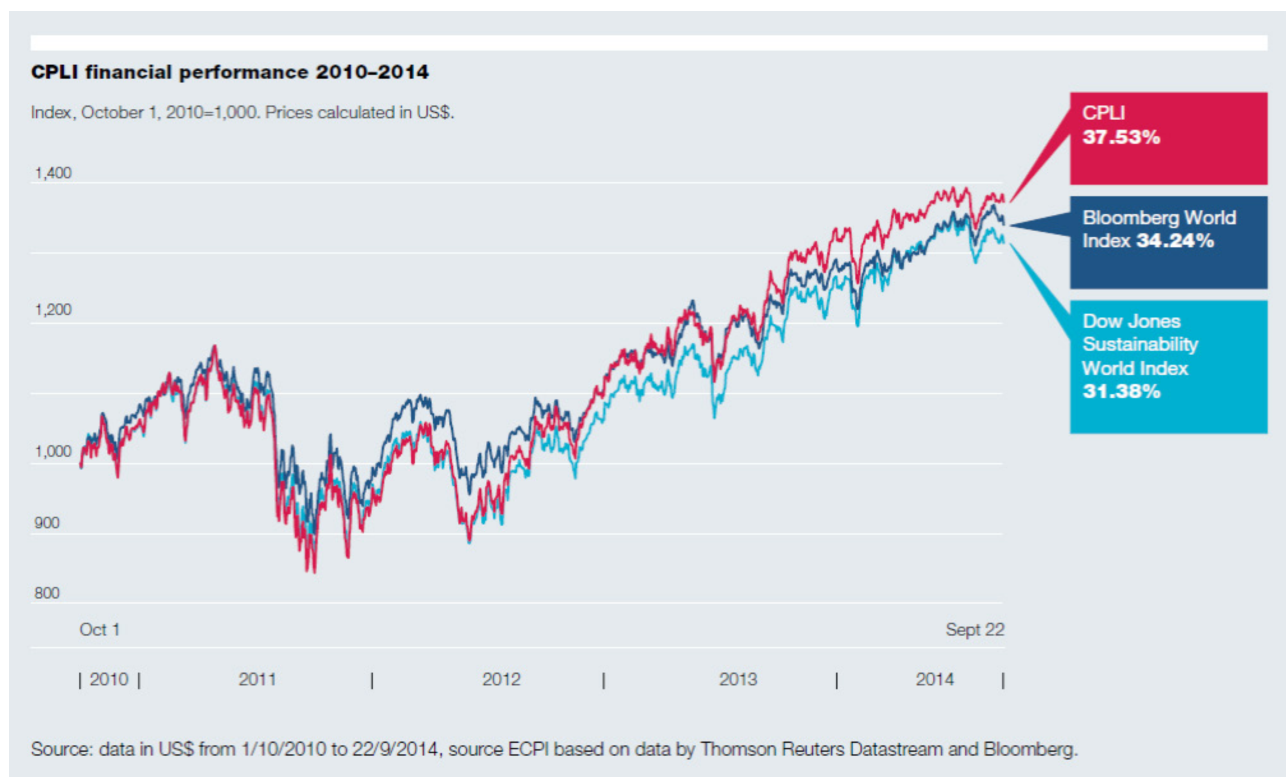

[51]

This is good progress, but it does not meet the scale of ambition required to drag society onto a 2°C trajectory. Weigh these figures against the global insurance sector's $32 trillion of invested assets and the need set out in the 2015 New Climate Economy report for society to "invest at least a trillion dollars a year in clean energy"[49], and it is clear there is a lot more that can be achieved if the industry has the will to make that step change and the external conditions are in place to facilitate it.

In parallel to positive fixed income investment behaviour, insurers are facing significant public and media pressure to consider environmental sustainability in their equity investments, with high profile divestment campaigns[50] encouraging firms to channel investment away from the most carbon intensive firms. The divestment debate is controversial and generally over-simplified, given the range of factors which investors need to bear in mind. Certainly, a firm shifting its focus away from carbon intensive industries rapidly and deeply is a decision not to be taken lightly. Nevertheless, the financial and risk based case for considered action in this space is growing. Firstly, to mitigate against the risk of asset stranding, where carbon intensive firms find that a significant part of their valuation is built on the ability to burn carbon that ultimately turns out to be unburnable in a low carbon world. Secondly because there is a growing body of evidence (see the graph above) that shows indexes covering the most progressive firms from a climate perspective consistently outperforming mainstream indexes.

So how can our industry build on the progress which has been made in recent years in order to deliver the step change in investment behaviour that underpins a two degree trajectory?

### 1. Make the most of Paris

The Paris summit promises to be a seminal moment, a window of opportunity for global climate policy, and will be a high point for the profile of the issue. Insurance and savings providers have an opportunity to achieve dual benefits. First, taking actions and making statements which demonstrate their important enabling role in solving a massive societal challenge, and as a result enhancing their individual reputations and that of the industry as a whole. Second, use any legally binding agreement from Paris to reassess the level of political certainty underpinning green investment. At present, a lack of long-term policy certainty increases risk and raises the cost of capital, particularly for long-term assets. A key outcome of Paris should be to improve this.

**2. Send positive signals to issuers of green debt**

There are many existing avenues that insurers can use to channel green investment. However, closer working with specialist green investment initiatives, such as the UK's Green Investment Bank, to align opportunities with the industry's needs, will be important, as well as sending an 'open for business' message to potential issuers of green debt such as cities, municipalities and major public sector institutions like the NHS, which may not be fully aware of the alignment between their needs and the needs of our sector.

**3. Embrace collaboration**

Responding to climate change is a complex, systemic challenge, which a collaborative response is vital to. ClimateWise[52] - part of the Cambridge Institute for Sustainability Leadership - is the global insurance sector's leadership group on climate change. It provides a platform for the sector to unite, share expertise and engage in collaborative action research with key stakeholders – such as issuers of green debt – to develop the knowledge on how the industry can respond to climate change in positive and proactive ways. Now is the ideal time for the industry to become more involved in collective leadership initiatives that organisations like ClimateWise can provide.

**4. Continue to push for a more enabling regulatory environment**

The industry can only deliver a step change in green investment if this is compatible with the regulatory framework in which it operates. This is not a given. For example, the treatment of infrastructure investments in Solvency II has been identified as a significant barrier to the industry investing in the infrastructure that is required for sustained economic growth in the EU. To 'sustained' we should add 'sustainable'. The European Commission has proposed tweaks to Solvency II to incentivise infrastructure investment, and it is vital that such changes are meaningful, and delivered promptly. Equally, in the UK, working with the Bank of England as they begin to align their growing climate agenda with their established regulatory practice, is an important next step.

**Ultimately, long-term, sustainable economic growth, for which a step change in green investment is a critical precursor, is vital for the long term prospects of the whole insurance and savings market. It is literally an issue that no firm can afford to ignore.**

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