Upon the door of every cottage...

Protecting the public through general insurance

1912–2012
A CENTURY OF PROFESSIONALISM

CII

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The CII would like to thank Ben Stafford and Cameron Penny, both of Cicero Consulting, for their help in compiling this report and reading through the drafts.

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If I had my way, I would write the word "insure" upon the door of every cottage and upon the blotting book of every public man;

Because I am convinced, for sacrifices so small, families and estates can be protected against catastrophes which would otherwise smash them up forever.

”

Winston Churchill, Manchester, 23 May 1909

Foreword

Insurance plays as pivotal a role in society in the twenty-first century as it did when Winston Churchill gave his famous "upon the door of every cottage and the blotting book of every public man" speech in 1909.

Now, as then, we rely on insurance for so many aspects of our lives. We rely on it to protect our homes and loved ones, and secure our possessions. We rely on it to give us peace of mind while travelling, be it down the road in our car, or across the globe. Hence the importance of building public confidence in the general insurance market.

The insurance industry has made major strides, collectively as a sector and individually as firms, to improve standards – as demonstrated by the Aldermanbury Declaration in 2010. But, the PPI mis-selling and collateral damage from the banking crisis have challenged public confidence.

This report sets out some of the challenges in our market. We asked a series of contributors to describe some of the issues the sector faces. These contributions range across stakeholders in the insurance landscape, including the regulator, firms, trade and consumer groups, politicians and commentators. It seeks to examine the issues and stimulate thinking about solutions that lead to better outcomes for customers and the insurance profession.

The insurance sector faces a choice. It can adopt a reactive approach to the issues it faces, or it can respond with vigour and enthusiasm towards finding solutions. The insurance profession has demonstrated with initiatives like the Aldermanbury Declaration and commitment to Chartered status that it can lead by improving standards and culture for the betterment of the sector, consumers and the wider public interest.

Dr Alexander Scott
Chief Executive, CII

April 2013

Executive summary

CII Introduction & analysis – The magic of averages to the aid of the millions: Protecting the public in the 21st century

- Good insurance lies at the heart of protecting the public, however some stakeholders are debating whether the sector is working effectively.
- Some are concerned whether the sector is able to respond to a changing society.
- Others debate whether its market practices are effective and fair, or whether they are simply features of the way insurance is designed.
- Meanwhile another debate ensues about the extent to which financial regulation and industry initiatives are dealing with these issues.
- The sector as a whole is on a journey towards better public trust and confidence, and it must be proactive in improving public attitudes.

Part 1 – A changing society and market

Responding to challenges in general insurance
Amanda Blanc ACII, Chartered Insurer and CEO, Commercial Lines & Personal Intermediary, AXA Insurance

- The sector faces major challenges, but these also present an opportunity for us as firms to show our capability in responding to change.
- The greatest challenge is building public trust and confidence, and this sector must demonstrate a relentless search for improvement at the individual level rather than waiting for some outside agency or force to change things.
- Central to this is a commitment to professionalism, not just improving knowledge but proactively creating the right conduct and culture within our organisations.
- The omens are good for our sector achieving this, and significant progress is already being made through initiatives such as the Aldermanbury Declaration and Chartered status but more work needs to be done to make this the industry standard.

The interconnectedness of risk and the need to develop long-term partnerships between the insurance industry and government
Sophie Spink, UK Head of Government and Industry Affairs, Zurich

- Government needs to think about public policy issues from a long-term perspective.
- Regulation needs to be stable and changes to it must be well signposted.
- Regulators, government and industry must maintain an active dialogue around key risks for the short-, medium- and long-term.

Flood risk: Planning in England and Wales
Professor David Crichton FCII, Chartered Insurance Practitioner and natural catastrophe researcher

- Local communities should receive direct revenue from new developments to fund local flood defences.
- The current planning system and recent reforms do not offer enough protection against the dangers of building on flood plains.
- Homes built since 1971 are more likely to be damaged by flooding and cost more to repair.

Part 2 – Insurance design, marketing and sales practices

Citizens Advice – Case Study: If we had the chance to do it all again, would we? Lessons from the great British PPI truth and reconciliation scandal

Teresa Perchard, Director of Policy & Advocacy, Citizens Advice

- A failure of ethics drove the mis-selling of a product that, sold properly, had a benefit to consumers.
- Some form of replacement for PPI might be possible in the future but this must be a fair, simple to understand and transparent product offering.
- The customer must come first and that focus starts with business leaders.

Protecting the public in general insurance: Issues affecting consumers in the general insurance market

Adam Phillips, Chairman, Financial Services Consumer Panel

- The biggest challenges within the general insurance sector, as in many other financial services, seem to relate to culture and how consumers are treated within the sales and post-sales process.
- In particular, there needs to be a re-balancing of information, and matching of expectations about what is being offered, between consumer and provider.
- Long policy documents may be transparent and clear, but they are seldom read and understood, as any of us who click through computer software and privacy agreements without reading them will understand.
- Ensuring consumers are easily able to determine what is covered within a product, and are able to choose the right cover based on this information, is in the interest of all sides.

Understanding the needs of an ageing society

Gordon Morris, Managing Director, Age UK Enterprises

- Insurers must adapt to the needs of older consumers, particularly given future changes to the UK's demographic makeup.
- Older consumers are likely to demonstrate greater loyalty; it is time for product providers to recognise and reward this.
- Discrimination and access to products for older consumers is an issue and insurers must ensure accessibility.

Protecting the public: the ombudsman's impact is 'just'

Caroline Mitchell, Lead Ombudsman, Casework Policy for Insurance and Investment, Financial Ombudsman Service

- The Financial Ombudsman Service's remit has expanded significantly since its inception.
- The insurance industry must show that it is prepared to take the lead in dealing with public policy issues, rather than being forced to address these by the FOS and statute.
- The FOS will continue to focus on preventing complaints in the first instance, rather than dealing with them afterwards.

Part 3 – Solutions: Balancing regulation and industry initiatives

Regulatory reform: Change under the FCA

Simon Green, Head of Department, Wholesale & General Insurance Markets, Financial Conduct Authority

- Behaviour and conduct will be at the core of the FCA's oversight, including staff incentivisation and how management deals with conflict and risk.
- The FCA will maintain a proactive interest in product development such as telematics.
- Product design and specific features will be monitored closely by the regulator, and the supply of certain products constrained or prohibited based on risk to consumers.

The view from Parliament: Let's have 'necessary and proportionate' regulation

Jonathan Evans MP, Chairman, All Party Parliamentary Group for Insurance and Financial Services

- Following reforms such as the Retail Distribution Review (RDR), the regulators should re-calibrate how they approach the insurance industry and allow recent initiatives to deliver enhanced professionalism.
- Technology should not completely remove the personal element in customer-provider relationships.
- The Financial Conduct Authority (FCA) should monitor the use of outsourcing companies by the insurance industry, to ensure this does not have a deleterious effect on processing claims.

Demonstrating the value of insurance to our customers and society

Huw Evans, Director of Operations, ABI

- Value is highly subjective and insurers must find a way to demonstrate it through more than the price of their products.
- The industry works well when it aligns positive policy change with reducing unnecessary cost, this is a particular focus in the motor sector at present.
- Insurers must step up and embrace the transparency agenda.

The challenge: The industry must lead rather than follow public policy debates

Jonathan Swift, General Insurance Journalist, Incisive Media

- The insurance industry has not, but must, make headway in educating the public about its value.
- The industry should be proactive in its dialogue with policymakers.
- Reputation takes a long time to build and a short time to lose; insurers should tackle problems head on rather than letting them fester.

Trust, motivation and ethical culture: Some thoughts for financial services firms

Duncan Minty ACII, Chartered Insurance Practitioner and independent adviser on business ethics

- Firms that "do the right thing" should receive a regulatory dividend in the form of less onerous oversight.
- Firms should incorporate ethical key performance indicators (KPIs) into remuneration structures, and regulators should monitor these.
- Regulators should more actively enforce current rules, to create a greater fear of being caught.

“It is not only a question of collective strength of the nation to render effective the thrift and the exertions of the individual, but insurance brings in the magic of averages to the aid of the millions.”

Winston Churchill, November 1909

The magic of averages to the aid of the millions: Protecting the public in the 21st century

Summary

- Good insurance lies at the heart of protecting the public, however some stakeholders are debating whether the sector is working effectively.
- Some are concerned whether the sector is able to respond to a changing society.
- Others debate whether its market practises are effective and fair, or whether they are simply features of the way insurance is designed.
- Meanwhile another debate ensues about the extent to which financial regulation and industry initiatives are dealing with these issues.
- The sector as a whole is on a journey towards better public trust and confidence, and it must be proactive in improving public attitudes.

Introduction: the challenge for insurance

Good insurance lies at the heart of protecting the public. For centuries, insurance has provided an efficient approach to mitigating the worst effects of misfortune. It does this through what Churchill described as "the magic of averages to the aid of the millions": by sharing the costs borne by the claiming few across the risks of the many. In so doing, insurance has made society more resilient to shocks while freeing up government resources to be spent on the few dangers that cannot be insured.

But is the insurance sector living up to this role? Many can cite examples of insurance rising to the call in society's time of need. There are some, however, who are less optimistic, expressing concerns about customers paying over the odds for policies of questionable value. They question whether the sector is up for the complex future challenges, such as climate change, cyber threats and an ageing population. A debate is clearly at hand, extending across three broad fronts:

- changes in the insurance market and society more generally, with mass-market commoditisation and emerging challenges;
- issues about how insurance is developed, priced, marketed and sold to the public, be they retail consumers or businesses; and
- how to respond to these issues, including the role of statutory regulation, industry-led initiatives and professional standards.

This paper examines and confronts this debate. We asked twelve contributors spanning the insurance landscape to describe some of the issues the sector faces in this environment. In so doing we take a fresh look at these areas, and stimulate thinking about solutions that lead to better outcomes for both the insurance profession and the public at large.

> *"We take a fresh look at these issues in general insurance, and stimulate thinking about solutions that lead to better outcomes for both the insurance profession and the public at large."*

Part 1 – A changing society and market

The last several years have seen major challenges confronting the insurance market, only some of which are down to the financial crisis and world economy. The key issues can be summarised across two key themes:

Insurance for the mass market

The need for insurance has reached unprecedented importance in modern times. More affluent consumers possess more products and undertake more activities that need to be insured. For example, take three aspects of everyday life: motor, home ownership, and foreign travel:

- On the roads, there is now slightly more than one car on average for every household in Britain, compared to under half in 1971.[1] There should be no surprise that mandatory motor insurance is now the largest single category of the personal lines market, making up about 37% of all personal lines Gross Written Premium (GWP) in 2010.[2]
- Household insurance has the second largest share at 29% of all personal lines GWP.[3] Although property owner-occupancy in the UK has declined slightly in recent years following the mortgage crisis; this still accounts for about two-thirds of all residential properties, compared to only a third in 1959.[4] Finally
- While foreign travel by UK residents has decreased slightly in recent years, given exchange rates and the recession, 2011 still saw on average just under one foreign visit for every member of the UK population, compared to just under half in 1990.[5]

Aside from these three insurable activities, people are buying more insurance. The value of the industry itself across the various lines has grown: personal lines GWP for motor, property, general liability, accident & health and pecuniary loss have all grown by on average about 2–3% annually from 1990 to 2009.[6]

The advent of mass market insurance has led to fundamental changes in product design and distribution. Products have become commoditised, with standard terms and sophisticated—and sometimes not so sophisticated—risk pricing techniques. Aggregators are challenging direct writers for control of distribution, with 50% of new private motor business generated this way in 2011.[7] Research suggests that consumer brand awareness of aggregators is as high as it is for many insurers.[8]

Several of the contributions in this report allude to these changing market conditions. Most notably, Amanda Blanc of AXA UK gives an insurer's perspective and focuses primarily on trust. She describes some of the challenges to this market and explains that building public trust and confidence is, in her view, the greatest test. Rising to this will help the industry confront other issues such as technological advancements and dealing with public policy themes such as flood risk, reform to personal motor insurance and fraud.

Emerging risks

The sector is seeing an explosion of claims related to extreme weather, cyber-crime and demographics. Two contributions in this paper allude to these emerging and changing risks. On the subject of climate change and flooding, established expert in this field Professor David Crichton looks particularly at the need for change in the planning system to make communities more flood resilient and in the process demonstrates how insurance plays a key role in determining which climate change future the UK faces. He also argues that the Government's need to be similarly forward looking is long overdue, as recent catastrophes in the UK have demonstrated.

1 RAC Foundation, Car Ownership in Great Britain, Oct 2008.
2 Datamonitor, UK Personal General Insurance, 2011.
3 Ibid.; ABI, UK Insurance Key Facts, Sep 2012.
4 FSA, Mortgage Market Review Data Pack, Supplement to PS12/16, Oct 2012.
5 ONS, Travel Trends 2011, 26 July 2012.
6 Datamonitor, UK Personal General Insurance, 2010.
7 Ibid.
8 Research by Ernst & Young for the CII, May 2010.

Also in this report, Sophie Spink from Zurich describes the implications of these changing risks from the perspective of a major global insurer. She describes Zurich's natural catastrophe response strategy and also looks at how it applies Enterprise Risk Management principles in dealing with other risks. Related to this, the direction of public policy suggests that the take-up of general insurance is set to rise even further, as governments struggle with ageing populations and fewer resources. This is happening right now with pensions and long-term care, but is also beginning to happen in general insurance: witness private medical insurance, personal accident insurance and income protection.

Part 2 – Insurance design, marketing and sales practices

General insurance should be a relatively straightforward retail proposition. It should be easy to understand: policyholders pay a premium in return for cover against pre-determined risks. It has many of the hallmarks of a competitive market: most people are served by a healthy range of providers for most lines; and most policies cover a short time period and have to be renewed annually, which should encourage switching. Despite these hallmarks, the fundamental aspects of general insurance can be quite complex. Many of the issues in the sector derive at least in part from this.

The concept of insurance: a promise to pay

For a start, insurance is a promise to pay in the event of a risk occurring. This is quite abstract compared to other retail propositions. Insurance thrives on the simple human desire for peace of mind: but fundamental to this is the element of trust required to believe that the insurer will actually pay a claim. The "magic of averages", as Winston Churchill eloquently described in his 1909 speech, means that very few customers actually make a claim, so really insurance is a payment for a claim that will hopefully never be made.

Not all risks should be insured

Insurance is not the most efficient solution for all risks. For some risks, simply absorbing the cost of the peril might be a better option, as the cost might not be that destructive. So the customer needs to take a view on how likely the risk could occur and the cost of absorbing the peril. This is not a process that comes naturally to people, and consequently the FSA highlighted "products of limited value" as one of the key general insurance risks in its 2012 *Retail Conduct Risk Outlook*.[9] Which? has also made no secret of its concerns about "potentially unnecessary" policies.[10]

Insurance is often a "sell" rather than a "buy"

While some insurance, such as motor and home, is mandatory, most is voluntary requiring the customer to think about possible risks that should be insured. However, most people tend to only think of the risks that come immediately to mind, either by their own experiences or awareness through friends and family or the news. This human trait is known as the *availability bias*, and its implications on general insurance were described in the book *Nudge*.[11] Consumers therefore have to rely on marketing, which on some occasions presents some interesting implications for sales practices.

9 FSA, Retail Conduct Risk Outlook 2012, pp.77-78.
10 "£100m down the drain: raw deal for water company customers," Which? (May 2012), pp.22-23.
11 Richard Thaler and Cass Sunstein, Nudge (London: Yale University Press, 2008), pp.24-26; Financial Conduct Authority, Risk Outlook 2013 (published 25 March 2013), pp.15– 16.

This is precisely what lay at the root of the recent Payment Protection Insurance (PPI) scandal in the UK. In this report, Teresa Perchard, Head of Policy & Advocacy at Citizens Advice, provides an important case study on this episode in recent history. She details how the scandal developed, how consumer groups tried to raise the alarm, and the various stages of response by the regulators. We are not saying the current issues in the wider general insurance are anywhere near the scale of PPI. However, all stakeholders should be mindful of the causes of that scandal, and why consumers had to suffer for so long before the appropriate safeguards were triggered. As far as the public is concerned, PPI was part of the insurance sector. So in the **public's** mind, the sector needs to show that it has learned its lessons and moved on.

Pricing

In theory, insurance premiums seem a straightforward proposition presenting a relatively fixed headline cost for insuring the risk, normally over the life of the policy. This is not always so clear in reality. A fundamental feature of insurance is the principle that risks are priced accordingly, and are often inherently specific to the policyholder.

Risk-pricing can give rise to potentially discriminatory generalisations: age, lifestyle and location can all be risk determinants. The European Court's ban on gender pricing has placed this under scrutiny, and arguably could lead to future rulings on other determinants such as age and disabilities. This not only presents the challenge of creating a form of pricing that balances individuality with equality; it also provides a test-case of the need to respond to the societal challenges described above. In our report, Gordon Morris of Age UK describes the scale of the problem for older consumers, and questions whether the sector is responding adequately to the ageing population. If this is how the sector is handling the ageing population, how will it fare for diversity, cyber-crime and other emerging risks?

Transparency

A related element of pricing and insurance is that the product features underpinning that price are not always the same. This transparency issue has been the focus of the regulator's pre-sale "Key Facts" disclosure material introduced in 2005, an approach predicated on consumers prioritising in advance what features are most important to them. In practice, those consumers who do shop around, do so on the basis of headline price without considering the product features.

Simon Green, Head of General Insurance at the newly formed Financial Conduct Authority (FCA), explains the regulator's new approach of looking more closely at pricing processes, as part of its general approach to product design and distribution. While pricing itself is a competition issue that is still outside the FCA's remit, the Authority can still look at how firms approach pricing with respect to their wider business model. Meanwhile, Adam Phillips of the Financial Services Consumer Panel (FSCP) highlights pricing as being fundamental to consumer protection. He suggests that transparency might be tackled with the creation of baseline specifications for the various personal lines. This would have a set of minimum essential features that must be included, which might help consumers better compare like with like.

Claims may not go as expected

Claims is the landmark moment for insurance customers, where the insurance "promise" is tested. Insurers must assess the legitimacy of the claim and then explore the damages incurred based on market factors. While this is fundamental to insurance, there are issues arising that question the extent to which insurance lives up to its "promise".

One issue is the quality and speed of the claims process and the integrity of outsourcing claims management and loss adjusting. Again, Adam Phillips of the FSCP describes the claims management experience as one of the "biggest areas of dissatisfaction" for consumers. He particularly highlights outsourcing and the implications for customer service, as well as payment and incentive structures.

Another, even more controversial, issue in claims is the charge that some insurers may actually be underwriting risks at claim rather than contract stage. This appears to lie at the root of the concerns expressed by Caroline Mitchell of the Financial Ombudsman Service. Consumers were effectively paying premiums for years, for policies that had not been properly assessed. Only when a claim was made did insurers actually check to see whether the policy was appropriate in the first place. This activity formed the basis of the call to review consumer insurance contract law, in no small part influenced by case law decisions by the Ombudsman.

Part 3 – Solutions: balancing regulation and industry initiatives

Having discussed the issues confronting the sector, we will now turn to the various responses by the regulator and industry.

Regulation

Changing market practices have resulted in major reforms to insurance regulation, on the back of concerns about conflict of interest and selling practices. Insurance selling was fully self-regulated less than a decade ago. Only in 2005 did a multi-layered FSA statutory regime come into force. April 2013 saw this being strengthened still further with the introduction of the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA).

Three contributions in this report discuss the changing regulatory landscape. The FCA's Simon Green provides an overview of the regulator's new approach to supervising the insurance industry, looking at such things as senior management, product design, and business models.

Meanwhile, Jonathan Evans MP stands back and looks at the changing structures from his position as Chair of the All-Party Parliamentary Group for Insurance and Financial Services. He asks whether the regulator will be sufficiently ahead of the curve on issues like claims management companies and new technological developments.

Perhaps the FCA's new approach, promising a better culture rather than just regulatory processes, will play a stronger role in changing performance and improving consumer outcomes? It's Business Plan, published at the end of March 2013, went into more detail on the regulator's focus on culture, and shows how the points summarised in Simon Green's paper will look in practice. Whereas previously, firms were regulated through rules and principles, the FCA plans to take a more holistic view of how firms are treating their customers. As PRA Chief Executive Andrew Bailey put it to *The New York Times*, "You can't regulate culture, but we expect standards that put more emphasis on the public interest."

Industry solutions

This new regulatory approach is clearly predicated on a significant degree of buy-in and support from the sector, in order to realise the better culture and public interest outcomes. So now, more than ever, the key to building trust and confidence is striking the right balance between statutory financial regulation and industry-led solutions.

> *"Now, more than ever, the key to building trust and confidence is striking the right balance between statutory financial regulation and industry solutions."*

CII introduction & analysis

The insurance industry comes from a good starting place compared to the rest of the financial services sector. Many of the issues described above—the promise, insurability, availability bias, risk-pricing, and distribution issues—all stem from fundamental features of the market which are, in most cases, fairly benign.

As Dr Scott sets out in his foreword, the sector must not rest on its laurels but confront these issues head on. Even if they are a by-product of the overall insurance proposition, they still need to be examined, and improvements need to be considered. Some of those challenges and issues are very real concerns.

The industry is working on initiatives. Huw Evans of the Association of British Insurers describes in his contribution some of the work the industry is doing to respond to the issues summarised above. For example, in motor insurance, the trade association is working to reduce costs through better processes, addressing the massive issue of whiplash claims, and improving road safety through initiatives like graduated licensing for young drivers.

However, industry-wide public policy responses do have their limitations. Insurance trade press journalist Jonathan Swift takes a spectator's look at how the sector has responded to issues in motor insurance over the last few years. His prognosis is that despite some collaborative actions in recent years, more could be done, and that there is only so much that industry-wide public policy activity can do. The rest has to be down to firms themselves, and the people who work for them.

Professionalism: The role of the people in the industry

For many of those issues, it is down to the practitioners of the industry to exercise professional judgement at all levels in the insurance process: from underwriters who price the products, brokers who sell them, and claims staff that assess whether or how a payout should be made. Amanda Blanc's essay describes how firms that demonstrate professionalism at a corporate level require the adoption of professional standards, not just by individual staff, but as a culture within the firm:

- Executive management: staff must have the necessary experience and expertise to ensure that the business model is sustainable and to implement the model effectively;
- Corporate systems and controls, including corporate governance: these should exert appropriate levels of control over the running of the business including risk management, maintaining adequate capital, record keeping, training and competency programmes, and developing a culture that encourages the fair treatment of customers; and
- Employee professional support: encouragement of professional standards for employees through supporting technical training and development and encouraging appropriate behaviour.

Amanda Blanc describes how initiatives such as the insurance sector's Aldermanbury Declaration aim to entrench these principles across firms. As AXA Commercial and Intermediated Personal Lines CEO, she comes from a unique position of understanding how relevant these issues are to retail as well as commercial insurance markets. She was also a founding member of the task force of sector leaders that put together the Aldermanbury Declaration, and explains that promoting professional excellence and high ethical standards will have a strong and positive effect on improving public confidence across insurance. There should be no reason why initiatives that are making significant progress among firms in the commercial insurance sector should not also extend to the retail markets.

Nearly 180 general insurance firms, including some major brands, have adopted the CII's Corporate Chartered status that codifies these three principles in a more formal professional body commitment. Duncan Minty explains in this paper why this take-up of Chartered status is an important milestone. He argues that firms should incorporate ethical key performance indicators into remuneration structures and regulators should monitor these. This way, firms that "do the right thing" would be incentivised by the regulator in the form of less onerous regulatory oversight. Professional standards can play an important role in improving the quality and perception of the insurance market. It is also complementary to the new regulatory focus on industry culture and standards described above.

How does this translate into practice?

So how do these professionalism principles actually work to make a difference to customers? This is the ultimate question for any professional body, and one where ready-made and easy-to-observe causal relationships are not available. Consumers know in their minds that better qualified professionals do give better service, and surveys indicate that they trust Chartered practitioners more than others.

Returning to the issues described as an example, insurability and pricing transparency are about treating customers fairly and ethically. Telematics in motor and life insurance shows the beginnings of a move towards pricing insurance on the basis of *usage* by the specific customer presently, rather than on features of allegedly similar users in the past. It is an example of people at various levels of the industry applying professional knowledge and considering ethical principles, from those designing better underwriting methods to realise fairer pricing to those selling the products to ensure it is used in the most appropriate situations.

Aside from these general trends that suggest improvement, the link between higher professional standards and better customer outcomes needs to be better understood. We are undertaking an extensive project assessing customer attitudes through consumer and small business surveys, and designing a set of indices to analyse this data. Over time, this will provide the sector with a valuable tool to measure progress, starting with a "baseline" paper which we intend to publish later this year.

Conclusion: a journey to better public trust and confidence

The general insurance profession, and the sector as a whole, is on a journey towards better public trust and confidence. We have seen in this essay how public attitudes towards insurance are changing, and their expectations are rising. Regulatory changes point to the need for a new mindset in conduct and culture by both individuals and firms, and industry initiatives need to make this happen. In an insurance market in a changing world, it will be down to the people in the sector acting professionally to confront the issues and challenges.

The sector faces a choice. It can take a reactive approach to the issues it faces, or it can respond with vigour and enthusiasm towards finding solutions. The insurance profession has demonstrated—through initiatives like the Aldermanbury Declaration and Chartered status—that it can lead and make the changes required both for improving the sector and the public interest.

Responding to challenges in general insurance

Amanda Blanc ACII, Chartered Insurer and CEO, Commercial Lines & Personal Intermediary, AXA Insurance

Summary

- The sector faces major challenges, but these also present an opportunity for us as firms to show our capability in responding to change.
- The greatest challenge is building public trust and confidence, and this sector must demonstrate a relentless search for improvement at the individual level rather than waiting for some outside agency or force to change things.
- Central to this is a commitment to professionalism, not just improving knowledge but proactively creating the right conduct and culture within our organisations.
- The omens are good for our sector achieving this, and significant progress is already being made through initiatives such as the Aldermanbury Declaration and Chartered status but more work needs to be done to make this the industry standard.

The insurance industry plays a vital role in our society. We provide good employment prospects to large numbers of people in many countries, we raise billions for the Exchequer and we provide financial security for our customers. However, our industry faces some major challenges that we must be prepared to confront and I believe those challenges also present an opportunity for us to show just how capable we are in responding to change.

The challenges

Recent years have not been the easiest for financial services. The LIBOR scandal and the Independent Commission on Banking Standards have uncovered revelations about ethical practices, and the PPI episode has resulted in 11,000 complaints per week. More recently, the general insurance sector has been hit by the ban on referral fees and increased levels of insurance fraud. The public perception of financial services as a whole has taken a battering.

Insurance is increasingly important in the global economy. Fiscal conditions may be showing signs of slow improvement but welfare states are being pressured to reduce their deficits and many are cutting public spending. Growth in Europe needs to be supported by long-term investment, so insurers like AXA have a key role to play: we are managing clients' long-term assets and we must match those assets with long-term liabilities, effectively making insurers structural long-term investing agents in our economies.

Meanwhile our industry is changing significantly. We have seen the emergence of higher market volatility, new types of risks such as climate change affecting our both property and casualty lines; and opportunities offered by new markets and geographies. Insurers have to adapt their offering and risk appetite to this changing environment in order to grasp new growth levers. At the same time, it is all the more important that financial regulation looks at us through this new lens as well: the way insurers are regulated must reflect the reality of our economic and financial environment.

Changes in clients' needs and behaviours are another significant long-term challenge for insurers. As bookshops and travel agencies have adapted to survive the e-economy revolution, insurers must redefine their business model and culture towards digital and multi-access. This is a long journey but I believe AXA is well positioned to benefit from this great opportunity.

The greatest challenge of them all

As critical as all these issues are to the sector, there is one that in my view that overshadows them all: public trust and confidence. Without that, confronting the others will be difficult or impossible. It is something that has to be built over time, and through a range of actions that extend across the sector in both personal and commercial lines.

Thinking about these issues, I am reminded of the crisis that confronted cycling earlier this year. Revelations about doping and cheating damaged public confidence in that sport. So cycling was faced with a dilemma, carry on as if nothing was wrong, or face up to the issues and deal with them. One team has taken a very public position. Team Sky invested heavily in technology, facilities and training – all geared to make their team the very best it can be, and also help their cyclists to win individual medals and honours. Their relentless search for improvement at the individual level is a lesson for us all. Those cyclists are utterly dedicating themselves to the pursuit of absolute excellence. They were not waiting for some outside agency or force to change things.

The importance of professionalism and culture

Our industry is, in a sense, not very different. It has taken outsiders to point out the mis-selling of PPI, the problems with referral fees, add-ons, commission, and questionable executive remuneration. I truly believe that core to building public trust and confidence is a commitment to professionalism. Not just improving knowledge levels but proactively creating the right culture within our organisations. Corporate ambitions absolutely must include greater emphasis on personal performance and behaviour. Product development, sales strategies, marketing methods and all core technical processes, such as claims handling, must be performed ethically and in a way that gives consumers real and justified confidence in our products and services.

How do we create the necessary positive cultures? As a sector, I think we need to encourage and reward three things more substantially than we do now: professional qualifications, professional development and ethical behaviour. Finally, we must absolutely condemn bad behaviour and unethical practices in our profession whenever we encounter them, particularly in our own companies.

> *“We need to encourage and reward three things more substantially than we do now: professional qualifications, professional development and ethical behaviour.”*

These traits also transcend the spectrum of insurance lines businesses. Whether you provide insurance for commercial firms or retail consumers, instilling a positive corporate culture through training, improved professional judgment and ethical conduct will influence end-customers in a way that improves public – not just consumer – trust and confidence. AXA believes that improving professional standards and culture at all levels, in so doing creating a positive image of insurance for the public, is vital to our business.

Positive steps towards professionalism: the Aldermanbury Declaration

I think the omens are good for our sector achieving this necessary cultural change. Significant progress is already being made. I participate in a General Insurance Professionalism Task Force which was formed in March 2009 comprising various players within the industry, including the CII. Our aim was to look at ways the market could adopt more professional standards and, as a result, instil greater confidence among our customers. Out of that task force came the Aldermanbury Declaration, a statement of intent by the sector on various ways it would create a professional culture within firms. It provided both a starting point and target to achieve just that sort of culture change we all wanted to see.

While the CII supported us with its knowledge and experience in this area, I must stress that the Task Force and the Aldermanbury Declaration were both thoroughly market constructs. This aspect was absolutely vital in this setting of increasing government regulation. This project to change culture would not have worked without the knowledge that the initiative was developed by firms, for firms.

Three years later, there are now 30 insurers, including AXA, plus 163 brokers signed up to the Aldermanbury Declaration. Between this and Chartered status which AXA has also embraced, these initiatives have become the standards to which all good insurance businesses aspire. I am convinced that there will come a time when these standards will be the norm: meeting them will be the basic expectation of all those operating in insurance.

We embraced these initiatives because we have long recognised the value of customer confidence. Although challenges such as reacting to changing customer patterns, an evolving economy and climate change are daunting, improving public trust and confidence are essential. It would not be reasonable to be pessimistic, but equally unreasonable to rest on our laurels and ignore these challenges. Significant steps have already been taken by the sector in embracing professional standards, but we think more firms need to see the benefits of doing the right thing.

“Although challenges such as reacting to changing customer patterns, an evolving economy and climate change are daunting, improving public trust and confidence are essential.”

The interconnectedness of risk and the need to develop long-term partnerships

Sophie Spink, UK Head of Government and Industry Affairs, Zurich

Summary

- Government needs to think about public policy issues from a long-term perspective.
- Regulation needs to be stable and changes to it must be well signposted.
- Regulators, Government and Industry must maintain an active dialogue around key risks for the short-, medium- and long-term.

The old saying goes that "a week is a long time in politics", but even a week seems an eternity in the immediate, social media-driven world that we now inhabit. Politicians are not alone, however. As governments, businesses and individuals all try to cope with immediate, urgent pressures, it can be tempting to put longer-term problems into the 'too difficult' pile.

The trouble with that approach though is that, as a global community, we are facing some difficult long-term challenges, such as demographic and climate change. Those are issues that need to be tackled well in advance and, as a result, we need to ensure that we learn the lessons from past inaction or halted progress.

Insurers find themselves in the challenging position of modelling the size and nature of extreme events, as well as determining if the efficacy of risk systems themselves to the more extreme impacts that could occur. This is in addition to tough market conditions and ongoing challenges in terms of public trust.

Take 2011 for example – the highest-ever loss year in terms of natural catastrophes, whose shifting scale and nature warrants ongoing attention from our industry. Yet it was also a year in which global economic pressures continued to loom large. This is a point that emerged strongly from this year's Global Risks Report, which brings together the views of over 1,000 experts on future risks or 'megatrends'. The conclusion reached was that economic and environmental stresses appear to be set on a collision course. Many countries are still struggling to cope with weak economies. However, at the same time, the next big global challenges are just over the horizon, including threats from climate change, pandemics and a growing resistance of bacteria to antibiotics, as well as threats from the digital age and the rapid spread of information in so-called 'digital wildfires'.

The nature of these risks is complex, global and often interconnected. The responses needed are both global and local, and also focused on both the short- and long-term. Building resilience on a national level is critical.

One approach is to apply the principles of Enterprise Risk Management (ERM) to countries. ERM is a discipline that typically involves: identifying risk and opportunities related to the organisation's objectives, assessing these in terms of likelihood and magnitude of impact, determining a response strategy, and monitoring progress. A similar approach would enable a nation to 'join up the dots' and take all the risks it faces, and will face in the future, into account. It can then plan wisely, cope during a crisis, withstand and recover.

Zurich Municipal took this theme a step further to analyse the impact at the community level. In our 'Risk and Response' report, undertaken with Ipsos Mori, we considered how the public sector deals concurrently with responding to major incidents while also facing an extended period of austerity. The report proposed a holistic "roadmap to resilience", including board-level responsibility for risk, business continuity management and developing crisis management plans. Arguably, a similar approach needs to be taken by central government.

In addition, politicians, business leaders and scientists need to get much better at planning for the future and three essential things need to be in play:

- Regular dialogue with key sectors that puts the long-term issues above short-term political or commercial gain.
- Stable regulatory and legal frameworks that protect the consumer but recognise that, while most businesses agree that some regulation is good for them, it should be proportionate and encourage innovation.
- Consideration of the growing need for public and private partnerships that marry together experience, expertise, R&D and innovation with strong policy options. Current areas being discussed in these terms include flooding, pensions, long-term care and the transition to the low carbon economy.

Linked to this last point is the issue of trust. Solutions developed by politicians and the financial services industry at this point in history are likely to be met with a reasonable dose of scepticism. The financial crisis and parliamentary expenses scandal had far-reaching effects, even for those not directly involved. Trust and reputation are not areas that will change overnight. Therefore, big discussions about longer-term problems that affect every individual, as well as the design of any future public/private solutions, must include input from a wide range of stakeholders. And it needs a long lead-time. Waiting until the 11th hour and trying to rush through an unsustainable solution is in no-one's interests.

“ *Waiting until the 11th hour and trying to rush through an unsustainable solution is in no-one' s interests.* ”

One of the key things about designing future solutions is that, sometimes, we need to break out of our comfort zone. For well over a decade, the search for a solution to the pensions' time-bomb has been ongoing. The area of compulsion or incentives, in particular, has always been a politically thorny one. Indeed, there is no guarantee that people will respond to the more recent suggestions of tax incentives for long-term care, or frameworks such as auto-enrolment into pensions. But, ultimately, the situation is not going to mend itself. We face a number of challenges, domestically and internationally, where we may have to accept the need to be bolder as a society about moving away from the status quo.

Governments need to spell out the consequences of inaction and focus beyond the next electoral term; the insurance sector needs to be ready to respond to the changing risk landscape by developing relevant products and services; and individuals need to become less reliant and more personally responsible for their own lives and futures. This is, of course, a real challenge. But ultimately, we all lose if we do not play our part.

Flood risk: Planning in England and Wales

Professor David Crichton FCII, Chartered Insurance Practitioner and natural catastrophe researcher

Summary

- Local communities should receive direct revenue from new developments to fund local flood defences
- The current planning system and recent reforms do not offer enough protection against the dangers of building on flood plains
- Homes built since 1971 are more likely to be damaged by flooding and cost more to repair

It is not the role of insurers to dictate planning policy. However, some might say that insurers have a duty to warn society if current policies are likely to lead to problems with the availability or affordability of insurance. Indeed, for many years, I have been in close dialogue on such issues with almost every local authority in Scotland and this has helped to reduce flood plain development to zero in most of Scotland. The position is rather different in England and Wales, where vested interests have taken over the planning process.

Planning in England and Wales: Top down or bottom up?

England's National Planning Policy Framework (NPPF) was published on 27th March 2012. It is much shorter than all the previous planning policy statements and was written by a small coterie of civil servants with little effective input from practitioners or experts. It pays only lip service to sustainable development, then neatly sidesteps it. Concepts such as social justice and equity seem to escape it completely. There is no longer (if there ever was) any clear guidance on issues of interest to insurers, such as preventing building in flood plains. Indeed, in Wales, the then environment minister (now the First Minister) specifically instructed in 2006 that flood plain development should be resumed. Not that there is much building actually going on anywhere in England or Wales any more.

When Eric Pickles became Communities Secretary in May 2010, one of his priorities was to do something about new housing construction. The Department's website says:

"For decades, there have not been enough homes to meet the needs of our growing and ageing population. From 2009 to 2010, only 115,000 new-builds were completed in England – fewer than any year in peace time since the 1920s and nearly a quarter of a million homes in England have stood empty for more than 6 months."

The housing market is also one of the biggest casualties of the 2008 global credit crunch and the government's priority has been to rectify a situation where lenders couldn't lend, so builders couldn't build and buyers couldn't buy.

The government intended to increase the supply of housing by providing financial assistance for projects and buyers, and by removing unnecessarily complex regulations. This meant big changes in the planning system. The 2011 Localism Act was to replace any form of "top down" approach with a "bottom up" system. The position is summed up in a government guide to the Localism Act:

"Instead of being able to act only where the law says they can, local authorities will be freed to do anything – provided they do not break other laws."

At the same time, the guide makes it clear that the powers of local authority planners would be reduced and decision making transferred to individual neighbourhood communities.

“This Act passes significant new rights direct to communities and individuals, making it easier for them to get things done and achieve their ambitions for the place where they live.”

This means that every neighbourhood has the right to write its own development plan, and this is being seen as a NIMBY charter. People living in nice houses are probably not keen to see their neighbourhoods developed with new, high-density social housing, for example.

Pickles wrote to council leaders in May 2010 to state his intention to discard all the previously agreed strategic plans. Previously, local councils had come together in groups to propose housing numbers and locations in a co-ordinated way. They could work in conjunction with River Basin Management Boards, established under the Water Framework and the Flood Directives, to help to avoid development in flood hazard areas, working on a catchment-wide basis. These Regional Spatial Strategies (RSS) are now condemned as “top down”, even though in practice they were a compromise between the views of individual communities and local objectors. But Pickles insisted they would have to go, which had the almost immediate impact of reducing planned housing targets. Also discarded was the National Housing and Planning Advice Unit (NHPAU), which had been set up in 2006 to give advice on regional housing targets.

As a result, after only two years, houses that had previously been permitted in regional plans can no longer be built. The amount of new housing has been reduced by more than 270,000 from the RSS figures, according to research in 2012 completed for the Policy Exchange by Tetlow King Planning.

Tetlow King Planning states that:

“...local authorities across England have reduced their housing targets by a total of more than 270,000 from RSS targets. The largest reductions have been in the areas where housing affordability problems are the most acute – the South West, South East and East of England. The report provides a treasure trove of information and statistics on how localism is impacting on housing targets.”

And all this because of a letter of intent written in 2010. RSS targets have not been abolished yet, two and a half years later. It is not clear why. One problem is that removing the targets would mean that new development plans for those areas would then be subject to the Strategic Environmental Directive, requiring much more “red tape”. In the meantime, Government has become concerned at the collapse of new house building, due to its bottom up strategy and, in a major and relatively unpublicised “U-turn”, has introduced a number of “top down” initiatives. For example:

Removing regulations

Government has already said that it does not intend to change building standards to require new homes to be more resilient to storm or flood damage. Already, insurers know that modern homes are more likely to be damaged and to need more costly repairs than homes built before 1971. If building standards were to be relaxed even more, then this would cut the costs of construction but impact insurance costs.

> “*Insurers know that modern homes are more likely to be damaged and to need more costly repairs than homes built before 1971.*”

New Homes Bonus

Local authorities can keep, for six years, the council tax income from all new housing built in their area. It has been claimed that this £1bn government scheme to encourage house building will benefit rich areas in the south of England, at the expense of poorer councils in the north.

Councillors in a number of northern authorities say the New Homes Bonus effectively moves millions from deprived neighbourhoods to affluent parts of the country.

The government says the scheme fairly rewards those councils that allow much-needed homes to be built.

"Buying" planning permission

Under this proposal, a proportion of the money from development would go to local groups to improve local infrastructure, instead of it all going to central government. This was introduced by Nick Boles, Minister for Planning, in January 2013, and he himself called it the "Boles' Bung". The idea is not new, and was indeed suggested by this writer some years ago. I proposed that the money might be used to pay part of the cost of new flood defences, and there is a certain irony in the fact that the current proposal suggests the money be used for developments such as swimming pools, so that more people can learn to swim. This is perhaps the next best thing. At the time of writing, the biggest top down change of all is before Parliament:

The Growth and Infrastructure Bill

Under this legislation, the government proposes to release large areas of greenfield land for development, especially in the South of England. The Growth and Infrastructure Bill, which passed its third reading in December 2012, would give developers powers to put major planning applications directly to central government, by-passing not only communities but also local planning authorities. So much for a bottom up approach.

It is not clear how long central government might take to make decisions on such developments, or how much regard they will pay to local feeling. Development could take place almost anywhere. The south of England is an attractive location for investment from China and other countries seeking property in an English-speaking area near stable and advanced financial, manufacturing and academic institutions and skilled workers. Increased flood plain building may be good news for vested interests such as property developers, councillors, and MPs, but should clearly be of concern to the insurance industry, not to mention our grandchildren. It now appears that much of this investment could take place on greenfield sites, including the "greenbelt" and flood plains.

John Prescott, when deputy prime minister, once told the BBC's John Humphrys:

"The greenbelt is a Labour Party success story and we intend to build on it."

It now looks like the current government plans to beat them to it.

> *"Increased flood plain building may be good news for vested interests such as property developers, councillors, and MPs, but should clearly be of concern to the insurance industry."*

Case Study: If we had the chance to do it all again, would we?

Lessons from the great British PPI truth and reconciliation scandal

Teresa Perchard, Director of Policy & Advocacy, Citizens Advice

Summary

- A failure of ethics drove the mis-selling of a product that, sold properly, had a benefit to consumers.
- Some form of replacement for PPI might be possible in the future but this must be a fair, simple to understand and transparent product offering.
- The customer must come first and that focus starts with business leaders.

About 16 million payment protection insurance (PPI) policies have been sold since 2005. In terms of the number of policies held, and theoretical coverage of risk, PPI was a very successful product. To a nation exhibiting a huge appetite for consumer credit during the last decade, PPI understandably had wide appeal. Consumers taking on this insurance were acting responsibly, to protect themselves and the lender, and other consumers, from downside risk. Peace of mind for all concerned. But it is now widely accepted that, for the customers who bought them, these products were just not going to do what they seemed to say on the tin, or they were positively mis-sold.

The financial services industry is now paying the price of those errors. In November 2012, the amount set aside by 14 banks, building societies and credit card firms for dealing with this issue, including paying compensation, stood at just under £13bn. And in February 2013, Lloyds Banking Group announced it had set aside a further £1bn, bringing its PPI bill to £5.2bn so far.

With the number of complaints rising, and potentially more to come, banks are now calling for a cut off point for claims. In January 2013, the Financial Ombudsman Service (FOS) reported a record quarter in the number of complaints received, with complaints overall up 75% and most of those (80%) being about PPI. The FOS received more complaints in the first three months of 2013 than in any whole year up to 2010. The FOS has now received half a million PPI complaints, a rate of 400 every hour.

What's worse is that, while these cases are the ones rejected by the banks and other lenders, the FOS upholds the vast majority of complaints: about 70%, on average – in favour of the customer. Some customer uphold rates are in excess of a shocking 90%. These are all cases where the customer was right and in which the financial institution could have resolved the issue more quickly and cheaply.

Moreover, Citizens Advice, which made the "SuperComplaint" about PPI in 2005, has now thrown the spotlight on the burgeoning claims management market offering to help consumers with their claims. In a report last year, it reported that nine out of ten people surveyed had been pestered by calls, emails and spam texts from these firms within a period of 12 months – with 72% of those contacts about making a claim for PPI.[12]

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12 Claims Pests, Citizens Advice, 2012

Citizens Advice has found that people are spending, on average, over £1,100 in fees for something they can do themselves, free of charge. One Citizens Advice Bureau (CAB) even saw a client who paid over £4,000 in charges to a claims manager. Some claims firms are charging upfront costs of £600 – without being clear if the consumer will get any sort of payout. One in five CAB clients was lead to believe they can make a claim for PPI without ever having, or being mis-sold, a policy. Many other problems, including misleading information and poor service, abound.

So it is perhaps timely to reflect on what has brought us to this point, whether there are any lessons for the future, and whether there is any possibility at all of rehabilitating PPI.

When did it start?

Citizens Advice Bureaux help people resolve problems with debts they cannot afford to repay. Every year for the last decade, around two million debt problems have arrived at the door of the bureaux, and most of those have concerned consumer credit debt. People usually need help with debts when they have experienced an unexpected financial shock and just cannot make ends meet – a loss of job, relationship breakdown, or bereavement are very common factors. So too is the simple fact of low income and the cost of living – coupled with a burden of servicing borrowing. Where a consumer has any insurance that might replace lost income, or pay off any debts, it is, in theory at least, really helpful. So the CABs always look to see if that is a possible solution. We also advocate that people borrowing money should not take on more than they can afford, and that they should be clear about how they could afford to repay, including if something goes wrong.

We first started to highlight concerns about weaknesses with payment protection products in 1995. At that time, the key concern was with mortgage payment protection insurance (MPPI). There had been record levels of mortgage repossessions, set against a period of high unemployment and high interest rates. Government was about to cut the social security benefits to help with mortgage interest, on the basis that the private sector (in the form of MPPI) should cover part of the cost. We were concerned that private cover could not be relied upon, because of our evidence on:

- mis-selling
- exclusion clauses
- products that might have been suitable when originally taken out no longer were, due to a change of circumstances, or because the insurance company changed the terms at short notice
- poor administration and standards of service by insurance companies

We recommended that the Government should implement statutory regulation of general insurance, but failing that, the Association of British Insurers (ABI) could develop better self-regulation of PPI, and there should be a minimum standard, or baseline set of product features, which all MPPI policies should meet.

By 2003, we were reporting on a tidal wave of consumer credit debt problems. In our report "*In too deep*", we examined our clients' debt problems, including whether they had any insurance. While the majority of our clients, 60%, cited a change of circumstance as responsible for their debt problem, only 11% of the debts in the survey actually had PPI associated. And where they did, the limitations of the policy meant that clients could only make claims in a quarter of these cases. Even fewer were successful – 1.7% of all the debts in the survey. Reasons for rejecting the claim included common exclusion clauses. As the FSA was about to take on the regulation of general insurance, we recommended that, it should take into account the findings of our report when formulating PPI regulation.

Almost concurrently to this, in September 2005 we published an in-depth report on PPI, which we submitted to the Office of Fair Trading (OFT) as a "SuperComplaint" under our then-recently conferred special powers.[13] We were continuing to see a substantial and growing number of cases of mis-selling expensive and inappropriate PPI products to clients. While the FSA had started a 'probe' into PPI, we were unsure that its action would tackle the problems we were seeing, as it wouldn't look at competition issues and it was unclear whether the probe would look at the content of policies. At this time, the FSA approach was predominantly about transparency and disclosure and we felt that a more interventionist response was needed.

We therefore decided to submit our evidence as a Supercomplaint, to raise the profile of the issue and demand a response from the regulatory community. The report outlined our evidence on mis-selling, the cost and cover provided by banks/insurers, exclusion clauses, and problems with claiming. We were particularly concerned about single premium policies sold with bank loans, where the customers we spoke to had borrowed the money to fund the premium as part of the loan. We were given the strong impression that taking the insurance was the key to being able to get the loan. We recommended a wide range of measures to improve consumer information and transparency, and the introduction of a baseline/standard product design for PPI.

The Supercomplaint had an immediate impact on the share prices of a number of banks, with the stock market rightly seeing this as a threat to profits from the sale of PPI. We received a lot of dismissive and aggressive responses from the industry, perhaps due to the scale of reliance upon this product for rewards, as revealed by the subsequent investigations by the OFT and Competition Commission (CC).

The issue trundled through the in-trays of the OFT, CC and FSA for almost a decade (see the timeline in Box 1). Meanwhile, more and more was uncovered from the frontline, which simply backed up our initial insight that consumers just were not getting a good deal.

Box 1: Key points in the timeline of shame

November 2005 – FSA 'probe' finds:

- poor disclosure of product and price details;
- the possibility that consumers may not be eligible to claim against their policies;
- that customers might not be aware they could receive little money back if they cancelled their policies early;
- advice given on buying PPI was likely to be poor, with a lack of proper monitoring and training meaning that staff in around half the firms in question were not competent;
- using sales commissions or bonuses to pay employees was encouraging some staff to mis-sell the policies; and
- product regulation would stifle competition.

December 2005 – the OFT issued its response to Citizens Advice Supercomplaint.

- It decided to undertake a market study on the selling and competition issues that our Supercomplaint highlighted.

January 2006 – FSA writes to companies asking them to improve sales practices.

- Confidential undertakings given.
- FSA working with the trade bodies to come up with a self-regulatory response.

13 Citizens Advice, Protection Racket, Sep 2005. Citizens Advice is one of eight designated consumer bodies conferred with powers under the Enterprise Act 2002 to submit to an appropriate authority "Supercomplaints" that describe "any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers." Under the Act, the authority receiving the report then has 90 calendar days to publish a reasoned response.

March 2006 – CC issues response to its store card inquiry, proposing:

- Un-bundling PPI from store cards because of sell-rather-than-buy implications; and
- The supply chain has no incentives to pay regard to the customer and their requirements.

October 2006 – FSA publishes results of second round of PPI probe. OFT market study:

- Shows that PPI is still failing customers, giving them a poor deal.
- Concludes that there is limited evidence that the industry is taking steps to improve the situation.
- Citizens Advice says it is disappointed by the length of time being taken.

February 2007 – OFT issues its reasons for referring PPI to Competition Commission (CC).

November 2007 – CC issues its emerging thinking

June 2008 – FSA's new rules on selling PPI come into force

CC publishes report on PPI:

- It agrees that there was a problem to address.
- People buying PPI are being overcharged by about £1.4bn a year.
- British Bankers' Association (BBA) response: 'I don't necessarily see that we have been overcharging at all' (Eric Leenders, BBA, 5 June 2008)

September 2008 – FSA publishes its third thematic review into PPI.

FOS issues wider implications letter to FSA about the increase in complaints about mis-sold PPI and the very high uphold rate.

October 2008 – CC publishes its provisional findings on retail PPI

November 2008 – CC publishes its provisional remedies.

- Creditors not allowed to propose PPI sale within 14 days of credit sale, although consumers can pursue this;
- Ban on single issue premiums, notices, advert requirements and price metrics.

Autumn 2008 – BBA sets up group on improving complaints handling.

January 2009 – Final CC report on the inquiry and remedies:

- Single premium policies to be banned (a highly interventionist remedy from the CC), and
- A range of other remedies designed to stop vendor-bias in the sales process and encourage consumer shopping around.

April 2009

Barclays appeals to the Competition Appeal Tribunal (CAT) on the point of sale ban and the analysis that led to the CC's decision.

October 2009

The CAT orders the point of sale ban to be reviewed. The CC must reconsider this remedy and the background to it. FSA consults on the assessment and redress of PPI complaints.

October 2010 – BBA take FSA to judicial review on PPI policy.

May 2011

The High Court dismisses the BBA's application for judicial review. The banks agree not to appeal.

Where next?

Despite the problem of delayed payments to customers, such is the scale of compensation that the Office for Budget Responsibility said that its economic forecast of growth at a positive 0.5% over two years would be "mainly due to the effects of payment protection insurance (PPI) fee repayments".[14] This constitutes a bigger impact than any government initiative, as Britons have used the refunds on home improvements and holidays, providing a boost to Britain's ailing economy.

> *"Such is the scale of compensation that the Office for Budget Responsibility said that its economic forecast of growth at a positive 0.5% over two years would be "mainly due to the effects of payment protection insurance (PPI) fee repayments."*

The improvement to growth aside, overall the PPI scandal has been a total tragedy. After a decade of damning indictments, timid regulators, prevarications and quarrels, the banks are now, slowly, paying back billions in compensation to consumers, but making too many of those customers seek independent redress.

The incident has spawned the new problem of a burgeoning claims management market and consumers remain no better protected for the downside risks if they are unable to afford to repay their debts. A product that still seems like a prudent concept is a toxic brand. As PPI includes the two magic words 'protection' and 'insurance', this will surely have had an impact on consumers' views of other products using similar labels.

Would we still make the Supercomplaint? Yes, absolutely. Without that, the full scale of the issues that the OFT market study and Competition Commission investigation revealed may not have surfaced even as quickly as within four years.

Lessons learned

So are there are any lessons for the future? Is there any possibility at all of rehabilitating PPI? Reviewing Citizens Advice involvement in this issue over the past 10 years, my view is that the two key lessons for businesses and regulators are:

Put the customer before the company

All the evidence on the PPI scandal shows us that companies have put themselves first all the way down the line, including even now, in the handling of complaints and the appeals for cut off dates for claims. The root of that is greed, intensified by firms becoming hugely dependent on the excess profits from one product line. Business leaders in financial services who have looked at the numbers down the years will have known, even from the figures alone, that they were taking advantage. Seeing those numbers will have told them the customer was not coming first. Fundamentally, it's about ethics.

> *"Fundamentally, it's about ethics."*

14 Office of Budget Responsibility, Economic & Fiscal Outlook, March 2012, p.57, para.3.59.

Listen to what consumer representatives are saying

Companies dismissed our SuperComplaint as anecdote – though the stock market response was telling. But even back in 2003, our modest recommendations for reforms – if adopted then – could have made a huge difference to the outcomes. Citizens Advice has two aims. One is to help people through advice and information, to ensure that they know their rights and their responsibilities. The other is to influence policy and practice, so that the problems we see are resolved on a wider scale and do not happen again.

Importantly, our aims are to act responsibly when influencing policy – we are not a knee-jerk, rent-a-quote campaign, but an authentic, evidence-based, responsible charity. We may not always have the whole picture about what is causing a problem in a market but, like the canary down the mine, we often get the first whiff that something smells wrong. If businesses and regulators had taken our insight more seriously, and acted more swiftly in response, some of the scale of this problem could have been reduced, and consumers might have got a better deal.

Is there any prospect of PPI being rehabilitated?

Right now, this may sound like an impossible prospect. But the fundamental idea that a consumer should have appropriate protection in place for risks, if they take on significant financial commitments, is a good one. That could include insurance. There is certainly an ongoing need for consumers to have protection, particularly as the level of support available from the welfare state seems set only to decline further, as we all live longer and the dependency ratio increases.

The challenge will be to engage consumers AND offer them simple and fair products and services that do what they say on the tin. There may not be a rush to market, and any firms that do wish to rehabilitate PPI will find consumers far more challenging and sceptical going forward. Getting the offer right will be key to restoring consumer trust and confidence, and product regulation is likely to be essential to achieve that.

Issues affecting consumers in the general insurance market

Adam Phillips, Chairman, Financial Services Consumer Panel

Summary

- The biggest challenges within the general insurance sector, as in many other financial services, seem to relate to culture and how consumers are treated within the sales and post-sales process.
- In particular, there needs to be a re-balancing of information, and matching of expectations about what is being offered, between consumer and provider.
- Long policy documents may be transparent and clear, but they are seldom read and understood, as any of us who click through computer software and privacy agreements without reading them will understand.
- Ensuring consumers are easily able to determine what is covered within a product, and are able to choose the right cover based on this information, is in the interest of all sides.

Insurance is an unavoidable part of life for most people and general insurance products cover various aspects of our daily operations. In recent times, the general insurance market has been forced to adapt to changing societal shifts, consumer demands, and the ever-developing technological advances. Some adaptations have been achieved well and in the interests of consumers, others not so well, creating detriment and dissatisfaction. This paper sets out several issues that the Financial Services Consumer Panel has identified as currently affecting consumers of general insurance products, and summarises the challenges these issues pose for consumers and industry.

Historical development of the general insurance market

The basic insurance relationship has not changed much throughout history. The Babylonians developed a system that was recorded around 1750 BC and used in early Mediterranean shipping. If a merchant received a loan to fund the cargo to be carried on his ship, he would pay the lender an additional sum in return, if the lender guaranteed to cancel the loan should the shipment be stolen or lost at sea. Of course, consumers can now shop around and are no longer tied to insuring at the point of purchase. Yet then, as today, insurance basically remains the same: “an arrangement by which a company or the state undertakes to provide a guarantee of compensation for specified loss, damage, illness, or death in return for payment of a specified premium”. It also continues to be a product where the consumer finds it hard to determine the value before, and even after, the purchase.

However, in recent decades, there have been fundamental changes to the way that consumers engage with insurance products and services. The days when at least one big insurance company occupied some premium retail space on the high street are all but gone. The internet, including comparison websites, is now a fundamental part of the buying process. And while comparison sites are popular with consumers, and have enhanced competition within the market (to the benefit of some of the smaller insurers), they have also put pressure on insurers’ traditional business models.

Issues and challenges

The issues identified by the Consumer Panel, through discussions with regulators, consumer groups, insurers and intermediaries, can largely be categorised into two groups: pre-sale issues – in particular relating to information provided before a decision to purchase; and post-sales - largely relating to claims handling and the complaints process.

Pre-sales issues

Accurate front-end information for consumers is vital in empowering them to make the right purchase decision. Yet it is not always sufficiently available and often it is stripped down to price alone. While price is always going to be a fundamental consideration in any purchase, wider considerations need to be taken into account, particularly given the devastating impact insufficient insurance cover can have.

Although this issue is widely recognised, and some work has been done to address it, achieving the required cultural shift in the way products are designed and presented, against the backdrop of tightening personal budgets, will be a key challenge for consumer groups and industry.

> *“Achieving the required cultural shift in the way products are designed and presented, against the backdrop of tightening personal budgets, will be a key challenge for consumer groups and industry.”*

Accompanying the growth in comparison sites and internet usage has been the large increase in basic insurance policies with charged-for extras. Certain features, historically included as standard, are now additional extras for which consumers are required to pay.

This approach is fine in theory, as long as there is a degree of industry-wide standardisation and basic cover. Consumers need to be confident they will get certain essential features with all policies, and be provided with the ability to easily extend cover for additional activities or considerations. In the case of travel insurance, for example, it could be argued that consumers should be able to reasonably expect a standard minimum for cancellation, loss of baggage and medical cover in all policies, starting with the most basic. From this starting point, they can then easily move up to additional levels should they want more cover or have additional requirements, such as including dangerous sports or going on an adventure holiday.

In housing, the standard format of a basic price based on bedrooms and type of building seems a good model. Of course, the design of basic products is extremely important. If too much is stripped out, the more opportunity there is for disproportionate ancillary charges. Consumers with particular needs or characteristics can find it difficult to access well-priced cover. Increasingly, the process of buying an insurance policy resembles that of booking a budget airline flight.

> *“Increasingly, the process of buying an insurance policy resembles that of booking a budget airline flight.”*

The post-sales and claims management experience

Undoubtedly the biggest areas of dissatisfaction for consumers, and the greatest challenges for industry to address, occur in the post-sale space. This is particularly acute when consumers need to claim or make a complaint: most general insurance complaints (which are rising annually) to the FOS relate to claims handling. Discussions suggest that consumers perceive a culture within the industry aimed at minimising claims and treating them all as potentially fraudulent. Insurers, for their part, are wary of consumers making fraudulent claims. This contention, possibly resulting from a mixture of unrealistic consumer expectations and insurers aggressively acting to achieve the lowest possible price, does not appear to have served either side very well.

The use of third parties to manage, or as part of, the claims process has added to consumers' levels of dissatisfaction. The outsourcing of the claims management and loss adjuster functions is perceived by some to have had a detrimental effect on customer service. It also raises questions around payment and incentivisation structures. Conflicts and inappropriate incentives throughout the value chain create additional costs, prevent the market working effectively, and lead to poor outcomes for claimants.

Conclusion

The biggest challenges within the GI sector, as in many other financial services, seem to relate to culture and how consumers are treated within the sale and post-sale process. In particular, there needs to be a rebalancing of information and matching of expectations about what is being offered between consumer and provider. Long policy documents may be transparent and clear, but they are seldom read and understood, as any of us who click through computer software and privacy agreements without reading them will understand. Ensuring consumers are easily able to determine what is covered within a product and are able to choose the right cover based on this information, is in the interest of all sides.

> “*The biggest challenges within the GI sector, seem to relate to culture and how consumers are treated within the sale and post-sale process.*”

Understanding the needs of an ageing society

Gordon Morris, Managing Director, Age UK Enterprises

Summary

- Insurers must adapt to the needs of older consumers, particularly given future changes to the UK's demographic makeup.
- Older consumers are likely to demonstrate greater loyalty; it is time for product providers to recognise and reward this.
- Discrimination and access to products for older consumers is an issue and insurers must ensure accessibility.

Age UK Enterprises is the commercial arm of the charity, providing financial and energy products to address the specific requirements of those in later life.

Reputation is an amorphous concept. It is intangible, difficult to define and often thought of as impossible to value. However, the London insurance market is believed to be the leading market for underwriting reputational and political risk.

And yet, while this may be the case, a contradiction exists. A contradiction between the expertise the industry has in underwriting reputational risk, and the reputational risk insurers expose themselves to by their operational practice, particularly in personal lines. To many outside of the industry, and even those that, like Age UK Enterprises, are closely linked as a social enterprise insurance provider, some of these behaviours seem short-sighted.

It is also baffling that the industry at large is still in this state. The reality is that the concept of reputational risk is well understood by the industry. It can hardly be considered as a new and emerging trend and, therefore, neither can it be a new entry to the industry's risk radar.

Certainly the insurance industry faces many challenges. To name a few: the regulatory environment itself is changing, the market remains soft, and the communication landscape is changing as insurers, like many other industries, grapple with social media.

Clearly, all of these issues are related directly to the customer in terms of responsibilities to customers, the customers' need for insurance, or their preferences in purchasing.

Therefore, a sensible response by insurers has been to examine their customer service propositions. At a recent industry event, a leading player in the industry announced that he had typed 'customer excellence in the insurance industry' into Google to find there was very little positive news. He argued that the results were not terribly surprising and urged the industry to remember the saying that, " 'If you always do what you've always done, you'll always get what you've always got.' Or more precisely, your customers will always get what they've always got."

That call to the industry is to be welcomed and embraced. However, insurers need to go further. Not to dismiss the importance of claims handling, or putting the customer in control in social media interaction, or all the other relevant issues pertinent to customer service. But quite simply, it often seems that insurers do not know who their customers are, and forget the society they live in. And it is this that is at the heart of many of the issues that the industry faces, particularly the changing regulatory environment.

For example, the UK has a growing ageing population. There are currently 10 million people aged over 65 years old, a sixth of the population. The latest projections are that there will be 5.5 million more people over this age in 20 years' time, and the number will have nearly doubled to around 19 million by 2050, when it is predicted that one in four people will be over the age of 65. Further, people aged 50+ represent 35% of the UK population and are responsible for £307 billion worth of spending a year – 47% of total spending in the UK. And yet it seems that the insurance industry largely dismisses this trend and this market segment. From the insights that Age UK research provides, many insurers are yet to attempt to understand this market and its needs.

Worse, however, is the fact that recent research carried out by Age UK found that older people still face discrimination by insurers. In a survey that reports on older people's experience in purchasing insurance, worryingly over a fifth (21%) of shoppers aged over 80 were not given phone or online quotes for car insurance simply because of their age.

Despite the Government and insurance industry "signposting" agreement, providing guidance to customers is also not nearly as commonplace as it should be. 85% of people aged over 80 in the same survey were not directed on to insurance providers who would cover their needs.

And one would think that age would not be a factor in how a customer is treated for home and contents insurance. Yet while customers in later life continuously show their providers loyalty – 36% have never considered changing providers and have remained with their provider for over 20 years – time and time again in our local trading branches we hear how older peoples' trust is abused by insurers.

Very recently, we met with a customer who had been with his insurer for over 25 years. He was paying a premium for his home insurance in excess of £1,800, where in fact that risk warranted a premium of a little over £200. While all consumers have their part to play in shopping around, accessing products with real value while on a fixed pension income is clearly very important.

Undoubtedly there are many factors that are pertinent to these experiences. But this ill-advised behaviour is commonplace across the general insurance product range and further afield. By the same token, in the annuity market, Age UK research has found that despite calls to make annuity provision more transparent, 31% of respondents said that their pension providers did not make them aware that they have the right to shop around for an annuity that best suits their needs.

Insurance is a vital financial product, needed by people of all ages. We all know that it provides protection against risk and unwanted outcomes, in both daily life and in business. But with the changing demographic of our population, it is becoming more obvious that the insurance industry is failing to cater for those in later life.

Fundamentally, it is unnecessary. Age UK Enterprises is an example of this – 30 years' experience of providing financial products and services that are tailored to older customers' needs and value for money. Consequently, Age UK has more than 1.1 million customers and provides over 14 financial products and services.

There are simple principles that should be adhered to and the industry is failing in that. It is essential that providers offer tailored products to suit individual needs, and importantly, do not discriminate against people based purely on their age.

Otherwise, a significant proportion of the population must face the risk of going uninsured. And the industry opens itself to much more criticism and regulation, and fails to cater for an important and growing market.

Protecting the public: The Ombudsman's impact is 'just'

Caroline Mitchell, Lead Ombudsman, Casework Policy for Insurance and Investment, Financial Ombudsman Service

Summary

- The Financial Ombudsman Service's remit has expanded significantly since its inception.
- The insurance industry must show that it is prepared to take the lead in dealing with public policy issues, rather than being forced to address these by the FOS and statute.
- The FOS will continue to focus on preventing complaints in the first instance, rather than dealing with them afterwards.

Insurers may well feel pretty proud of themselves when looking at the banks and the tsunami of complaints we're seeing at the ombudsman about PPI. But there are still big issues for insurance – not least that it took a change in the law for the industry to follow the ombudsman's approach to non-disclosure and misrepresentation.

Consumer insurance has come a long way since the Marine Insurance Act 1906 (MIA), which brought together case law dating back to the mid-eighteenth century. It was, of course, about commercial shipping contracts – but influenced the way all insurance disputes were dealt with. I have to wonder how much relevance shipping law dating back to the start of the last century has in today's world – where people buy insurance over the phone or online. And they do so for products and insurances that eighteenth-century lawyers could never have dreamed of – such as mobile phones or ski-trip cover.

The MIA, of course, contained the concept of 'utmost good faith' – but how many consumers understand that they have a duty (before they sign on the dotted line) not to misrepresent material facts? And that they should disclose material facts even if no question is asked? How do they know what the insurer considers to be 'material'? And how many consumers fully understand the concept of materiality?

Consumers can find they have no cover if the law is strictly applied – and the policy avoided (i.e. regarded as non-existent) – when they may simply have made a mistake or not understood what the underwriters want to know.

In 1981, given growing concern about consumer protection, insurance companies set up a voluntary scheme to handle consumer insurance disputes – our predecessor, the Insurance Ombudsman Bureau. Unlike the courts, the ombudsman was required to reach a solution to a complaint that's fair and reasonable in all the circumstances – which remains our cornerstone to this day.

And in the 1990s, the ombudsman decided commercial shipping law was too harsh when applied to consumers and to retail insurance contracts like motor or travel. So a different approach was developed – applying a proportionate remedy in cases where the non-disclosure or misrepresentation was accepted not to be deliberate. In other words, there was an adjustment in the premium or in the level of cover, rather than a cancellation of the policy and the retention of the premium and recovery of any amount paid. If the insurer showed it would not have offered any terms of insurance, then it would be entitled to decline the claim and cancel the cover.

Of course, the ombudsman now deals with complaints across the whole range of financial products – not just insurance. As a statutory scheme, it is a matter of law that the ombudsman must make decisions that are fair and reasonable in all the circumstances. So, if we find in a consumer's favour, we need to then decide what is fair compensation.

Guidance for long-term protection insurance products was published by the Association of British Insurers (ABI) in 2008. This applies to life, critical illness, income protection and permanent total disablement policies. The guidance is something we take into account – along with the law, regulation and good industry practice – when deciding what is fair and reasonable in complaints about these protection products.

The ombudsman suggested a number of times that similar guidance should be in place for general insurance. But despite our approach being widely-known across the industry, our suggestions were not followed by many businesses. Indeed, we found we were still dealing with complaints where the law is being strictly applied – to the detriment of consumers.

Major change on this front did not happen until the involvement of the Law Commission. Working closely with us and studying many of our decisions, it put forward proposals for reforming the law for consumer insurance contracts. It said that the ombudsman's approach to non-disclosure and misrepresentation was 'workable and just.'

The result is the Consumer Insurance (Disclosure and Representation) Act – which comes into effect in April 2013. The act reflects the practice of the ombudsman over many years and is a great example of how our fair and reasonable approach can lead to improved outcomes for consumers.

So, our approach to insurance law has proved to be influential. An approach applied to individual complaints will now be imposed across the industry – so that all consumers forming insurance contracts have the benefit of it, not just those who complain. But it does seem a shame that a change to the law was needed before many insurers altered their approach.

We play an important part in consumer protection in all areas of financial services. Since the first ombudsman schemes were set-up, most consumer disputes have been considered by the ombudsman and not by the courts. Because we deal with individual complaints on the basis of their own facts and circumstances, they do not create precedent – but how we approach different issues and topics can be applied to facts in different cases.

Another part of our role is to help prevent complaints. We publish a great deal of information on our website about our approach, as well as example case studies – available both online and in our regular newsletter. And there are technical notes for businesses covering the full range of products we deal with. There is very little (if any) excuse for a business not to know how we might look at most situations.

Formal liaison arrangements with the industry and regulator mean we can help to identify potential issues before they become widespread. And we have less formal liaison arrangements with businesses, and with trade bodies and consumer groups, as well as conducting training days for consumer advisers across the UK.

And in 2013, we will be publishing the final decisions made by our ombudsmen – so the full range of our ombudsmen's work will be available to view.

It's essential, then, that insurers don't rest on their laurels; that they should always look to get it right first time. Rather than abiding by the letter of the law – doing what's fair and reasonable now means happier consumers and the benefits of increased consumer loyalty. And of course, learning the lessons from complaints remains as vital as ever.

Regulatory reform: Change under the FCA

Simon Green, Head of Department, Wholesale & General Insurance Markets, Financial Conduct Authority

Summary

- Behaviour and conduct will be at the core of the FCA's oversight, including staff incentivisation and how management deals with conflict and risk.
- The FCA will maintain a proactive interest in product development such as telematics.
- Product design and specific features will be monitored closely by the regulator, and the supply of certain products constrained or prohibited based on risk to consumers.

This is a pivotal moment in conduct regulation. The FSA will soon split into two separate regulators – the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

The FCA will have the primary overarching objective of ensuring that markets work well for consumers. Underpinning this are three operational objectives focusing on: consumer protection; promoting and enhancing the integrity of the financial system; and, competition in the interests of consumers.

To deliver on these objectives, the FCA will have new powers, including the power to ban misleading financial promotions and to announce publicly that we have begun disciplinary action against a firm or individual.

Across the financial sector, meeting customers' fair and reasonable expectations should be at the centre of how firms and markets operate. This should be demonstrated through the way they treat their customers, their behaviour towards each other, and the way they operate in the market. This is what we mean by 'conduct'.

> *It is vital that the market demonstrates resilience and trust.*

Insurance has a unique and important role to play in the daily lives of millions of people in the UK and global economy. From insuring and reinsuring specialist international risks to providing essential cover to retail consumers and small businesses, it is vital that the market demonstrates resilience and trust. We all want an industry that provides the everyday services consumers need in a straightforward way, and that delivers on the promises it makes to them.

We will work more with industry and its representative bodies where we can to deliver increased customer and market trust and confidence.

Changes in our supervisory approach

Delivering this will be challenging for us all, particularly given the current economic circumstances. In response to the challenge this presents, we are making some key changes to our supervisory approach.

Focus on senior management

Our new style of supervision will increase focus on how firms' senior management consider and address conduct risk. We will challenge senior management to demonstrate that the customer is at the heart of the business model. Senior management teams set the culture of their firms, so we will be testing that the strategy and tone at the top align with good consumer outcomes.

In our supervisory work, we will look at how this affects consumers where it really matters. We will do this through increased thematic work, undertaking more consumer research and mystery shopping, and through our firm risk assessments where we will focus on key issues and risks to consumers and markets.

Enhanced analysis of the sector and insurers' business models

We will gather and use a wide range of data, information and intelligence to enhance our insights into the market. We will consider current and future environmental challenges, changing dynamics, and wider regulatory and legislative developments.

Our analysis of the sector will feed into our analysis of insurance business models, which will help to deliver informed insights into how business models are driving conduct risks. So we can get to problems early, we will consider, on a forward-looking basis, the key consumer risk drivers inherent in business models; where in the value chain current and prospective detriment could occur, and how it could manifest itself. A fundamental part of this will be testing the viability of business plans and strategies, in the context of the wider market and the risks posed to consumers.

Product design and distribution

For example, we will combine the outputs of our business model analysis with consumer and market intelligence to inform our view of product design. Our experience of product mis-selling issues has been that products designed for a specific market or group of consumers were sold beyond the original design parameters. By putting more responsibility on providers to ensure that products only reach the customers they were designed for – and that they function as expected – there should be fewer incidents of major consumer harm.

The FCA will go further than before in challenging providers on the value-for-money of their products and services, and in checking that charging and remuneration structures can ensure good outcomes for consumers. If necessary, we will be ready to intervene directly, for example, by restricting the use of specified product features or the promotion of particularly high risk product types to some or all consumers. We will also continue our work on sales incentives, and will review how firms are acting on the guidance we published, to help firms avoid creating and operating incentives schemes that drive mis-selling.

More about the consumer experience

The way we look at sectoral issues through our thematic work is also changing. We are going to be more challenging of the consumer experience, and have already started to do this. An example of this is our recent thematic work on motor legal expenses insurance (MLEI). As part of this work, we commissioned consumer research to test understanding of the product. This work delivered unique insight into both the product and the way customers view the motor industry as a whole.

Working with the sector at an earlier stage

Part of this approach is earlier engagement with the industry, as well as taking a proactive interest in market developments at an earlier stage, as we have done in our recent work on telematics.

Telematics offers benefits, particularly to young drivers. But it could also present risks in relation to insurers' use of data and consumers' understanding of how it could be used, possible penalties for moving insurer, as well as practicalities around installing the technology. We have engaged with the Association of British Insurers in its development of a good practice guide on telematics, to ensure these potential issues are highlighted to the industry and consumers.

Other areas of focus

More broadly, in relation to market conduct, we will focus on certain behaviours and areas that could cause damage to market integrity, for example, poor management of conflicts of interest. We will look at conflicts inherent in firms' business models, or created by elements of business models, and the controls in place to identify, understand and mitigate these.

Against a backdrop of pressure on pricing and costs, we will look to ensure that claims are handled fairly and that firms deliver on the promises they make, and give customers the level of service and outcomes they were led to expect when a product was sold to them. Claims represent the moment of truth for customers, and an opportunity for insurance firms to show the value of their service.

Aligned with our new way of working and the FCA's competition objective, we are also looking into general insurance products sold as add-ons. We are conducting a study that will consider whether there are common features of add-on markets that weaken competition and drive poor consumer outcomes. This will cover the whole of the relevant markets, taking full account of firm and consumer behaviour, and how they interact to shape prices and the quality and consumption of the product.

In conclusion

We want to see a sustainable sector – with firms competing for business by offering better services, better value and the types of products their clients want and need: a market where the successful firms are the ones that respond most effectively to customers' genuine needs.

Rule-making and regulatory interventions are tools we can use. But above all, we are looking to you as market participants to recognise the critical contribution you can make in delivering good customer outcomes and in improving trust and confidence in the market. Professionalism across the sector will be a key part of achieving this – maintaining a focus on standards, and keeping customers at the heart of your business models.

> *"We want to see a sustainable sector – with firms competing for business by offering better services, better value and the types of products their clients want and need."*

Let's have 'necessary and proportionate' regulation

Jonathan Evans MP, Chairman, All Party Parliamentary Group for Insurance and Financial Services

Summary

- Following reforms such as the Retail Distribution Review (RDR), the regulators should re-calibrate how they approach the insurance industry and allow recent reforms to deliver enhanced professionalism.
- Technology should not completely remove the personal element in customer-provider relationships.
- The Financial Conduct Authority (FCA) should monitor the use of outsourcing companies by the insurance industry, to ensure this does not have a deleterious effect on processing claims.

The core focus of the Parliamentary Group on Insurance and Financial Services is to defend the interests of our constituents – the insurance industry's customers. Our Group, which has existed for over 22 years, played a key role in the creation of Pool Re 20 years ago, and has more recently helped bring about clearer and more enforceable wording for customers in insurance contract law.

We have also had a busy agenda in the current Parliamentary session. We have examined the PPI and similar mis-selling scandals; we have looked at the issues regarding the cost of motor insurance, fraud, credit hire, the Jackson reforms and whiplash; as well as hearing from practitioners about the major Retail Distribution Review (RDR) initiative.

We were greatly encouraged by the Prime Minister's initiative in hosting a general insurance summit in Downing Street in February 2012. We identified a clear agenda of the steps needed to bear down on the increased costs of motor insurance, and we were heartened to learn that a programme of further meetings was scheduled. Following the government reshuffle in September, this initiative seemed stalled, but there are now welcome signs of renewed activity from the Government. We await real proposals in the near future to crack down on abuses like the current arrangements for whiplash claims, perhaps including some form of mandatory physical examinations by an independent agency.

My Group's briefings have taken place against a climate of major regulatory reform, and there remain mixed views about the wisdom of breaking up the old Financial Services Authority (FSA). This is not the place to re-open that debate, but parliamentarians are increasingly concerned about whether the new regulatory architecture will really deliver better experiences and outcomes for consumers.

> *"Parliamentarians are increasingly concerned about whether the new regulatory architecture will really deliver better experiences and outcomes for consumers."*

The CII has rightly played a central role in promoting the RDR. However, one wonders to what extent regulators are taking account of this step-change in terms of their approach to the quality of advice offered to consumers. It is also crucial in a post-FSA world that we maintain close dialogue and coordination between the different regulatory bodies. And yet we also face the curiosity of waiting for this market to be subject to scrutiny, only to find that, like London buses, two separate inquiries from the Competition Commission and from the new Financial Conduct Authority come along one after another both focused on the issue of add-ons in general insurance.

It is unclear whether there will be any coordination between these inquiries, in relation to either findings or remedies, or even the timing of their reports.

It is also unclear whether the FCA will be directing its efforts into the areas where our Group hears about most complaints. We already know of major concerns arising from the activities of Claims Management Companies (CMCs), particularly over the telephone, and through the use of texting and internet tactics, to harvest PPI claims. The Information Commissioner pleads that it is difficult to regulate these activities because so many of them originate abroad. But it should be simple to require that anyone accepting a referral should only be able to do so from a regulated party. This concern is not about limiting access to justice in any way, but challenging the shocking scandal of rip-off fees claimed by some CMCs, just for submitting claims. Regulators need only to 'follow the money' to understand this latest scandal towards consumers and see that it is a multi-billion pound industry. Yet the Government has so far rejected calls to put the CMCs under the regulatory control of the FCA, leaving the matter in the benign hands of the Ministry of Justice. By doing so, they ensure that these well-chronicled abuses continue unchecked.

Other areas of concern relate to the potential impact of new technology upon personal relationships within the insurance industry. I am not sure that this is a risk identified by the FSA in its Risk Outlook report in 2012, but it is an issue. The need for the insurance industry to bear down on processing costs, combined with fast moving technology advances, carries the danger of increasingly removing the personal element, and with it, concerns about both commercial and customer focussed judgement from industry relationships.

Similarly, our Group has been hearing an increasing number of complaints about the general insurance industry's growing use of outsourcers, whether in business processing or loss adjusting, where this has the effect of significantly slowing down the settlement period for claims. This in itself should be an area for FCA interest, on the basis of the over-arching principle of treating customers fairly, rather than solely left to the Financial Ombudsman Service.

Overlaying all of this should be the continuing requirement that regulation ought to be necessary and proportionate. The professionalism of the insurance industry has been hugely enhanced by the RDR, and it would be disproportionate for the industry to be treated by regulators as though RDR had never been implemented. While my Group keeps focused on the interests of the insurance consumer, we also believe that insurance in itself is fundamentally a 'good thing'. It is crucial that regulators do not allow the industry to be dragged into the mire alongside the bankers. All of our constituents depend upon the availability, strength and integrity of the insurance industry, and it is those things that regulators should be working to maintain.

> *"It is crucial that regulators do not allow the industry to be dragged into the mire alongside the bankers."*

Demonstrating the value of insurance to our customers and society

Huw Evans, Director of Operations, ABI

Summary

- Value is highly subjective and insurers must find a way to demonstrate it through more than the price of their products.
- The industry works well when it aligns positive policy change with reducing unnecessary cost, this is a particular focus in the motor sector at present.
- Insurers must step up and embrace the transparency agenda.

At the very heart of the general insurance industry lies the value proposition we offer our customers and wider society. First, there is the product promise of helping retail and business customers to plan for the future and cope with bad luck, accident and disaster. Second, there is the industry's investment of our client assets and customers' hard-saved cash into the businesses and governments of Europe and the world, generating growth, jobs and prosperity by providing capital to the economy.

But value is always subjective. Somewhere along the way in the insurance industry's proud 400-year history, from the emergence of fire insurance among the ashes of the Great Fire of London to today's fiercely competitive quotes for car or travel insurance on price comparison websites, the value proposition that we offer consumers and society has become clouded. The worst financial crisis in living memory, and three years of the toughest austerity programme since World War Two, have compounded the difficulty in convincing the modern customer of the benefits we provide and the wider society we support.

It is now hard to see how the customer and the provider will ever agree fully on what value looks like in insurance. Maybe they never have agreed. But I believe a key part of getting more people engaged and in control of their finances is by helping them feel confident about the value that they and society get from insurance. So how do we communicate clearly the added value we offer – and achieve the seemingly impossible feat of improving consumer trust and confidence in our industry? A good starting point is driving out unnecessary costs, pricing risk accurately, and being ever more transparent in the process.

A good case study is car insurance. Here, there are two sides to the story. As a motor insurer where underwriting losses have been made for years, it can sometimes look like the customer is getting more than decent value for money and the price of motor insurance is too low. From a customer viewpoint, struggling with the rising price of essentials such as energy bills and food, it does not appear possible that insurers are making losses.

As a trade body, the Association of British Insurers (ABI) has a clear role in dispelling myths and shining a light on how our industry works. We recently provided, for the first time, a breakdown of outgoings as a percentage of premium income for motor insurance. Not only does the breakdown highlight that outgoings are more than 100%, but that personal injury claim costs now make up the largest proportion of motor insurance claim costs, with whiplash claims accounting for a massive 20% of premium income. We are making good progress in our campaign to reduce unnecessary costs and lower premiums are already feeding through in anticipation of legal and regulatory changes. But the test will be to see how customers respond and whether policymakers and commentators recognise the competitive nature of the market.

Driving out unnecessary cost is one part of demonstrating how insurers want to provide value to their customers; another is through the use of risk pricing to make the premium as personal as possible. But in certain markets, this can also lead to a perception of rip-off pricing and unreasonable behaviour by insurers. Young driver premiums are probably the most extreme version of this, with young people and their parents widely criticising the price of the premium, which seems completely unrelated to the value of the car. In reality, catastrophic and personal injury costs associated with drivers under the age 25 are the key factors driving the price of the premium, but many people simply do not understand this or the other risks that generate an average annual premium for a 17–18 year old driver of £1,853.

In this case, reducing premiums can be aligned to a noble public policy aim: improving road safety. This has two main benefits. Firstly, campaigning for changes helps to widen understanding of why premiums are set as they are. Secondly, if the Government agrees to change the way young people learn to drive, we estimate that the full ABI package of reforms (including a minimum learning period of one year, plus restrictions on carrying passengers and driving between 11 pm and 5 am) should help to reduce premiums for under-25s by an estimated 15–20%, thanks to a significantly reduced number of catastrophic motor accidents.

But questions about risk pricing can also be more subtle, such as when customers receive their premium renewal letters. It can be hard for customers to understand renewal price rises, particularly when they have made no claim and their circumstances have not changed – and especially if they pretend to be a new customer and get a cheaper rate than their renewal quote.

This may be linked to questions about risk pricing, but it is also a transparency issue. The transparency of products and processes is a key building block to help all of us in the industry to demonstrate value. It is probably also the most challenging to deliver. I think the whole industry recognises increased transparency with customers as one of the key drivers of the future. This is why ABI members in the life insurance market have recently signed up to an ABI Retirement Choices Code. The Code makes it compulsory for ABI members to encourage customers to shop around at the point of purchasing and annuity. But customers struggle to understand not only the products we sell, but also the way they are priced. ABI research has shown that a third of people did not understand that their insurance product premium included a first year discount, and that the increased cost in subsequent years is the 'standard' price.

Added to increasing consumer pressure for greater transparency is the significantly greater focus from regulators on how general insurance products are designed, sold and priced – particularly with the emergence of the new Financial Conduct Authority. The FSA has published a discussion paper on transparency, including proposals about publishing claims data and, along with its existing work on value for money, the signs are clear as to where regulatory focus will be targeted. The onus is on insurers to step up and respond: by winning the argument and reflecting on what it wishes to defend.

Ultimately, demonstrating value must always come back to the customer. Value is not simply about cheap headline prices, it is about what lies beneath and the customer's perception of the content of the product. Get that wrong and it impacts upon the trust and willingness of people to engage in the market and provides a path for the active and inquisitive regulator to follow.

If we can get to a place where there are minimal surprises between insurer and customer, in a market that is confident every product and service fulfils its promise, we will be well on the way to displaying the economic and social value of insurance for all to see in a way that resonates with the 21st century customer.

The challenge: the industry must lead rather than follow public policy debates

Jonathan Swift, General Insurance Journalist, Incisive Media

Summary

- The insurance industry has not, but must, make headway in educating the public about its value.
- The industry should be proactive in its dialogue with policymakers.
- Reputation takes a long time to build and short time to lose; insurers should tackle problems head on rather than letting them fester.

In the wake of the "banking crisis" of 2008, insurance chiefs spoke about a 'once in a lifetime' opportunity for the industry to improve its standing in the public's eye. And they hoped that an uptake in talent recruitment would follow. This was crystalised in 2009, when the Labour Government-sponsored Insurance Industry Working Group (IIWG) published a report outlining its vision for the industry.

Now five years on, there is serious doubt as to whether the industry has made the progress it had expected to. It is also unclear whether the window has now shut (or is closing), and whether more bad than good has been done.

These doubts arise because, for all the talk of not posing the 'systemic risk' of banks, the insurance industry has yet to make any obvious headway in convincing the public of its inherent value. Nor has it persuaded the cream of school leavers or graduates that it is of a comparable professional standing to the likes of law or accountancy. And to think things seemed so much brighter in July 2009, when the IIWG report garnered positive coverage. So what has changed?

Obviously, we have had a change of Government. The then-chancellor Alastair Darling is not the only member of the IIWG committee to move on. Only two of the original nine industry members still work for the same organisation now as they did then, RSA's Adrian Brown and Richard Ward of Lloyd's. Hardly a ringing endorsement of the need for a consistent message.

Secondly, one MP's change of heart while in opposition has had more impact on the insurance industry than when he was in power. Jack Straw, Labour MP for Blackburn, took advantage of a slow news day in June 2011 to rail against the insurance industry's "dirty secret" that he claimed was driving up rates, namely the referral fee "racket".

Some sharp-witted industry insiders noted that as Justice Minister in the Labour Government, Straw had publicly railed against banning referral fees, but that was lost in the subsequent coverage. As was the fact that far from being a "secret", dirty or otherwise, these had been vociferously debated for years — with the ABI's stance firmly set in stone: they should be outlawed. The motor insurance sector was already under the political spotlight in the shape of the Transport Select Committee, but Straw's participation in the debate took the coverage to a whole new level.

> *"Instead of seizing the moment to get its well-worn messages across, the insurance sector ultimately did itself a dis-service by pointing the finger elsewhere and somewhat clouding the issue."*

But instead of seizing the moment to get its well-worn messages across, the insurance sector ultimately did itself a dis-service by pointing the finger elsewhere and somewhat clouding the issue. Following its report, "The Cost of Motor Insurance", the Transport Select Committee received flak by suggesting that insurers publish a list of firms with which they have referral relationships and the amount they are paid. As one senior figure sniped, "referral fees are the symptom of the dysfunctional market and not its cause". Consumers simply shrugged their shoulders and asked what the firm had to hide.

There were grievances that the insurance industry was being unjustly highlighted more than others with their noses equally – if not more deeply – in the trough; but only one insurer – AXA – publicly said it would no longer take these fees, ahead of any proposed ban. Until that happened, the public could easily assume that the others would not relent because everyone else was "at it" and, if they did not participate, they would be at a competitive disadvantage. It was hard to ascertain where the customer was in this thinking, as shareholder value seemed higher up the agenda.

One positive outcome of this whole hullabaloo was that, in February 2012, the Prime Minster invited a select group of senior insurance figures to 10 Downing Street to explain how a sector that had seen double digit rate increases in recent years was still failing to return an underwriting profit. By the time the parties gathered again – without Cameron – in May 2012, a proposed panel of independent medical practitioners to tackle whiplash, and affordable cover for young drivers, topped the agenda.

Interestingly, having toured the UK with his referral fee agenda in 2011, Straw took up the whiplash baton as his new crusade a year later. This is another subject that had long been exercising the ABI and its members, not least because three-quarters of personal injury claims in the UK are for whiplash, more than elsewhere in Europe.

The trade body estimated its proposals for young drivers – including a one-year minimum learning period, limiting the number of young passengers and restrictions on night-time driving – would cut their premiums by 15–20%. On the flipside, others have painted the proposals as curbing the rights of this age group, and questioned how the new rules would be policed.

The Office of Fair Trading's report into the sector labelled the motor insurance market as "dysfunctional". It is difficult to see the industry shaking off this tag for some time – no matter what progress it makes on these key issues before the Competition Commission reports back in September 2014.

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That is because, for all its good intentions, the sector does not have a great record of keeping its house in order. Many of the issues mentioned as being at the heart of this "dysfunction" have been around for years: credit hire, referral fees, claims management companies, to name but a few. But instead of being attacked head on, they have been left to grow and fester until the smell became so putrid that politicians had no choice but to intervene.

Of course, reputation is a slow-burner. And despite these motor mis-steps, it would be overly doom laden to suggest that no progress has been made – even if the momentum is gathering progress under the surface. A number of insurers and organisations such as Lloyd's are reporting that entry levels for graduate programmes are up, in terms of both numbers and standards. And the efforts of the Insurance Profession Task Force (IPTF) – dating back to March 2010 – requiring firms to commit to a number of professional standards under the auspices of the Aldermanbury Declaration, looks to have the legs to make a greater enduring impact than the IIWG.

At least a significant number of the IPTF still work for the same firms as they did when it was formed. And by not having a political sponsor, its lifespan and ultimate success in improving the industry's consumer image will not be dictated by the nation's polling mood.

Trust, motivation and ethical culture: some thoughts for financial services firms

Duncan Minty ACII, Chartered Insurance Practitioner and independent adviser on business ethics

Summary

- Firms that "do the right thing" should receive a regulatory dividend in the form of less onerous oversight.
- Firms should incorporate ethical key performance indicators (KPIs) into remuneration structures, and regulators should monitor these.
- Regulators should more actively enforce current rules, to create a greater fear of being caught.

The public's trust in financial service firms is not usually expressed in terms of the ethics of this or that behaviour. The complexity of product and process does not regularly allow for such fine-grained judgements. Instead, that trust and confidence is often summed up as financial services firms needing to 'do the right thing'. Broad as this may be, it also neatly brings together the breadth of expectations that the public, in all its variety, can have.

So how do you get financial services firms to 'do the right thing'? Some do take the initiative and explore ways of putting values like honesty and integrity at the heart of how they design products and deliver them to the public. They tend, however, to be in a minority – and not a large one at that.

Encouraging more firms to follow their example often has to rely on some combination of carrot and stick. This means motivating companies, by either increasing the rewards and recognition for 'doing the right thing', or increasing the fear and cost of 'doing the wrong thing'.

Unfortunately, in the present economic climate, good firms will not find it easy to earn much of a premium from 'doing the right thing'. It's difficult to charge more for something that consumers assume you're doing already.

When I talk about the fear and cost of 'doing the wrong thing', I don't mean an increase in the amount of regulation – I don't want to widen the scope of the rulebook. And I hardly think the public wants more rules either.

What I believe is needed is more visible and intrusive enforcement of existing regulations to increase the fear of being caught, coupled with greater fines for those who do get caught.

The Financial Services Authority (FSA) may have levied a record amount of fines in 2012, but the total is still pretty small compared with the level of fines dished out by US authorities. I believe the new Financial Conduct Authority should consider expanding its penalty framework in a similar way to the US Sentencing Guidelines.

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In weighing up a financial sanction, the US Sentencing Commission looks at seven indicators of a firm's ethical culture. Those who can demonstrate that, overall, their company has been 'doing the right thing' have their fine reduced, while those who can't demonstrate this find their fine increased.

What that visible connection between penalty and ethics does is get many companies off the fence and paying some attention to their ethical culture. It hasn't stopped the worst offenders from doing the wrong thing, but it does seem to have tilted the US playing field a little more in the right direction.

Another way in which financial services firms can be penalised for poor ethical culture is through the market for commercial insurances. Underwriters of policies such as bankers' blanket bonds, professional indemnity, and directors & officers should think about the extra risk they carry from the moral hazard of a 'why bother?' attitude to ethical behaviours.

I've advocated in the past that indicators of ethical culture should be used to underwrite these types of policies. At the moment, it looks like the premiums of good firms are subsidising the risks run by poor firms. Remove that subsidy and the good firms will start to get a return from 'doing the right thing'.

Another way in which firms 'doing the right thing' can be rewarded is in the form of a 'regulatory dividend', with the FCA rewarding firms that demonstrate high standards of professionalism with less onerous oversight.

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So, for example, a significant number of companies have been devoting a lot of energy to achieving Chartered Firm status, through compliance with a range of professional standards. At the same time, on a group basis, many firms in the insurance market have joined together under the Aldermanbury Declaration to commit to greater professionalism across the market as a whole.

These firms didn't take these steps with the expectation of receiving a regulatory dividend. But the regulator should at least consider how that commitment could be nurtured and sustained (or at least publicly recognised) through the regulatory framework. It's worth remembering that the insurance market has been making great strides in its professionalism, resulting in a professional body membership many times that of its banking equivalents.

Of course, the challenge is to make sure that firms wearing the badge of professionalism really are 'walking the talk' when it comes to 'doing the right thing'. If you want to be paid for doing good, you need to be able to justify the payment.

This means that initiatives like Chartered Firms and the Aldermanbury Declaration need to be able to demonstrate real traction in how their commitments have been turned into changes of behaviour. They need to say goodbye to the world of 'tell me' and 'show me' and prepare for the world of 'prove to me'.

So how do you prove to someone that your firm is 'doing the right thing'? Enron demonstrated that publishing an ethics policy tells you very little. Yet a decade on from Enron, I'm not sure the lessons have been learnt across all jurisdictions. Although most UK firms have an ethics policy, they don't know whether they're moving forward, backwards or sideways on ethics. That's because they haven't put any mechanisms in place to measure ethics. It's this type of challenge that now needs to be overcome.

It's also a challenge that seems unlikely to go away, in large part because financial services firms could soon find their 'ethical culture' being scrutinised by the regulator. I believe the FCA will soon be looking for signs of a firm's ethical culture and factoring this into their risk assessment. What exactly they will be looking for is unclear at the moment, but a firm that isn't setting any business objectives for ethics, or measuring and reporting on relevant metrics, could be in for a rude awakening.

One example that is worth watching at the moment is how the Monetary Authority of Singapore will respond to a review into the conduct of financial advisers there. In early 2013, following some disappointing results from a mystery shopping exercise, an expert panel recommended that regulated firms adopt a set of approved key performance indicators (KPIs) for ethical conduct, to be monitored independently of the advisers themselves. Failure to meet these conduct KPIs would mean that managers "incur heavy penalties from their own remuneration".

How these recommendations are incorporated into Singapore's regulatory system will become clear during 2013. But what's clear now, from this and other examples, is that regulators around the world are increasingly expecting firms to take concrete steps towards building and sustaining an ethical culture across their workplaces.

What we need now from across the financial services market is the initiative to carry a concerted and coordinated response to earn the public's trust.

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