BANK OF ENGLAND

Regulating the insurance industry to support the real economy

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Published in The Times on 22 May 2014

Insurance is a major part of the British financial system, contributing £25bn to our economy, supporting over 300,000 well-paid jobs, and providing a home for almost £2 trillion of savings. It is also a world leader: the UK is home to the third largest insurance market in the world, and British insurance companies earn a third of their income overseas.

An effective insurance sector is vital to an open and resilient financial system that serves the needs of the real economy. By spreading and managing risks, our insurers safeguard companies and individuals from perils they could not otherwise shoulder. They increase the resilience of the economy to the unexpected and make entrepreneurship and trade more viable.

Insurance companies also play a stabilising role in the financial system. They weathered the financial crisis better than many other institutions, partly because they are less vulnerable to certain risks, such as those that affected banks. The risks to which insurers are exposed are not, in general, correlated with the business cycle and, because they collect premiums in the present with a view to paying claims in the future, insurers are less vulnerable to sudden outflows of funding. This allows them to take a long-term perspective that others cannot, and to make long-term investments in the infrastructure that is essential for our future prosperity.

Nevertheless, the insurance sector faces challenges in adjusting to the post-crisis landscape. The macroeconomic situation, including the prolonged period of low rates that is necessary to generate a sustained expansion in the economy, is making some types of traditional insurance business less viable. These challenges come alongside post-crisis regulatory reforms, and legislative changes that challenge insurers' business models.

These challenges could lead insurance companies towards new classes of business, less traditional types of investments, or new opportunities in emerging markets. This is not necessarily a problem, but the Bank of England, which now supervises Britain's insurance companies, will be vigilant to the risks in any such moves. Our supervisors focus on what matters: they take a forward-looking and judgment-based view of whether insurers' business models and strategy could threaten policyholders or the wider financial sector in future. If we think that management's actions today pose a risk tomorrow, we won't hesitate to step in.

What the Bank of England won't do is protect insurance companies from the consequences of their own decisions. It is for boards to run their companies, and for those who manage insurers to be accountable for their actions if things go wrong. So alongside reforms that Parliament has asked us to make to hold senior bankers to account, we will create a similar regime for senior managers in the insurance industry. Integrity, honesty and skill are not optional, whether you run an insurance company, global investment bank or building society.

Of course, even prudent insurers will sometimes face bigger-than-expected losses after disasters strike. The UK already has some of the most robust and comprehensive standards for the capital buffers we expect insurers to hold. But we are also working towards global capital requirements so insurance companies that operate around the world are consistently strong. International co-operation is vital in negotiating common global standards, and the Bank of England is taking a leading role to ensure that the UK's voice is heard. Our aim is to create as level an international playing field as possible.

Even with tough capital requirements, some insurance companies will still fail from time to time. The Bank of England doesn't regulate to prevent failure: companies that make mistakes should face market discipline. Our role is to make sure that failing insurers don't harm their policyholders, cost the taxpayer money or make insurance harder to obtain. That task is harder where insurance companies operate internationally, so we work closely with our counterparts in Europe and elsewhere to address these challenges.

Regulation is not just about minimising the risks insurers pose. It's also about allowing them to play a positive role as a source of long-term finance for the economy. With this in mind we are working alongside the European Central Bank to address impediments to markets so that institutions other than banks to provide funding to SMEs, multinational companies, and infrastructure projects. We are mature in our approach, and if we learn that regulation at UK, European or global level is holding back insurance companies from contributing to growth, we will not hesitate to refine that approach.

The responsibilities the Bank of England has been given for regulating the insurance sector form a core part of our work. The vital role of insurance in our economy demands that our approach to supervision be tailored. The global position of our insurance industry demands that our approach is international. And the need to promote the positive role insurance can play demands that our approach is mature.

The UK insurance industry's strengths are its innovative approach, deep human capital and global perspective. The Bank of England's approach to supervising it will maximise its resilience and allow it to make the biggest possible contribution to the UK and global financial systems and to the real economies they support.