A time of change

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We're living through a time of great political, economic and technological upheaval. But while this presents a considerable challenge for the insurance industry, it is also an opportunity to replace old business models and systems and lay the foundations for a new period of growth.

Sir Christopher Meyer, the former British Ambassador to the US, has backed British Prime Minister Theresa May to have the kind of positive and influential relationship with US President Donald Trump that former PM Thatcher had with President Reagan.

While noting that May dislikes comparisons with Thatcher, Meyer said he was impressed with the outcome of her US visit, where she was able to convince Trump to soften his rhetoric on NATO, trade and torture, while toughening it on Russia.

"Sometimes it is harder to negotiate with friends and allies than it is with adversaries,"

Meyer told his audience, at the Hogan Lovells Global Insurance Summit in London, where he was keynote speaker.

Meyer emphasised the importance of the US-UK relationship, and the positive influence May can have on the new US President, at a time of increasing political uncertainty. The election of Trump in the US must be seen in the global context of a "great unravelling," in which institutions and treaties that many had been assumed were eternal – such as the UN and the World Trade Organization – can no longer be taken for granted."

But he hinted that the upheaval might ultimately be beneficial, acknowledging that parts of the old order had ceased to function properly by calling the UN Security Council "virtually useless." By surrounding himself with "hard-nosed pragmatists" like Rex Tillerson, Reince Priebus and Mike Pence, the hope is that what has been unravelled can be reconstructed with improvements.

There are certainly positive indicators. The market responded favourably to the US election outcome, while the Bank of England published a flurry of upbeat figures in February, showing inflation and growth were up.

But while rates have also started to creep up, they remain low by historic standards – and are unlikely to realign with their long term average in the foreseeable future. Yields are also low relative to longer term norms.

Such is the uncertainty facing the global economy generally, and the insurance industry specifically, in early 2017. The principal problem facing the global economy, which arguably underlies the political upheaval, is the accumulation of leverage in the system since the 1950s, predominantly secured against real estate. The fallacy is that this debt can be paid off, said Lord Adair Turner, former Chairman of the Financial Services Authority, giving the morning keynote speech: in fact, once created the debt has never gone away, but has merely moved around the system.

Japan illustrates the problem. Its real estate boom in the 1980s saw lending increase three-fold in five years, affecting both corporates and households. When the economy went into recession corporates endeavoured to pay down their debt. This increased public expenditure, reducing taxes, and resulted in rising public debt.

The world has been going through something similar since 2008. Growth, which has long been fuelled by growing consumer debt, has stalled. Global policymakers have had some limited success getting it going again, but only by encouraging more lending. Central banks' traditional policy levers are producing diminishing results, with the transmission mechanism of ultra-loose monetary policy to the economy weakening, while inflating asset price bubbles in equity and real estate markets. Competitive devaluation, a powerful solution for countries going through localised crises in the past, have not worked because all economies are in the same position.

Old problems exacerbated

But recent years have only seen an acceleration of trends that have been playing out for decades. Around 60% of interest rates' decline, since their peak in 1986, came before 2008. While the weight of global debt became crippling in 2008, it had been building up for a long time.

One catalyst for the changes sweeping through the global economy is technology, which ultimately presents huge opportunities in the insurance sector and beyond. Imbalances are being exacerbated by the reduced investment needs of a new generation of high tech companies that boast enormous balance sheets but employ relatively few people, said Turner. Facebook has less than 15,000 employees but has a market capitalisation of $374bn. The modern economy creates huge equity value with very little investment, he said, quite unlike the industrial economies that sucked up investment to pay for machines, plants and labour.

Another catalyst is demographics. Ageing populations will require a fundamental rethink of social safety nets, pension provision – and insurance provision. This is having a direct impact at the corporate level, as Japanese and Chinese outbound investment flows into the global insurance sector via M&A deals.

At the same time, younger consumers have different expectations of their service providers, and winning their custom will require insurance companies to innovate in customer services and pricing. Technology enables them to do just that.

The insurance industry is going through seismic change, but it remains as relevant as ever, as illustrated by the contrasting response to two natural disasters in 2010. Chile, a country with extensive insurance penetration, has made good progress recovering from its earthquake: Haiti, where insurance coverage is more limited, has not. While insurance is not the only factor, it does help to explain their different fortunes.

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