## THE STATE AS CONTROLLER AND COMPETITOR

A Paper submitted to the Anglo-German Insurance Law Seminar held in Cologne on 29 and 30 May 1980 by Professor Hugh Cockerell, City University Business School.

The philosophy of successive British governments to private insurance has been to exercise the minimum of supervision regarded as necessary to safeguard the consumer rather than to exercise control. Until the twentieth century, regulation was confined to life assurance companies under the Life Assurance Companies Act 1870. This Act followed on the spectacular failure of a large company (the Albert) which had acquired the business of a score of other companies and had failed to build up proper reserves. Even then, the state confined itself to requiring accounts and actuarial returns from existing companies, to stipulating for a deposit of £20,000 to be made by new companies and to laying down a procedure for amalgamations of companies designed to ensure that the financial interests of policyholders were protected. The government used the slogan "freedom with publicity", that is, the facts about the financial position of each insurance company being made publicly available, it was left to individuals to choose among them at their own risk. Once the Act came into force, failures of life assurance companies practically ceased for a century.

Not until 1909 were the same principles extended to the principal classes of non-life insurance at that time, namely, fire, personal accident, employers' liability and marine. With the introduction of compulsory third party motor insurance in 1930, the principles were applied to motor insurance though here a deposit of £15,000 only was required from a new company.

A number of motor insurance companies failed in the 1930s. The Assurance Companies Act 1946 revised the supervisory system in various ways. For example, in lieu of deposits from new insurance companies only, it required all companies to show a margin of solvency. The supervisory authority (the Board of Trade, now the Department of Trade) was given limited powers to check the affairs of companies.

Further failures occurred among motor insurance companies and the supervisory authority obtained additional powers to verify the position of companies by the Insurance Companies Act 1958 and again by the Companies Act 1967. The government was seeking to exercise a more positive supervision but it did not give itself the resources of manpower to do so. Failure of motor insurance companies continued in the 1960s. Public dissatisfaction came to a head with the collapse of the Vehicle and General Group in 1971 which involved some 800,000 motor policyholders. A tribunal of inquiry found that the official in charge of the supervisory department (the Under Secretary) had been negligent in the exercise of his functions.

Motor insurance was not the only troubled sector. The tax advantages enjoyed by life assurance had led a number of life companies to issue bonds providing either income or capital gains over a term of years. Many companies allowed these to be redeemed during their course for all (or almost all) the purchase money. Some smaller companies matched their investments to the maturity date and in so doing did not allow sufficiently for the possibility of earlier redemptions. When security prices fell and interest yields rose, the bonds lost their attractions and heavy redemptions took place which not all companies were able to meet without financial embarrassment. Most of these companies were taken over by other life assurers but two or three were forced into liquidation with resultant loss to policyholders and annuitants. The most notorious case was that of a company controlled by a property developer which had placed a large proportion of its investments in an uncompleted development, the realisable value of which was speculative.

The government took threefold action. The Insurance Companies Act 1974 still further increased the powers of the Department of Trade. The Insurance Division of the Department was doubled in size. (It now has 120 employees plus some specialist assistance.) And the Policyholders' Protection Act 1975 required solvent insurance companies to meet all (or almost all) the losses of private United Kingdom policyholders that might arise as the result of any subsequent insolvency of an insurance company.

Some of the unsuccessful life companies had been largely supported by insurance brokers who had received high rates of commission from them. The unsuccessful motor insurance companies had nearly all drawn most of their business from brokers. The title of insurance broker was available to anyone who chose to use it and there were estimated to be some 10,000 firms styling themselves insurance brokers. The government in 1975 invited the various associations of well-established brokers (there were four such associations) to devise a scheme of self-regulation. The associations came together (they have since merged in the newly formed British Insurance Brokers' Association) and proposed a scheme which was substantially adopted by Parliament in the Insurance Brokers (Registration) Act 1977. The Act set up an Insurance Brokers Registration Council which consists of 12 persons elected by insurance brokers and 5 government nominees. The Council is required to set standards for persons who seek to call themselves insurance brokers and to maintain a register of such persons and a list of insurance broker firms. It has been required by the state to make regulations as to a code of conduct for insurance brokers, their keeping clients' money in a separate account, their solvency and their possession of professional indemnity insurance. They have also been required to establish a fund to compensate persons who lose money through their dishonesty.

The system for registration of insurance brokers is perhaps typical of British government philosophy in the supervision of insurance. The regulations made by the Insurance Brokers Registration Council have required official approval but their enforcement is left to the Council with its permanent majority of members elected by the brokers themselves. In a similar way, supervision of the activities and solvency of underwriters at Lloyd's is left to the Committee of Lloyd's which makes aggregate returns on their behalf and certifies the solvency of Lloyd's syndicates.

Insurance intermediaries other than brokers are not as yet the subject of any control. Anyone who can persuade an insurance company to grant him an agency can draw commission on the business he introduces. In Britain, insurance agents constitute a wide spectrum including the self-employed tied agents of some life assurance companies, professional men such as accountants and solicitors, and individuals who obtain an agency for the purpose of drawing commission which they are free to pay over in whole or in part to the policyholder. An official discussion document of 1975 entitled Insurance Intermediaries said

> 'The Government believes that consumer protection in the field of insurance selling can only be improved significantly if high standards are enforced on insurance agents as well as insurance brokers.'

It rejected the possibility of action to lay down standards and proposed that insurance companies should accept more responsibility for the conduct of agents. How this is to be done has not been determined so far.

It should be borne in mind that there is hardly an equivalent in the British insurance system of the large firms of agents to be found in say, France, where they may have exclusive rights to represent certain insurance companies in a particular area. Insurance companies in Britain operate either through a branch system or through brokers or through both though some life companies use self-employed individuals as agents.

There is at present no control of premium rates and policy conditions in the insurance market. It is considered that competition is an effective safeguard for policyholders. Insurance companies are free to devise such policies as they like and this allows for innovations.

So in some sense, freedom with publicity has survived as a policy though supervision of insurers' activities has become active rather than passive, as it was until thirty years ago. The Anglo-Saxon tradition is to allow business to evolve and only to intervene when the need for state intervention has been demonstrated by something going wrong. This approach has had to be modified to some extent to meet the requirements of the EEC for co-ordination of the laws relating to insurance supervision and the insurance contract. Even so, there has been reluctance to do more than the minimum necessary to conform with EEC requirements. For example, British insurers, and the British government, have not been fully convinced of the need for separate companies to transact life and non-life insurance or liability and legal expenses insurance, and compromises have had to be worked out. Similarly, the proposals for uniformity in the law relating to the insurance contract have had a difficult passage, in particular with regard to the legal effect of innocent non-disclosure on the part of a proposer. Discussions are still proceeding. But undoubtedly our law has benefited from the adoption of other countries' practices. The best example is perhaps the German requirement for persons floating a new insurance company to submit a business plan showing how they propose to proceed, how much business they intend to do, and what their reinsurance arrangements will be.

The present Under Secretary in charge of insurance supervision spoke recently to the British Insurance Law Association of the relaxed style of supervision that we apply. It would be called in question, he pointed out, if there were any scandal or the exploitation of insurance for non-insurance purposes. We need, he concluded, the vigilant help of everyone in the industry in ensuring that our framework works well in an industry run by persons of integrity and skill and resource. British insurers accept the need for reasonable control as they have done for a century.

I am asked also to deal with the topic of the state as competitor with private insurers. The general philosophy, except among those socialists who subscribe to the nationalisation of banking and insurance, is that the state should not transact insurance if the commercial market can give consumers what they need. When the state has entered the field in the past, it has been because private insurers could not cope. The principal examples are insurance of exports against political risk and insurance of private property and marine ventures against war risks in wartime. In the 1930s the state came into the marine insurance market to reinsure part of the value of the giant Atlantic liners of the day because the private market could not cope with the large values, but the market grew and the government was able to withdraw.

I need not deal with the long-standing controversy we had over the respective spheres of the state and of private employers in providing pensions because that is the subject of another session. Instead, I will just mention two fields where private enterprise and the state could be considered in competition.

The more important of these is in the provision of hospital and medical services. These are broadly speaking available to everybody without charge through the National Health Service. A small minority (less than 5% of the population) effect insurance to pay the fees charged for private rooms in hospitals and the medical fees that their occupants have to pay. A private room in a London teaching hospital now costs over £100 a day, apart from medical fees. The insurance is provided almost wholly by non-profit making societies. The majority of the people concerned are in group schemes provided by their employers. The last Labour Government, and many of the workers in the National Health Service, are opposed to the existence of private patients in public hospitals and the private medical insurers are opening nursing homes of their own which cater quite extensively for wealthy Arabs. There is an area of conflict here but it is quite small in the numbers concerned.

Finally, I would mention one minor field in which private insurers may lose business through state action. This is the insurance of exhibits at art exhibitions. The cost of insuring them is high because of the high values of paintings and the like. A Van Gogh, for example, has just been auctioned for over $5M. For some time, where valuable items which are the property of certain national collections have been lent to exhibitions, the Treasury has been willing to grant a guarantee to the lenders at no cost. It has been lucky in that there have hardly been any claims (£20,000 in all over a number of years). This scheme has recently been extended because organisers of exhibitions found the cost of insurance prohibitive. In a sense, therefore, it can be said that the state is competing with private insurers, but in all the main fields of insurance, apart from social security, there is no such competition.

To sum up, British insurers have no complaints about the system of insurance supervision. They accept it as they accept the weather, and we have a mild climate. Nor is the state seen as a competitor to private insurance. Only if a strongly left wing government dedicated to the principle of public ownership were to come into power would insurers begin to feel any threat to their position.

H.A.L.C.