FFS0035

**Written evidence submitted by Aon**

Thank you for the opportunity to respond to this inquiry. Aon is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Headquartered in London, we have 6,000 colleagues based in the UK. Aon UK placed $7.5 billion in annual insurance premium in 2020 and $8.9 billion in reinsurance premium in 2020. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance. We are supportive of efforts to maintain the UK's best-in-class regulatory regime and welcome the Treasury Committee's interest in post-Brexit financial services.

London's (re)insurance industry is the largest centre in the world, double the size of its nearest rival Bermuda. Supported by a 35,000 strong workforce, the sector contributes roughly £30 billion pound annually to GDP, and constitutes almost a quarter of the City of London's output. Our innovation, scale and global reach stretches from savings and pensions, through to household and automotive, to liability and speciality risk management for business. We are truly international, doing business from London to the United States and the Americas, and from Europe to the Far East.

The UK's status as the centre of the world's insurance market is under threat from fast developing markets and has seen London's share of the global insurance market shrink in recent decades. The UK's competitive position was built on the depth of its broker and underwriter expertise, the scale of capital and an attitude toward innovation that allowed for a broad product offering. But, operating in London means accepting higher expense ratios and, recently, a degree of regulatory uncertainty. Nonetheless there are meaningful opportunities for the UK to reverse its decline in global market share, and, in fact, to grow the available global market.

We would urge the Treasury Committee to take account of the following points as they relate to financial services and the insurance sector in particular. We have structured our response by the themes we consider most important.

**UK-EU relationship**

As a non-EU member state – and, in particular, outside of the single market – EU Directives are no longer directly applicable to UK firms. Whilst this provides an opportunity for the UK to diverge from EU financial services regulation, we would urge policymakers to be cautious in their approach. Aon adapted its business model to ensure it was able to provide continuity of service after the end of the Brexit transition period. The continuity of this solution is dependent on political will from regulators and legislators in Belgium and other countries. With these short-term changes accommodated, it becomes vitally important to the sector that the UK/EU Memorandum of Understanding for financial services, currently under negotiation, recognises the need to provide mutual market access, and seeks to replicate passporting rights as closely as possible. That said, the UK should not take rules unless they are beneficial to the partnership with the EU and equally apply to the EU.

**Regulatory structure**

As an overarching principle, we believe that the government's priority for financial services should be to ensure that the UK preserves its pre-eminent position as a global financial centre. The UK's world-leading specialist insurance market is vitally important to the long-term success of the financial services industry and, following the UK's exit from the European Union, preserving the London insurance market's international competitive advantage has never been more important.

To facilitate this, regulation of post-Brexit financial services should provide long-term certainty to firms whilst at the same time allowing a degree of flexibility to innovate. We have concerns that the Financial Conduct Authority (FCA) has historically been too fragmented at an executive level, split under separate divisions such as authorisations and supervisions; this has prevented a coherent regulatory strategy and has resulted in a regime that is slow to adapt to emerging trends and industry innovations.

For example, last year the FCA consulted on proposals to introduce new rules to ensure operational resilience in financial services firms. This was despite the fact that it already has two layers of rules: the Systems & Controls Handbook and Senior Managers & Certification Regime (SMCR), which place requirements on firms and individuals to ensure resilience. Of the examples of failures of resilience cited in the paper, none showed evidence of being systemic issues as opposed to one-off incidents, and none involved firms engaged in insurance distribution. Indeed, one statistic that was cited – the increase of reporting of issues to the regulator – could well have been evidence of the success of the existing rules FCA has in place to enforce operational resilience and require such reporting.

In addition, responses to identified issues in the market should not be dealt with via sweeping regulatory changes that may lead to unintended consequences or additional burdensome processes, which in turn can affect the ability to deliver low-cost solutions for consumers.

We understand that the regulator has recently undergone a restructuring, with the competition and supervision divisions merged. In this regard we would urge the Treasury Committee to encourage the FCA to maintain and build on a joined-up approach to regulatory activity, such that the regulator becomes a catalyst for cross-financial services innovation and collaboration. Moreover, co-ordination between international regulators could be improved, with UK taking a leading and proactive role, if the UK is to realise its intention to make it easier to do business across borders.

**Administrative burdens**

Regulators must also remain mindful of the administrative burdens that some of their discretionary studies can impose on the companies they regulate. While it is important for the FCA and other regulators to understand how well various markets work for consumers, participation in a market study can cost firms millions of pounds in external legal fees as well as huge amounts of internal resources. It can also stifle innovation and competition – needed now more than ever to tackle cyber security issues, the sharing economy and climate change to name but three. Moreover, regulators' knowledge of the industries they regulate are, at best, out of date and would benefit from increased accountability to parliament.

Before imposing these costs on regulated firms, the FCA should have a clear idea of which potential problems it is trying to solve. If market studies and similar inquiries are to be used as a form of routine fact-finding, then the Treasury Committee should encourage regulators to conduct them in a way that imposes fewer costs and burdens on regulated firms whilst simultaneously holding them to account. There is also little in the way of useful quantitative or qualitative feedback to industry following numerous data requests (or the larger market studies). We believe this should also change. Our suggestion would be to allow for more data sharing with firms. Regulators hold a unique position in the marketplace, covering in excess of 60,000 firms. Those firms should benefit from the insight that brings, without compromising the independence of the regulator or sharing confidential information. The FCA should move towards being a mature counterpart in seeking compliant solutions, rather than a relationship based on control. Aon has seen the difference of how this works when engaging with the Belgian financial services regulator.

**Regulation development**

Compared with other similar jurisdictions, the UK's regulation development process is of a high standard. In particular, the UK boasts strong ethical credentials in its regulations which we believe are the envy of the world. This includes a sophisticated approach to environmental and social considerations, and how these relate to investment and underwriting decisions. Our industry established ClimateWise in the 2000s and we follow the Lloyds responsible business approach. With that in mind, we welcome the regulators' collaboration with industry through consultation papers and policy statements which are clear on the rules and with helpful guidance. The FCA's predecessor body, the Financial Services Authority, established an expert panel consisting of Chief Risk Officers to help shape and review the Basel II regime. We believe such a process led to the creation of more pragmatic rulemaking. We would encourage this system of expert panels to be extended to other aspects of key regulation.

**Data protection**

In addition, maintaining equivalence in other key areas is critical. For instance, in data protection and specifically in relation to the flow of personal data across geographical borders. The digital world has few borders, but legally compliant data transfers are critical to the furtherance of digital innovation and successful trade. Currently, the EU-UK Trade and Cooperation Agreement (TCA) provides data privacy equivalence for the

UK thanks to a so-called “bridging mechanism” whereby personal data can continue (temporarily) to flow freely from the EU to the UK without interruption. This bridging mechanism provides a crucial safety net for data transfers and gives UK firms confidence and flexibility to continue digital trade in the short term. The bridging mechanism lasts for an initial four months whilst the European Commission (EC) considers the UK’s adequacy application which, if granted, would enable the continued free-flow of personal data to the UK indefinitely. The initial timeframe could be extended by a further two months (i.e. until 1 July 2021) unless the UK or EC objects to such an extension.

The TCA appears to pave the way for a UK adequacy finding, although this is not guaranteed. Firms must of course prepare for all eventualities to safeguard future personal data flows, but we must emphasise that the absence of an adequacy finding would generate significant costs as well as extra administrative and compliance burdens for firms; not only UK firms operating in the EU but also EU firms offering services and relying on business partners in the UK market. Recent research highlighted that in the absence of an adequacy decision, the cost of having to put in place alternative transfer mechanisms could collectively cost UK businesses £1.6 billion[1]. Moreover, without an adequacy decision, substantial complex compliance burdens would arise for EU firms which transfer personal data to the UK following the recent *Schrems II case*[2]. In particular, EU companies would be required to conduct "mini adequacy assessments" of the UK’s legal framework (including the UK surveillance laws) prior to transferring personal data to the UK, using the same criteria as the EC when conferring adequacy decisions. This complex analysis will be required to ensure compliance of any EU firms with this *Schrems II case*. Therefore, (and noting the number of other jurisdictions that have already been deemed “adequate” by the EC), there is no reason that pursuit of this policy goal should be viewed as inconsistent with the UK’s new capacity for independent policy making on data protection. We would reiterate that a UK adequacy decision is critical for digital trade and the overarching success of the financial services.

Furthermore, EU and UK data protection laws apply extraterritorially, meaning that certain firms could be subject to both legal frameworks. In practice, this subjects UK and EU firms to dual (or even multiple) data protection regulators, investigations, breach reporting obligations and enforcement. The UK regulator – the Information Commissioner's Office (ICO) – is no longer part of the European Data Protection Board (EDPB). However, the TCA does envisage the development of a new regulatory relationship between the ICO and EDPB to enable the sharing of data protection expertise and to ensure cooperation on investigations and enforcement actions where appropriate. We are fully supportive of this; close cooperation between the ICO and EDPB is essential to ensuring regulatory certainty and consistency. The Treasury Committee should be mindful of this when considering any regulatory divergence and making recommendations to government.

**Outcomes-based approach – believing in markets**

The UK’s regulators are world-leading and their particular focus on conduct marks them out from other similar financial supervision authorities. We believe this gives the UK a competitive advantage, showcasing the stability of the financial services environment, even if it does drive a significant cost base for companies operating in the UK. However, there are areas where we believe there is an opportunity for regulation to span more but supervise less, with a outcomes-based approach. At the moment, there is a regulatory focus around supervision of firms such as Aon’s which can create a potential disadvantage as the firms then staff up to respond to supervision, potentially diverting investment from better client outcomes. This is not the best return of capital for UK plc and UK GDP. By focusing on clearly defined client outcomes, regulators will reduce the bureaucratic burden on firms. For example, the recent FCA General Insurance Pricing Review has triggered a significant change programme, putting out a customer expectation of price reductions which may never actually be realised in practice. This in turn provides further reputational challenges for our sector. There is an opportunity for the Treasury to write to the regulators to set out the public policy objectives it considers most important for the financial sector. Regulators should in turn be required to respond to these letters setting out how their actions have met these objectives. We would further add that this should be a public and transparent process to allow for industry and consumer confidence.

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[1] McCann, D, Patel, O and Ruiz, J (2020) The cost of data inadequacy. Retrieved from ucl_nef_data-inadequacy.pdf

[2] Case C-311/18 (*Data Protection Commissioner v. Facebook Ireland and Maximillian Schrems*).

This must start with a reaffirmation of government's belief in markets and requirements for the FCA and other regulators to only seek to intervene where there is clear evidence or demonstrable risk of market failure. We would propose that an independent body is set up with the specific responsibility of ensuring the regulators stick to this principle, and that this body is given the power to override regulatory action if it deems it to breach the principle. Too often market studies and other interventions can be triggered by agitation from vocal lobbies rather than evidence of actual detriment to consumers. Generally speaking the FCA should distinguish clearly between consumer and professional market actors. With the latter, such as commercial risk or reinsurance, there is an opportunity for the UK to benefit from greater liberalisation of rules for educated market participants.

**International openness and flexibility**

Trends in technology development and dependence, increased global interconnectedness and the increasing risks associated with climate change have all made the business of insurance more complicated and resource intensive. Improvements to the international competitiveness of the sector, as outlined above, should come alongside government partnerships with the sector to expand product lines and services to cover new and emerging risks for where there is currently little or no market.

These risks number in the hundreds – but the three most obvious we consider to be un- or under-insured are cyber, climate change, and pandemic. For instance, less than 10% of cyber risk is currently insured[3], there is little to zero market for pandemic risk, and available risk capital for climate-related perils are also diminishing despite events such as flooding becoming more frequent and severe. Almost 65% of global losses from natural disasters alone are not insured and in 2020 uninsured losses relating to weather, climate and catastrophe totalled $268 billion.[4] Globally, the insurance sector has trailed behind other areas of the financial services industry when it comes to innovative solutions.

But with this comes an opportunity for the UK market to become the go-to centre for where these problems are solved. The UK is uniquely placed to meet this demand given our traditional strengths and strong expertise in complicated or specialised risks.

Through this pandemic we have seen the limitations of the state as the sole protector of businesses and the wider economy. The unprecedented levels of public spending will have consequences for the government's balance sheet for decades. Looking ahead to the future, we need to find a solution that ensures both government and the economy can remain resilient should there be another systemic event. We believe that this requires a public-private solution. One with clearly defined risk and triggers – that recognises that the insurance industry does not, on its own, have the financial resources to accept or cover total losses of events like COVID-19. Doing so would render many policies unaffordable. Where loss is so wide-ranging, innovative approaches are required to ensure that coverage is targeted where insurance can most meaningfully address the most important aspects of the risk. It is not possible for government to avoid being the insurer of last resort, but an innovative partnership with the insurance industry can help to spread the load and define the point at which the public sector needs to step in.

Moreover, the (re)insurance industry as a forecaster and protector against risks has a critical role to play in building new protection mechanisms into the economic recovery. Through the use and analysis of data, the sector can develop effective contingency plans for clients, for example flood catastrophe models that apply previously collected data to the modern day via simulation techniques, enabling more detailed insights on loss estimates and enhanced planning. Our industry can be a force for good in seeking and rewarding resilience. Intermediaries, such as Aon, advise clients on techniques and strategies that build resiliency and preparedness ahead of future disasters. Insurers then provide the financial incentives, in premium and protection, for increased preparedness. Our sector has access to huge volumes of data and increasingly hires experts in earth science, geoscience, actuarial analysis, and other data-driven backgrounds into the field. Being able to combine this scientific expertise to develop tools such as catastrophe models or other data visualisation products, allows the industry to support business transition to net zero.

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[3] Based on $6 billion in insured cyber-crime, out of $6 trillion total: https://cybersecurityventures.com/cybercrime-damages-6-trillion-by-2021/

[4] Based on figures in Aon's Weather, Climate and Catastrophe Report 2020

A systemic risk solution should also be considered rather than just a pandemic-specific solution given the multiple systemic risks affecting our global economy ranging from cyber, climate, geo-political risk and terrorism. Any solution will need bi-partisan support as well as political commitment to economic resilience planning, to ensure long-term perspectives and objectives are met. It will also need to examine remedies to potential issues around low consumer take-up for insurance and industry supply of products. As the Chair of the UK Commons Public Accounts Committee, Meg Hillier, highlighted, “Pandemic planning is the bread and butter of government risk planning. But we learn it was treated solely as a health issue, with no planning for economic impacts.” An independent inquiry by the Treasury Committee to look at the UK’s economic and societal resilience towards systemic risks would help kick off the necessary discussions and bring a sharper focus to the issue of disaster preparedness and response.

In order for the London insurance market to meet the demand to address emerging unmet needs, the regulatory regime should be designed to give rise to that process. This also requires collaboration between the public and private sectors to work out how best to appropriately share the burden of such systemic risks. Open dialogue and engagement is an important first step to establish how further collaboration could help meet these societal challenges.

The growth in the global insurance sector is being driven by opportunities in the Far East. By way of example, the most recent Global Financial Centre Index published by Z/Yen shows that Shanghai, Tokyo, Singapore and Hong Kong are all closing in on New York and London as the dominant global financial centres. The Treasury Committee should be mindful of the fact that the London market attracts two thirds of its business from overseas when considering a regulatory regime that is conducive to international openness. The principal way this can be achieved is by clarifying the UK’s regulatory regime’s role when supervising businesses that deal primarily with non-UK customers – as our sector frequently does.

The FCA’s approach towards territoriality is one of the opaquest areas of the current regime, leading to UK firms that deal with overseas markets to err on the side of caution and comply with both local requirements of the overseas market and those of the FCA. This is despite the FCA not having any statutory duty to protect foreign customers. Such duplication adds very materially to the cost of doing business – especially for the London market-based businesses - and reduces the scope for, and pace of, innovation and growth.

To address this, we would recommend greater co-ordination between international regulators to boost cross-border trade. There is also an opportunity for a lighter-tough regulatory regime where the borders of the FCA’s responsibilities are clearly articulated. Such an approach must be explicitly stated if firms are going to have the confidence to work within it without running the risk of future regulatory action.

**Innovation and FinTech**

The future of financial services regulation must reflect shifts in business models and the economy and, crucially, should be mindful of the need to foster innovation. By way of example, we note from our own experience that achieving workable regulatory compliance for companies in the sharing or ‘gig’ economy is challenging and is often subject to interpretation. A flexible approach to regulation to enable new models such as those emerging in the sharing economy will assist the UK in leading the way in responding to growing global economic trends, and will help ensure that it maintains its global position as a pre-eminent financial centre, and the world’s InsurTech and FinTech hub.

By way of example: Aon may be approached by a “platform” that provides opportunities for people to deliver food from restaurants to people’s homes. This is done by way of engaging riders or drivers who are either self-employed or perhaps on zero-hour contracts or paid per delivery. These drivers will wish to, and indeed may be required to, have insurance in place in order to use the “platform”. The traditional approach to motor insurance would be an annual premium payable either in full in advance of inception or in instalments. Drivers using the “platform” will desire a more flexible option where they can use mobile devices to receive notification of potential work as well as to share data with the platform provider to track their movements and to record and reconcile any amounts due to the driver.

FinTech insurance options can link in with the platform and the driver by allowing them to “tap an app” at the beginning and end of each shift or delivery and to obtain cover only for the periods absolutely necessary for them. This provides a cost-effective alternative to sharing economy workers but also allows insurers to hone their prices based upon richer data that can be collected.

The implication for insurers and brokers is that the traditional paper-based model of issuing insurance documents does not meet the needs of these customers. Even where information can be transmitted electronically the likelihood of insurance buyers wishing to or being able to read all of the documentation on a mobile device is quite low. This can be proven by click times but anecdotally where, in general, most insurance policy "packs" consist of several pages of text, exclusions, disclosures: most consumers do not read all of the documentation sent to them.

The need, therefore, is for insurers and brokers to be able to deliver products at speed to consumers at the price that suits them and with simple, easy to read language, in formats that suit mobile devices and which gives certainty to the user as to the value and usability of their product.

This has implications for development and the need to move from traditional distribution models but also for cost. The FCA sets a high standard in terms of product development expectations and in particular in the insurance industry under PROD 4. These detailed Rules set a high bar for those manufacturing or distributing regulated insurance products.

There is a cost attached to the detailed regulations in terms of both time and capital, launch and post-launch reviews, and also in terms of (the potential to stifle) innovation. The detailed Regulations, by requiring levels of governance to launch a new product, exceed those in the wider economy for launching a new business. While they seek to minimise the risk of failure and potential harm to consumers, they emphasise governance and regulation where other methods of protection, such as capital, would be equally if not more appropriate.

According to a 2019 article in Real Business that analysed 14 years of ONS statistics on business births and deaths:

> *"42% of micro businesses (employing fewer than 10 people), 45% of small businesses (employing between 11 and 50 people), and 51% of medium-sized businesses (employing between 50 and 249 people) make it to the fifth birthday. For large businesses (employing over 250 people), only a dismal 15% make to the five-year mark. Of course, the raw data reveals that on average, fewer than 100 large businesses are 'born' yearly, so the birth rate is understandably minimal."*

It is clear from these statistics that not all start-up ideas and products will succeed in the long term. That also means that, logically, the growth rate of these businesses even when growing rapidly from a small base in the early years is unlikely to have reached a market size where failure of the business in a UK insurance sector would cause only minimal disruption to the market place overall.

Furthermore, an insurance policy that is underwritten by an insurer that is not connected to the start-up will survive the failure of the start-up and thus clients can continue to have protection even if the start-up fails. In addition, insurance fund levies on the industry give extra protection to consumers should the insurer fail.

Here, we return to the issue of governance and regulation in respect to innovation in the shared economy. The governance required of firms by the FCA when designing any product is heightened whenever the FCA deems a consumer to be involved. For example, from the FCA guidance:

> *PROD 4.2.21 G 01/10/2018*
> *The level of granularity of the target market and the criteria used to define the target market and determine the appropriate distribution strategy should be relevant for the product and should make it possible to assess which customers fall within the target market. For simpler, more common products, the target market should be identified with less detail while for more complicated products or less common products, the target market should be identified with more detail taking into account the increased risk of consumer detriment associated with such products.*

By the very nature of new and innovative products the FCA guidance insists upon an immediately heightened product governance standard. This is despite the evidence that most start-ups may not gain sufficient market share to make them a threat to the UK financial system, and that there are other safeguards to consumers as mentioned above in the protection afforded by the policy and the guarantee funds available to compensate consumers.

We believe that a lower, or at least equivalent, threshold to a simple product should be accorded to new and innovative products being developed and that the governance and oversight should scale up as sales and customer numbers, and hence risk, grows. We believe that the insurance industry is already well suited to recognise, monitor and manage risks in this way.

**Parliamentary oversight**

Aon recognises the need to ensure a robust approach to the development and scrutiny of financial services policy and regulation, particularly in light of the UK's exit from the European Union. With regards to developing a greater role for parliament, for example by establishing a financial services-focussed select committee, we note both the merits and drawbacks of such an approach.

Above all else, a committee with a financial services remit could go some way to improving co-ordination between different regulatory bodies, as we have called for earlier in this response. We would however encourage the Treasury Committee to be mindful of the unintended consequences of establishing a financial services committee; namely the danger of creating more instability and greater political influence into regulation. Regulation must be sustainable and consistent to allow firms to flourish within it. Our concern would be that a financial services committee would prioritise politicking over what is best for firms and the sector.

The Treasury Committee has tended to approach problems arising from business failures or poor regulatory oversight in a thoughtful and effective way. In our assessment, the unique prestige of the Treasury Committee has led to a culture in the committee that tends to promote rational and sober reflection on issues rather than 'grandstanding' for party political purposes. Our concern is that a new financial services committee would not have the same degree of prestige as the Treasury Committee, would not attract MP membership of the same experience/calibre and may, therefore, not bring the same level of responsible and apolitical reflection to financial services issues.

Any new regime should demonstrate the following features.

- It should ensure that the fundamental democratic principle that public bodies should ultimately be responsible to parliament is maintained.
- But it should be mindful of the fact that the Treasury Committee consists of MPs who may lack the resources necessary to provide the expert scrutiny required and who may have other obligations, such as the interests of constituents, that may compromise their ability to provide independent oversight. The industry being regulated should therefore have a role in the accountability framework – primarily in an educational capacity.

    Any oversight body should also ensure it has representatives able to distinguish between consumer and professional experts/company market interests.
- The regime must have the power of censure. The current approach makes it too easy for FCA to appear before the select committee at regular intervals but not make any changes to policy even when faced with significant criticism of its actions.

*February 2021*