

KEYNOTE ADDRESS

AMERICAN BANKERS ASSOCIATION

NATIONAL RISK AND INSURANCE MANAGEMENT CONFERENCE

Sheraton

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William J. Kelly

**Managing Director
J.P. Morgan**

**President
IFRIMA**

GOOD MORNING,

I FEEL LIKE I'VE GROWN UP IN THE BUSINESS WITH THIS CONFERENCE. I REMEMBER ITS ORIGINS AS A SEMINAR IN THE 70'S WHEN I WAS AT CHASE AND ITS EMERGENCE AS A NATIONAL CONFERENCE IN 1980, WHEN I WAS AT BANKERS TRUST. SINCE JOINING J.P. MORGAN, I'VE HAD THE OPPORTUNITY TO WORK ON THE ABA INSURANCE COMMITTEE AND CONFERENCE PLANNING COMMITTEE, HOWEVER, IN RECENT YEARS, I'VE BEEN MUCH MORE INVOLVED WITH RIMS AND IFRIMA.

I DON'T RECALL OUR EVER HAVING A RISK MANAGER AS THE KEYNOTE SPEAKER BEFORE. THIS CHOICE IS A CLEAR SIGNAL THAT THE PURPOSE OF THIS GATHERING IS NOT ONLY FOR A HIGH LEVEL REVIEW OF DEVELOPMENTS IN OUR INDUSTRY BUT ALSO TO SERVE AS A FORUM IN WHICH TO FOCUS ON THE DAY TO DAY CHALLENGES EACH OF US FACE IN EVALUATING A CONFUSING ARRAY OF FUNDING ALTERNATIVES.

GIVEN THIS PRAGMATIC APPROACH, I WOULD LIKE TO DO SOMETHING WHICH MAY BE A LITTLE UNUSUAL IN THE KEYNOTE PORTION OF A PROGRAM. AFTER I HAVE HAD THE OPPORTUNITY TO SHARE SOME OF

MY PERSPECTIVES WITH YOU, I PLAN TO OPEN THE FLOOR, NOT ONLY FOR QUESTIONS BUT ALSO TO OFFER THE OPPORTUNITY FOR THE EXPRESSION OF POTENTIALLY DIFFERENT POINTS OF VIEW. IN THIS WAY, WE CAN IMMEDIATELY BEGIN TO BENEFIT FROM EACH OTHER'S PERCEPTIONS AND EXPERIENCE.

AT THIS TIME, WHEN CORPORATE MANAGEMENT IS SO FOCUSED ON COSTS, IT IS IMPORTANT TO REMEMBER, THAT, WITH RESPECT TO INSURANCE AND RISK FUNDING, COST IS ONLY ONE OF SEVERAL CONSIDERATIONS. OF PRIMARY IMPORTANCE IS THE FINANCIAL STRENGTH OF THE FUNDING MECHANISM, WHETHER A COUNTERPARTY INSURER OR AN ALTERNATIVE DEVICE. THE SECOND CONSIDERATION IS THE BREADTH OF PROTECTION BEING PROVIDED. ONLY WITHIN THAT CONTEXT CAN WE BEGIN TO EVALUATE THE COST.

WE CAN'T ADDRESS THE ISSUE OF EFFICIENCY ON THE INDIVIDUAL LEVEL, UNTIL WE CONSIDER THE OVERALL ENVIRONMENT IN WHICH WE FUNCTION AND THE MAJOR CHANGES WHICH HAVE AND ARE OCCURRING. THE MOST OBVIOUS CHANGE DURING THE PAST YEAR HAS BEEN THE MASSIVE CONSOLIDATION IN THE INSURANCE BROKERAGE INDUSTRY.

A FEW YEARS AGO WE SAW THE PHENOMENON OF MORE AND MORE BROKERAGE FIRMS CHASING LESS AND LESS BUSINESS, AS CLIENT FIRMS IN VARIOUS SECTORS CONTINUED TO CONSOLIDATE. THIS TREND, WHICH WE HAVE LONG EXPERIENCED IN BANKING, HAS BEEN OCCURRING ACROSS ALL BUSINESS SECTORS ON A MULTI-NATIONAL BASIS. AS WITH MANY TRENDS, INSURANCE IS USUALLY NOT THE FIRST BUSINESS SECTOR INVOLVED. HOWEVER, IN RECENT YEARS CONSOLIDATION HAS BECOME MANIFEST, NOT ONLY IN BROKERAGE BUT AMONG INSURERS AND REINSURERS AS WELL.

IN THE PAST, WE SPOKE OF DISINTERMEDIATION AND THE DIMINISHING SIGNIFICANCE OF THE INTERMEDIARY IN SECURING INSURANCE FROM THE SOURCE, THE INSURERS. NOW, GIVEN EXTENSIVE CONSOLIDATION, THE FORMER INTERMEDIARIES ARE EMERGING AS THE CRITICAL SOURCE OF BUSINESS FOR THE INSURERS. INDICATIVE OF THIS IS THE FACT THAT CURRENT DISCUSSION OF BROKER COMPENSATION NO LONGER FOCUSES ON THE COMPENSATION PAID BY THE INSURED TO THE BROKER, BUT ON THE COMPENSATION PAID BY THE INSURER TO THE BROKER FOR PROVIDING BUSINESS. IT BECAME CLEAR YEARS AGO THAT AN INSURED CAN READILY NEGOTIATE ONE GLOBAL FEE FOR ALL SERVICES PROVIDED BY A MULTI-NATIONAL BROKER.

GIVEN THE DEGREE OF CONTROL WHICH NOW LIES IN FEW HANDS, ATTENTION IS BEING FOCUSED ON THE GREATLY INCREASED LEVERAGE BROKERS HAVE RELATIVE TO INDIVIDUAL INSURERS. CONTINGENCY FEES PAID BY INSURERS TO BROKERS, BASED ON VOLUME AND/OR PROFITABILITY OF BUSINESS PLACED, ARE NOTHING NEW. HOWEVER, SOME IN THE RISK MANAGEMENT COMMUNITY ARE NOW CONCERNED THAT A FAR GREATER PORTION OF THEIR PREMIUM DOLLARS INTENDED TO FUND RISK, WILL FORM PART OF CONFIDENTIAL, INTERMEDIARY, COMPENSATION PACKAGES. (I REFER TO CONTINGENCY ARRANGEMENTS BASED ON OVERALL BOOK OF BUSINESS NOT THOSE SPECIFIC TO ANY ONE INSURED.)

GIVEN THE EXTENSIVE AND INCREASING CAPACITY IN THE MARKET, INSURERS ARE CLEARLY DEPENDENT ON BROKERS TO OFFER PORTIONS OF LARGE COMMERCIAL ACCOUNTS TO THEM. NO ONE INSURER, HOWEVER LARGE AND GLOBAL, CAN USUALLY ASSUME MORE THAN A PERCENTAGE OR SEGMENT OF A COMPLEX, GLOBAL, COMMERCIAL PLACEMENT. TO DATE, INSURERS, EVEN THOSE WITH LARGE MULTI-NATIONAL NETWORKS, ARE GENERALLY NOT EQUIPPED TO SYNDICATE THE PLACEMENT OF RISK ACROSS THE GLOBAL MARKET.

THAT INSURERS SHOULD FIND IT NECESSARY TO OFFER CONSIDERATION TO KEY SUPPLIERS IS NOT SURPRISING NOR UNUSUAL IN THE NORMAL INTERRELATION OF SUPPLIERS AND DISTRIBUTORS. ALTHOUGH, AS I HAVE SAID, THERE IS SOME AMBIGUITY AS TO WHICH OF THESE ROLES THE INSURER AND BROKER ARE NOW PLAYING RELATIVE TO EACH OTHER. I CAN ALSO UNDERSTAND WHY SUCH ARRANGEMENTS ARE APPROACHED ON A CONFIDENTIAL BASIS. I BELIEVE THE CONFIDENTIALITY IS NOT SO MUCH INTENDED TO HIDE THE TRANSACTION FROM THE INSURED BUT FROM OTHER BROKERS, EACH OF WHOM WILL DEMAND THE MOST FAVORABLE TERMS EVER OFFERED.

THE DISCUSSION IN THE COMMUNITY SEEMS TO FOCUS SOLELY ON THE INTERRELATIONSHIPS AMONG INSURED, INTERMEDIARY AND INSURER, IGNORING THE CRITICAL SUBTEXT WHICH EXISTS FOR ALL PUBLICLY HELD COMPANIES. THAT IS THE INTEREST OF THE STOCKHOLDERS. IT IS STOCKHOLDER INTEREST PERHAPS MORE THAN ANY OTHER FACTOR WHICH IS DRIVING THE CHANGES IN OUR INDUSTRY AND THE CORPORATE WORLD AS A WHOLE.

I DON'T BELIEVE RISK MANAGERS NEED TO BE PARTICULARLY CONCERNED WITH THE MATERIALITY OF CONTINGENCY

ARRANGEMENTS. THE DEGREE TO WHICH CONTINGENCY COMPENSATION ARRANGEMENTS IMPACT INSURER PROFITABILITY AND CLAIMS PAYING ABILITY, WILL BE INDIRECTLY REFLECTED IN EACH INSURER'S HIGHLY PUBLIC FINANCIAL REPORTS, WHICH WILL BE THOROUGHLY REVIEWED BY ANALYSTS AND STOCKHOLDERS.

ON THE POSITIVE SIDE, THE INSURED CANNOT IGNORE THE POWERFUL POSITION NOW ENJOYED BY THE BROKER RELATIVE TO THE NEGOTIATION OF PREMIUM, COVERAGE AND CLAIMS PAYMENT.

IT SURPRISES ME THAT OTHER MORE OBVIOUS AREAS OF IN-EFFICIENCY GO UNQUESTIONED. FOR EXAMPLE, THE CENTURIES OLD PREMIUM PAYMENTS SYSTEM. UNDER THIS SYSTEM, INTERMEDIARIES MAY HOLD PREMIUM PAYMENT DOLLARS FOR SIGNIFICANT PERIODS OF TIME BEFORE REMITTING THEM TO INSURERS. CONSIDERING THAT EACH MONEY CENTER BANK TRANSFERS HUNDREDS OF BILLIONS OF DOLLARS EACH DAY, THE ABILITY TO EFFECT PREMIUM PAYMENT ON A DIRECT BASIS IS CLEARLY PRESENT. PERHAPS THIS ISSUE HAS NEVER RECEIVED MUCH ATTENTION BECAUSE IT IS ONLY SIGNIFICANT IN THE AGGREGATE, NOT ON THE LEVEL OF THE INDIVIDUAL INSURED. HOWEVER, THIS IS ALSO TRUE OF CONTINGENCY ARRANGEMENTS BASED ON VOLUME AND/OR OVERALL PROFITABILITY.

ANOTHER COMPLAINT OF RECENT VINTAGE, BY SOME LARGE COMMERCIAL ACCOUNTS, IS THAT MAJOR BROKERS WILL DEPERSONALIZE THE BUSINESS BY APPROACHING IT MORE AS A COMMODITY AND ON A REGIONAL RATHER THAN LOCAL BASIS. IN POINT OF FACT, ANY CLIENT LARGE ENOUGH TO COMMAND PERSONAL SERVICE AND INTERACTION WILL CONTINUE TO RECEIVE IT AND WILL BE ABLE TO FOSTER LONG TERM RELATIONSHIPS WITH INSURERS. HOWEVER, IT IS INEFFICIENT TO OFFER THAT SAME INFRASTRUCTURE TO CLIENTS WHO BUY INSURANCE AS A COMMODITY, BASED PRIMARILY ON PRICE.

THE PRESENCE OF INSURANCE BROKERAGE OFFICES ON A HIGHLY DISPERSED GEOGRAPHIC BASIS HAS NEVER BEEN NECESSITATED BY THE NEED TO SERVICE THE LARGE COMMERCIAL ACCOUNT. IT IS MUCH MORE A FUNCTION OF THE NEED TO REACH OUT TO PERSONAL LINES BUYERS AND THE SMALL TO MEDIUM SIZE BUSINESS WITHIN THE CONTEXT OF STATE REGULATION. CONSIDER THE FACT THAT, IN THE PAST WITH TRADITIONAL INTERSTATE BANKING RESTRICTIONS, NEW YORK MONEY CENTER BANKS SUCCESSFULLY SERVED MAJOR CORPORATE CLIENTS THROUGHOUT THE COUNTRY NOT ONLY

WITHOUT LOCAL OFFICES BUT WITHOUT SIGNIFICANT REGIONAL PRESENCE AS WELL.

WITH RESPECT TO PERSONAL LINES AND SMALL TO INTERMEDIATE BUSINESS, THE CURRENT FAR FLUNG DISTRIBUTION SYSTEM HAS EVOLVED LARGELY AS A FUNCTION OF THE NEED TO MEET THE DEMANDS OF TIME AND DISTANCE. AS THE FUNCTIONALITY AND SECURITY OF THE INTERNET AND OTHER FORMS OF ELECTRONIC INTERACTION EVOLVE, IT WILL BE INTERESTING TO SEE WHAT HAPPENS TO THE EXISTING INFRASTRUCTURE, AS TIME AND DISTANCE CEASE TO BE IMPORTANT CONSIDERATIONS AND THE DEMAND FOR GREATER AND GREATER EFFICIENCY CONTINUES.

ALL OF THIS DOES NOT MEAN THAT INSURERS ARE TOTALLY DOMINATED BY THE FEW REMAINING BROKERS. WHILE THIS MAY BE TRUE WITH RESPECT TO LARGE COMMERCIAL ACCOUNTS, INSURERS HAVE AND WILL CONTINUE TO SEEK, ALL POSSIBLE AVENUES OF DISTRIBUTION AND/OR SOURCES OF BUSINESS. IN ANSWER TO THE QUESTION, "THROUGH WHAT MEANS WILL INSURERS DISTRIBUTE THEIR PRODUCTS GOING FORWARD?" I BELIEVE THE ANSWER IS ANY AND ALL. WE HAVE ALREADY SEEN THE GROWING UTILIZATION OF MIXED DISTRIBUTION SYSTEMS EMBRACING AGENTS, BROKERS, DIRECT

WRITING, AND MORE RECENTLY, RETAIL BANKS. IN SHORT, ANY METHOD PREFERRED BY A SIGNIFICANT PORTION OF THE CLIENT BASE WILL BE UTILIZED AND DEVELOPED AS ADDITIONAL PRODUCTS ARE ADDED. LIKE FLOWING WATER, INSURANCE WILL TAKE ANY PATH OPEN TO IT.

OVERALL, THE SYSTEM IN WHICH WE OPERATE CONTINUES TO HAVE EXTENSIVE REDUNDANCIES. THESE INEFFICIENCIES INCLUDE THE DUPLICATION OF EXPERTISE WITHIN EACH BROKERAGE, IN PART BECAUSE OF PAST GEOGRAPHIC STRUCTURES. THERE IS ALSO EXTENSIVE DUPLICATION OF EXPERTISE BETWEEN THE BROKERAGE AND INSURANCE INDUSTRIES RELATIVE TO EACH OTHER, AS WELL AS REDUNDANT ADMINISTRATIVE FUNCTIONS AND SYSTEMS SUPPORT.

NEVERTHELESS OUR INDUSTRY HAS COME A LONG WAY WITH THE CONTINUING EXPANSION OF THE BERMUDA MARKET AND THE REINVENTION OF LLOYDS AS A PREDOMINANTLY CORPORATE ENTITY. TODAY WE'VE COME FULL CIRCLE AS THE BERMUDA MARKET, WHICH WAS IN LARGE PART SPAWNED BY THE LIMITATIONS OF TRADITIONAL LONDON/U.S. CARRIERS, IS INVESTING IN U.K. AND AMERICAN INSURERS. IN SUMMARY, IF WE HAVE LEARNED NOTHING ELSE FROM THE PAST TEN YEARS, WE SHOULD RECOGNIZE THAT THAT WHICH FAILS

TO ADD REAL VALUE WILL CEASE TO BE. IT IS FROM THIS PERSPECTIVE THAT WE SHOULD ASSESS THE VARIOUS COMPONENTS OF THE OVERALL MARKET.

AS I SAID AT THE OUTSET, IN ADDITION TO OFFERING THOUGHTS ON THE BIG PICTURE, I PERCEIVE A MANDATE TO ADDRESS THE ISSUES THAT WE ALL PERSONALLY FACE AT THE WORKING LEVEL EVERY DAY.

IN LATE 1996, IT BECAME CLEAR TO ME THAT THERE WAS A GROWING DISPARITY BETWEEN THE RISKS ABOUT WHICH MY FIRM WAS CONCERNED AND THOSE WHICH INSURERS WOULD ENTERTAIN.

INSURANCE POLICIES CONTINUED TO INCLUDE ARCHAIC COVERAGES FOR EXPOSURES LIKE COUNTERFEIT CURRENCY LOSSES, WHILE REAL EXPOSURES LIKE UNAUTHORIZED TRADING, REMAINED UNINSURABLE.

IN ADDITION, ALTHOUGH COVERAGE LIMITS AFFORDED P&L PROTECTION, THE LEVEL OF PROTECTION HAD BECOME LESS MATERIAL OVER TIME AS THE INSTITUTION GREW IN SIZE.

I DECIDED TO TEST THE GLOBAL INSURANCE MARKET'S APPETITE FOR A NEW TYPE OF INSURANCE PROGRAM AT A HIGHER LEVEL OF PROTECTION THAN PREVIOUSLY AVAILABLE. I INITIALLY ENVISIONED A 500 MILLION PROGRAM, EXCESS OVER 100 MILLION RETENTION, OR

UNDERLYING LIMIT OF EXISTING COVERAGE. THE BASIC PURPOSE OF THE INITIATIVE WAS TO DESIGN AN INSURANCE PROGRAM WHICH WOULD PERMIT THE COST EFFECTIVE TRANSFER OF THOSE RISKS ABOUT WHICH THE FIRM IS PRESENTLY CONCERNED AND TO DO SO AT A LOSS LEVEL WHICH WOULD BE MORE MATERIAL TO THE FIRM AND ITS STOCKHOLDERS.

THE THREE COVERAGE GOALS WERE: FIRST, TO ARRANGE COVERAGE FOR PREVIOUSLY UNINSURABLE RISKS SUCH AS UNAUTHORIZED ACTS; SECOND, TO SECURE COVERAGE FOR PREVIOUSLY INSURABLE RISKS, WHICH, FOR MY FIRM, WERE NOT INSURABLE ON AN ECONOMICALLY ATTRACTIVE BASIS AT THE PRIMARY LEVEL; AND THIRD, TO ARRANGE EXCESS CATASTROPHE COVERAGE OVER THE DIRECTORS AND OFFICERS LIABILITY POLICY AND THE CRIME PROGRAM INCLUDING COMPUTER CRIME. THIS LATTER APPLICATION WAS SIGNIFICANT AS INFORMATION SECURITY IS AN IMMEDIATE CONCERN AMONG FINANCIAL SERVICE FIRMS.

WITH RESPECT TO PREVIOUSLY UNINSURABLE EXPOSURES, WE HAD ALSO INITIALLY SOUGHT TO INCLUDE BUSINESS INTERRUPTION NOT CAUSED BY PHYSICAL DAMAGE. BUT IT WAS PARTICULARLY DIFFICULT TO INCLUDE THIS PROPERTY INSURANCE CONCEPT IN DISCUSSIONS

WITH PROFESSIONAL LIABILITY/CRIME INSURANCE UNDERWRITERS. IN ADDITION, THE LOOMING ISSUE OF YEAR 2000 WAS NOT CONDUCTIVE TO THESE DISCUSSIONS. HOWEVER, UNDERWRITERS REMAIN OPEN TO FURTHER CONSIDER THIS EXPOSURE AS WE WILL DISCUSS.

AFTER TEN MONTHS OF NEGOTIATION IN THE U.S., THE U.K. AND BERMUDA AND TWENTY DRAFTS OF THE POLICY FORM, WE EXECUTED A \$400 MILLION PROGRAM ON AUGUST 1, OF LAST YEAR. THE COVERAGE INCLUDES DIRECT LOSS AND THIRD PARTY LIABILITY ARISING OUT OF UNAUTHORIZED ACTS, CORPORATE PROFESSIONAL LIABILITY FOR ERRORS AND OMISSIONS IN PROVIDING SERVICES, EXCESS DIRECTORS AND OFFICERS LIABILITY AND EXCESS CRIME. AS WE HAVE SEEN, ONE CATASTROPHIC EVENT CAN ULTIMATELY TOUCH ALL THESE COVERAGE AREAS.

THE ULTIMATE LIMIT OF COVERAGE WAS FOUR RATHER THAN FIVE HUNDRED MILLION BECAUSE OF THE PRICING WE SET AT THE OUTSET. MUCH LIKE A SECURITIES' SYNDICATION, WE SET THE PRICE PER MILLION OF COVERAGE THAT WE WERE WILLING TO PAY BEFORE APPROACHING POTENTIAL PARTICIPANTS. AT THE END OF THE TEN MONTH PERIOD, WE WERE SOMEWHAT OVERSUBSCRIBED AT THE \$400 MILLION LEVEL, AT AN AVERAGE PRICE PER MILLION SLIGHTLY LESS

THAN THAT WHICH WE HAD INITIALLY SET. THE PLACEMENT INVOLVED APPROXIMATELY 20 DIFFERENT INSURERS IN THE U.S., U.K., AND BERMUDA, LED BY AIG AND INCLUDING SOME PARTICIPATION BY A FEW LLOYDS' SYNDICATES.

THIS APPROACH IN NO WAY AFFECTED ANY OF OUR PRIMARY COVERAGES OR RELATIONSHIPS. FOR A FIRM WITH A GOOD LOSS HISTORY, I REMAIN SKEPTICAL ABOUT BLENDED PROGRAMS AT THE PRIMARY LEVEL. WHILE THE POTENTIAL VALUE WILL VARY WITH THE INDIVIDUAL FIRM'S RISK PROFILE, I REMAIN CONCERNED ABOUT UNECONOMIC INCREASES IN RETENTIONS, LOSS OF OCCURRENCE COVERAGE, LOSS OF MULTIPLE AGGREGATE LIMITS, ELIMINATION OF THE DIVERSITY OF INSURERS AND THE CONSEQUENT TERMINATION OF MANY LONG TERM INSURER RELATIONSHIPS. I GET CONCERNED WHEN RISK MANAGERS SAY THEIR BLENDED PROGRAM HAS RESULTED IN SAVINGS BECAUSE, "KNOCK WOOD," THEY HAVEN'T HAD ANY LOSSES. ON THE BASIS OF THIS RATIONALE, THEY COULD SAVE EVEN MORE MONEY BY ELIMINATING ALL THEIR INSURANCES, AS LONG AS THEY, "KNOCK WOOD," DON'T HAVE ANY LOSSES.

IF ANY ONE WOULD LIKE TO REVIEW THE FINAL POLICY FORM WE DEVELOPED, PLEASE LET ME KNOW AND I WILL FORWARD A COPY TO

YOU. AS WITH ANY SUCH POLICY DRAFTING, THE FINAL FORM BECOMES AVAILABLE IN THE MARKET BEFORE THE INK IS DRY ON THE BINDER, AS EVIDENCED BY BANK OF AMERICA'S DECISION TO EFFECT THE SAME COVERAGE NOT LONG AFTER WE FINALIZED IT.

ALTHOUGH WE WERE THE FIRST TO CREATE INSURANCE FOR UNAUTHORIZED ACTS, IT SEEMS, AS WITH SCIENTIFIC BREAK-THROUGHS AND ATHLETIC RECORDS, SIMILAR ACTIVITY ERUPTS IN A VARIETY OF VENUES. HAVING EFFECTED OUR PROGRAM ON AUGUST 1ST, AS WAS REPORTED IN BUSINESS INSURANCE ON AUGUST 11TH, I WAS VERY INTERESTED TO READ LLOYDS' ANNOUNCEMENT THE FOLLOWING OCTOBER OF A NEW POLICY THAT WOULD BE THE "FIRST" TO COVER UNAUTHORIZED TRADING. WHILE I WOULD ARGUE THIS CLAIM, THE APPROACH TAKEN BY THESE PARTICULAR LLOYDS UNDERWRITERS WAS QUITE DIFFERENT AND WE HAVE DEDICATED A SESSION IN THE PROGRAM TO A DISCUSSION OF THIS ISSUE.

IN SHORT, THE LLOYDS' APPROACH IS STRICTLY A FIRST PARTY COVERAGE, APPLICABLE ONLY TO PROPRIETARY TRADING LOSSES INCURRED BY THE INSURED ITSELF. AMONG OTHER THINGS, IT EXPRESSLY EXCLUDES INDIRECT AND CONSEQUENTIAL LOSS OF ANY NATURE AS WELL AS THE INSOLVENCY OF COUNTER PARTIES. IT IS

MUCH MORE NARROWLY FOCUSED BECAUSE IT IS INTENDED TO APPLY AT A LOWER ATTACHMENT POINT AND IS CONSEQUENTLY ALSO MUCH MORE EXPENSIVE.

I THINK IT IS A POSITIVE DEVELOPMENT TO SEE THE INDUSTRY SEEKING TO INITIATE CHANGE. HOWEVER, AS WITH ANY NEW FINANCIAL PRODUCT, THERE SEEMS TO BE A NARROW WINDOW OF PROFITABLE OPPORTUNITY, WHICH ONLY REMAINS OPEN UNTIL MARGINS TIGHTEN THROUGH COMPETITION. OTHER INSURERS ARE ALREADY DRAFTING POLICIES TO MATCH OR BROADEN THE LLOYDS' COVERAGE. IF PAST IS PROLOGUE, BROKERS WILL SOON GO FROM QUOTING THE LLOYDS' PREMIUM, TO HALVING IT, TO OFFERING IT AS A THROW-IN, TO ULTIMATELY ADVISING THAT THE ADDITIONAL COVERAGE CAN BE EFFECTED RETROACTIVELY... WITH A CREDIT.

THERE HAS ALSO BEEN SIGNIFICANT ACTIVITY OUTSIDE THE REALM OF TRADITIONAL INSURANCE, IN THE AREA OF CAPITAL MARKETS AND RISK POOLING PROPOSALS. THIS HAS OCCURRED NOT ONLY WITH RESPECT TO THE UNAUTHORIZED ACTS COVERAGE BUT IN THE MUCH BROADER AREA OF SO-CALLED BALANCE SHEET PROTECTION. I HAVE SEEN A VARIETY OF SUCH PROPOSALS FROM BROKERS AND CONSULTANTS SEEKING TO OFFER AN ALTERNATIVE OR SUPPLEMENT

TO INSURANCE. I UNDERSTAND THAT THERE IS GREAT INTEREST IN THESE APPROACHES, BECAUSE I READ THE INDUSTRY PRESS, WHICH CONSISTENTLY QUOTES THE SAME THREE OR FOUR PEOPLE WHO ARE TRYING TO SELL THESE PRODUCTS AND WHO ALWAYS ADVISE THAT THEY ARE ABOUT TO TAKE OFF.

A TYPICAL PROPOSAL USUALLY INVOLVES THE SUGGESTION THAT A GROUP OF SIMILAR (OR DISSIMILAR) ORGANIZATIONS POOL SIGNIFICANT AMOUNTS OF MONEY TO CREATE A VEHICLE WHICH COULD RESPOND TO ALMOST ANY BALANCE SHEET THREAT. THERE IS USUALLY CLEAR DISCLOSURE THAT SHOULD MAJOR LOSSES BE INCURRED BY MANY PARTICIPANTS, OR IF ONE SYSTEMIC EVENT AFFECTS ALL AT THE SAME TIME, THE APPROACH MAY PROVE COMPLETELY INADEQUATE.

FOR FACILITATING THE CREATION OF THIS VEHICLE AND MANAGING IT, THE PROPOSER USUALLY SUGGESTS THAT ITS COMPENSATION INCLUDE COMMISSIONS, BOTH PRIMARY AND REINSURANCE, MONEY MANAGEMENT FEES, FACILITY MANAGEMENT FEES, PLACEMENT FEES, ANNUITY RELATED FEES, AND, OF COURSE, OTHER EXPENSES. I HAVE SEEN PROPOSALS WHERE THE AGGREGATE FEES AND COMMISSIONS

ALONE OVER THE LIFE OF THE PROPOSAL APPROACH 200 MILLION DOLLARS.

FORGIVE ME, BUT SUCH PROPOSALS REMIND ME OF THE BROADWAY MUSICAL LES MIS AND THE LYRICS FROM THE SONG “MASTER OF THE HOUSE,” WHICH DESCRIBE THE MANNER IN WHICH THE INN KEEPER DETERMINES FEES:

“CHARGE EM FOR THE LICE, EXTRA FOR THE MICE, TWO PERCENT FOR LOOKING IN THE MIRROR TWICE. HERE A LITTLE SLICE, THERE A LITTLE CUT, THREE PERCENT FOR SLEEPING WITH THE WINDOWS SHUT.

.....HOW IT ALL INCREASES, ALL THEM BITS AND PIECES. JESUS ITS AMAZING HOW IT GROWS.”

I SUGGEST THAT ANY ENTITY PROPOSING SUCH A PROGRAM BE ASKED TWO QUESTIONS: WHAT DO THEY GET AND WHAT DO THEY RISK? GIVEN THE POTENTIAL UPSIDE, WHICH IS USUALLY SIGNIFICANT, THE PROPOSER SHOULD ALSO HAVE AN EXTENSIVE FINANCIAL INTEREST IN THE ULTIMATE SUCCESS OF PROPOSAL AND OF THE RELIABILITY OF THE MODEL THEY DEVELOPED TO SELL IT.

CERTAIN OF THE EXPOSURES WHICH TRIGGERED THE DEVELOPMENT OF THESE LIQUIDITY PROPOSALS CAN NOW MUCH MORE EFFICIENTLY BE ADDRESSED THROUGH INSURANCE. THESE PROPOSALS ARE, THEREFORE, SHIFTING EMPHASIS TO HIGHER AND HIGHER LEVELS OF ATTACHMENT. IF WE HAVE ONLY JUST DEVELOPED THE APPETITE FOR INEXPENSIVE COVERAGE OVER 100 MILLION IN CERTAIN COVERAGE AREAS AND AT THE LARGEST INSTITUTIONS, I DOUBT THAT A FELT NEED WILL QUICKLY ARISE FOR HIGHER LEVELS OF FUNDING INVOLVING SIGNIFICANT INVESTMENT.

PERSONALLY, I BELIEVE SOME OF THESE PROPOSALS TO BE SOMEWHAT LIKE THE BANKERS INSURANCE CAPTIVE OR BICL OF THE MID-EIGHTIES, AN INTERESTING IDEA WHOSE TIME HAD COME AND GONE BEFORE IT COULD BE IMPLEMENTED. THE PREMISE OF BICL WAS THE ANTICIPATED ABSENCE OF THE COMMERCIAL MARKET. HOWEVER, AS WITH THE UNAUTHORIZED ACTS EXPOSURE, THIS WAS NOT THE CASE.

TO THOSE WHO WOULD SAY, “YES, BUT INSURANCE IS CYCLICAL,” I WOULD SUGGEST THAT A GROWING NUMBER OF INDIVIDUALS IN THE BUSINESS TODAY HAVE NEVER SEEN AN INSURANCE CYCLE AND THERE IS NO REASON TO ANTICIPATE ONE AT THIS TIME. THE EARTH MAY ONCE HAVE BEEN COVERED WITH WATER AND MAY BE AGAIN, BUT I DO

NOT PROPOSE A STRATEGIC LONG TERM COMMITMENT TO THE BUILDING OF AN ARK.

WITH RESPECT TO SECURITIZATION IN GENERAL, IT HAS BEEN, AND NO DOUBT WILL CONTINUE TO BE, UTILIZED BY INSURERS AND REINSURERS WITH EXTENSIVE PORTFOLIOS OF RISK, BUT THE DESIRABILITY FOR NON-INSURANCE FIRMS REMAINS QUESTIONABLE. PROFESSOR KENNETH FROOT OF HARVARD RECENTLY EXPRESSED THE COMPLETELY UNQUALIFIED OPINION THAT SECURITIZATION WILL “NEVER” PROVIDE THE MOST EFFICIENT RISK FUNDING FOR NON-INSURER FIRMS.

I CANNOT CONCLUDE A DISCUSSION OF THE CURRENT ISSUES CONFRONTING US WITHOUT TOUCHING ON THE YEAR 2000 PROBLEM.

I DON'T BELIEVE THAT EXISTING PROPERTY AND GENERAL LIABILITY POLICIES APPLY TO THE BASIC EXPOSURE OF COMPUTER FAILURE, AS SUCH. IT APPEARS THAT INSURERS WILL BE FURTHER EMPHASIZING THIS THROUGH ADDITIONAL EXCLUSIONS AND QUALIFICATIONS.

I DO EXPECT THAT REAL COVERAGE DISPUTES WILL ARISE WITH RESPECT TO THE CONSEQUENCES OF COMPUTER FAILURE, WHICH

CONSEQUENCES MAY INCLUDE BODILY INJURY AND PROPERTY DAMAGE. THERE WILL ALSO, NO DOUBT, BE ISSUES OF PROFESSIONAL LIABILITY FOR TECHNOLOGY CONSULTANTS AND OTHERS. HOWEVER, THESE EXPOSURES APPEAR TO BE OF SECONDARY IMPORTANCE TO FINANCIAL INSTITUTIONS.

OUR PRIMARY EXPOSURE REMAINS BUSINESS INTERRUPTION, OUR OWN, AND CONTINGENT BUSINESS INTERRUPTION, THAT OF A THIRD PARTY ON WHOM WE RELY. BUSINESS INTERRUPTION, NOT CAUSED BY PHYSICAL DAMAGE HAS, TO DATE, BEEN UNINSURABLE. HOWEVER, WITH RESPECT TO NEW INSURANCE DEVELOPMENTS FOR THE Y2K EXPOSURES, THIS CONFERENCE IS VERY TIMELY. JUST WITHIN THE PAST WEEK OR SO, REAL INSURANCE OFFERINGS HAVE BEEN FINALIZED BY MAJOR BROKERAGE FIRMS.

YOU MAY RECALL THAT EARLY ON AIG HAD OFFERED A FINITE RISK APPROACH BUT, AS THE AIG PROGRAM WAS LARGELY SELF INSURANCE, IT DID NOT GAIN ACCEPTANCE. I SUSPECT AIG WILL BE BACK WITH AN ALTERNATIVE APPROACH.

THERE ARE NOW SEVERAL PROPOSALS TO PROVIDE REAL RISK TRANSFER. JOHN GOLDBERG, OF J&H MARSH & MCLENNAN, ADVISED

ME THAT HIS FIRM IS OFFERING A COVERAGE PROPOSAL WITH A LIMIT OF \$200 MILLION OR MORE, AN ATTACHMENT POINT, WHICH WILL VARY, BUT COULD BE APPROXIMATELY \$10 MILLION AND A RATE ON LINE OF FROM 2 TO 10%. HE ADVISED THAT FINANCIAL INSTITUTIONS CAN EXPECT TO BE ON THE HIGH END OF THE PREMIUM RANGE. IN WHICH CASE A 200 MILLION DOLLAR POLICY COULD INVOLVE A ONE TIME PREMIUM OF \$20 MILLION. COVERAGE IS INTENDED TO APPLY TO LIABILITY FOR WRONGFUL ACTS, BUSINESS INTERRUPTION AND CONTINGENT BUSINESS INTERRUPTION. WITH RESPECT TO CONTINGENT BUSINESS INTERRUPTION, THIRD PARTIES WILL HAVE TO BE IDENTIFIED AND AUDITED BEFORE BEING EXPRESSLY SCHEDULED ON THE COVERAGE.

PHILIP LIAN OF AON ADVISES THAT AON IS OFFERING A SIMILAR PROPOSAL. THE AON PROGRAM IS LED BY AMERICAN RE WITH \$100 MILLION, HOWEVER, AON HAS IDENTIFIED AN ADDITIONAL 900 MILLION IN CAPACITY IN THE MARKET. THE MAIN COVERAGES ARE THE SAME AS THOSE OFFERED UNDER THE J&H MARSH PROPOSAL. THE APPROACH TO CONTINGENT BUSINESS INTERRUPTION WILL NOT BE SPECIFIC BUT PART OF THE OVERALL INITIAL DUE DILIGENCE. THE DEDUCTIBLE STRUCTURE WILL ALSO BE SIMILAR WITH A MINIMUM ATTACHMENT POINT OF 5 MILLION DOLLARS AND SOME ELEMENT OF COINSURANCE.

THE PREMIUM RATE ON LINE FOR THE FIRST \$100 MILLION IS FROM 5 TO 8%, SLIDING DOWNWARD AT HIGHER LEVELS OF COVERAGE.

JIM DAVIS OF WILLIS CORROON INDICATES THAT HIS FIRM IS ALSO FORMULATING A PROPOSAL, WHICH WILL BE ANNOUNCED IN THE NEAR FUTURE.

IF ANYONE IS AWARE OF ANY OTHER COVERAGE OFFERINGS PLEASE LET US KNOW ABOUT THEM WHEN WE OPEN THE FLOOR FOR DISCUSSION.

THESE NEW INSURANCES WILL BE AVAILABLE TO ALL BUSINESS SECTORS. HOWEVER, BANKING IS PERHAPS THE ONLY INDUSTRY WHICH MUST SOLVE THE Y2K PROBLEM THIS YEAR, TO THE SATISFACTION OF REGULATORS. THIS FACT SHOULD BE SIGNIFICANT IN INDIVIDUAL NEGOTIATIONS. GIVEN THE EXTRAORDINARY AMOUNTS EACH BANK IS ALREADY SPENDING TO SOLVE THE Y2K PROBLEM, A DECISION TO SPEND MORE MONEY ON INSURANCE MAY NOT BE EASILY MADE.

IF THESE NEW PRODUCTS ARE PURCHASED, ACTUAL PREMIUMS WILL, OF COURSE, BE SUBJECT TO NEGOTIATION WITH EACH POTENTIAL INSURED AND WILL ALSO REFLECT THE AFFECTS OF COMPETITION.

YOU WILL NOTE THAT THERE IS A SESSION DEDICATED TO THE Y2K ISSUE.

REGARDING INDIVIDUAL LIABILITY, THESE PROPOSALS WILL APPLY IN EXCESS OF THE DIRECTORS AND OFFICERS LIABILITY COVERAGE (D&O). WITH RESPECT TO D&O, DESPITE RUMBLINGS ABOUT POTENTIAL EXCLUSIONS, THREE YEAR POLICIES RUNNING THROUGH THE YEAR 2000 ARE BEING ROUTINELY RENEWED.

I PERSONALLY NEVER UNDERSTOOD HOW AN EXCLUSION COULD BE INTRODUCED AT THIS TIME, WHEN THERE IS UNIVERSAL AWARENESS OF Y2K AS A FACT OR CIRCUMSTANCE THAT COULD GIVE RISE TO A CLAIM. IT IS TO THE INSURANCE INDUSTRY'S CREDIT THAT NO SUCH EXCLUSIONS TO THE D&O COVERAGE HAVE ACTUALLY BEEN PROPOSED. HOWEVER, WERE D&O EXCLUSIONS TO BE THREATENED, IT WOULD BE PRUDENT TO PROVIDE IMMEDIATE FORMAL NOTICE TO INSURERS.

AS WE INITIATE OUR DISCUSSIONS OF HOW BEST TO EVALUATE THE QUALITY AND EFFICIENCY OF OUR RISK AND INSURANCE MANAGEMENT PROGRAMS, THERE ARE A FEW CONCEPTS TO KEEP IN MIND. PREMIUMS ARE NOT INVESTMENTS ON WHICH TO EXPECT A RETURN. OUR GOAL IS

NOT TO TRADE DOLLARS WITH INSURERS BUT TO HAVE OUR LONG TERM INSURERS BECOME SO COMFORTABLE WITH OUR LOSS HISTORY AND QUALITY OF MANAGEMENT THAT SUBSTANTIAL PROTECTION IS OFFERED TO THE FIRM AND ITS STOCKHOLDERS AT NOMINAL COST.

NOR IS RISK FUNDING A SUBSTITUTE FOR RISK MITIGATION: E.G., BUSINESS INTERRUPTION INSURANCE DOES NOT ELIMINATE THE NEED FOR CONTINGENCY PLANS. RATHER, TESTED CONTINGENCY PLANS ENABLE US TO PURCHASE SUBSTANTIAL BUSINESS INTERRUPTION INSURANCE AT REASONABLE COST.

IN SEEKING THE MOST EFFICIENT METHODS OF FUNDING THE BROAD SPECTRUM OF RISK, WE MUST BE OPEN TO OFFERINGS FROM ALL SECTORS: INSURANCE AND NON-INSURANCE, SEPARATELY AND IN COMBINATION. HOWEVER, KEEP IN MIND THAT THE MOST EFFICIENT APPROACHES MAY NOT BE THE MOST COMPLEX, THE MOST RADICAL OR THE MOST NEWSWORTHY.

FINALLY, AS HAS BEEN DEMONSTRATED OVER THE PAST YEAR, IF WHAT YOUR FIRM NEEDS DOESN'T EXIST, YOU CAN ALWAYS CREATE IT. THAT IS, IF YOU ARE WILLING TO INVEST THE NECESSARY TIME AND ENERGY

**IN EXPLAINING YOUR NEEDS TO A WORLD MARKET WHICH HAS NEVER
BEEN MORE RECEPTIVE TO NEW IDEAS.**

THE CHALLENGE IS OURS.

THANK YOU.