

**WILLIS
EXCEPTIONAL PRODUCERS' MEETING**

**EVERYTHING I EVER WANTED TO
SAY TO AN INSURANCE BROKER**

**Loews Ventana Canyon Resort
Tucson, Arizona**

April 14, 2000

**William J. Kelly
Managing Director
J.P. Morgan**

**Chairman
International Federation
of Risk and Insurance Management
Associations (www.rims.org/ifrima)**

WILLIAM J. KELLY

William J. Kelly is a Managing Director of J.P. Morgan, a leading, global, financial services firm based in New York City. His responsibilities include corporate risk and insurance management and various other corporate resource areas. Before joining J.P. Morgan fifteen years ago, he was the Director of Insurance and Risk Management at Merrill Lynch.

Mr. Kelly is presently the Chairman of the International Federation of Risk and Insurance Management Associations *(IFRIMA), a global body of 30 national and regional associations representing over 20 countries throughout the world. He is also a member of the board of the Global Risk Management Institute, which oversees the administration of the Fellow in Risk Management designation. He was the 1995-96 President of the Risk and Insurance Management Society (RIMS), the world's largest such organization with membership of 4,500 entities in the U.S. and Canada, employing 8,000 individual deputy members. Mr. Kelly is a member of the Risk Management Advisory Council of Allianz Insurance Company and the National Accounts Advisory Board of AIG. He is a director of the Spencer Educational Foundation and has served as a member of the Risk Management Executive Council of Protection Mutual Insurance Company. Mr. Kelly is a former Chairman of the Insurance Committee of the American Bankers Association (ABA), served as Chairman of the ABA's 1993 National Security and Risk Management Conference and Co-Chairman of the 1995 Monte Carlo Risk Management Forum. He also received the 1995 Matthew Lenz Risk Management Award from the New York Chapter of CPCU. Mr. Kelly frequently speaks in forums throughout the world and has published many articles on diverse subjects.

Mr. Kelly began his insurance career as an underwriter with the INA in 1972 and subsequently served as an officer of The Chase Manhattan Bank, and as a Vice President of Bankers Trust Company.

Mr. Kelly holds a B.A. in English Literature from Fordham University in New York City and an M.B.A. from Fordham's Graduate School of Business at Lincoln Center.

* www.rims.org/ifrima

GOOD MORNING

CONGRATULATIONS ON YOUR EXCEPTIONAL PERFORMANCE THIS YEAR.

I UNDERSTAND THAT THIS IS A TIME OF MAJOR ORGANIZATIONAL CHANGE WITHIN YOUR FIRM. FROM WHAT I HAVE READ, IT APPEARS THAT MANY GOOD IDEAS ARE BEING IMPLEMENTED.

AS POSITIVE AS THESE CHANGES ARE, I KNOW HOW DIFFICULT IT IS TO LIVE THROUGH THE PROCESS OF CORPORATE REORGANIZATION. THESE INITIATIVES ALWAYS SEEM TO INVOLVE CONSULTANTS, USUALLY YOUNG, ENERGETIC, HYPERACTIVE , WHO INVADE THE ORGANIZATION, EXHORTING EVERYONE TO “USE THE LEFT SIDE OF THEIR BRAIN TO BE CREATIVE... RECOGNIZE THAT IN CHANGE LIES OPPORTUNITY....” AND MY PERSONAL FAVORITE, “THINK OUTSIDE THE BOX.” THERE SHOULD BE A CLICHÉ ERADICATION SQUAD THAT DETERMINES WHEN PHRASES ARE SO HACKNEYED THEY MUST BE BANNED FROM USE. BUT DESPITE THE ANGST OF MAJOR CHANGES, THE GOALS, AS WE WILL DISCUSS, ARE IMPORTANT TO ACHIEVE.

ON FEBRUARY 17TH, I RECEIVED AN E-MAIL INVITING ME TO SPEAK TO YOU TODAY. MY ASSIGNMENT, THE E-MAIL INDICATED, WOULD BE TO DESCRIBE THOSE QUALITIES AND BEHAVIORS THAT WOULD MOTIVATE ME TO DO OR NOT TO DO BUSINESS WITH AN INSURANCE BROKERAGE FIRM. THE E-MAIL ENDED WITH THE STATEMENT THAT THIS WOULD BE AN OPPORTUNITY TO SAY WHATEVER I’VE ALWAYS WANTED TO SAY TO INSURANCE BROKERS... AN OFFER I COULD NOT REFUSE.

ALTHOUGH I’VE BEEN AN UNDERWRITER AND A RISK MANAGER AND EVEN PASSED THE NY STATE INSURANCE BROKER LICENSING EXAM SOME YEARS AGO, I HAVE NEVER ACTUALLY WORKED AS A BROKER. I CAN, THEREFORE, SPEAK WITHOUT THE INFLUENCE OF ANY PREJUDICES, WHICH MIGHT HAVE RESULTED FROM ACTUAL EXPERIENCE IN OR FIRST HAND KNOWLEDGE OF YOUR BUSINESS.

HOWEVER, IN ANOTHER SENSE, I HAVE FOR MANY YEARS MANAGED SMALL GROUPS OF PROFESSIONALS SERVING AS THE SOLE INTERMEDIARIES TO INSURANCE RESOURCES FOR GLOBAL ORGANIZATIONS. I, THEREFORE, HAVE SOME APPRECIATION FOR THE CHALLENGES INVOLVED IN RESPONDING TO AND ANTICIPATING THE NEEDS OF DEMANDING CLIENTS THROUGHOUT THE WORLD.

IN APPROACHING THIS SUBJECT, I THOUGHT IT MIGHT MAKE SENSE TO MOVE FROM THE MICRO TO THE MACRO, FROM VERY PERSONAL PREFERENCES AND DISLIKES TO SOME OVERALL PERSPECTIVES ON THE INDUSTRY AS A WHOLE.

IN TERMS OF PERSONAL PREFERENCES, WE WILL USE THE LETTERMAN MODEL AND BRIEFLY REVIEW THE TOP TEN REASONS TO DO BUSINESS WITH AN INSURANCE BROKER. I WILL DISCUSS INSURANCE BROKERS IN GENERAL, YOU HAVE ALREADY DISTINGUISHED YOURSELVES AS EXCEPTIONAL.

I APOLOGIZE IN ADVANCE IF MY COMMENTS TEND TO RELATE TO INSURANCE TRANSACTIONS. I UNDERSTAND BROKERS ARE ATTEMPTING TO DISTANCE THEMSELVES FROM THE TRANSACTION IN ORDER TO DEFINE A BROADER ROLE AS CONSULTANTS, JUST AS RISK AND INSURANCE MANAGERS DO NOT CONSIDER THEMSELVES TO BE INVOLVED IN PROCUREMENT. I ALSO SPEAK FROM THE PARTICULAR PERSPECTIVE OF A LARGE GLOBAL FIRM.

UNLIKE LETTERMAN, WE WILL BEGIN WITH THE NUMBER ONE SINGLE MOST IMPORTANT QUALITY I LOOK FOR IN A BROKER, SPECIFICALLY THE ACCOUNT MANAGER, AND THAT IS A THOROUGH KNOWLEDGE OF THE RESOURCES OF THE BROKERAGE FIRM ITSELF. I BELIEVE THE MAJOR BROKERAGE FIRMS ALL HAVE EXCELLENT CAPABILITIES. I NEED SOMEONE WHO KNOWS WHERE THEY ARE AND CAN GAIN IMMEDIATE ACCESS TO THEM. THE BEST ACCOUNT EXECUTIVE I'VE EVER DEALT WITH WAS NOT A TECHNICIAN IN ANY ASPECT OF THE BUSINESS, BUT HE KNEW HIS FIRM AND ITS RESOURCES.

AS A RISK MANAGER, I HAVE NEVER CHANGED FROM ONE MAJOR BROKERAGE FIRM TO ANOTHER BECAUSE OF A FIRM'S POOR PERFORMANCE. I HAVE CHANGED INDIVIDUALS ON THE ACCOUNT IN ORDER TO GET THE BEST ACCESS TO QUALITY SERVICE. RISK MANAGERS WHO CHANGE FROM ONE MAJOR BROKER TO ANOTHER ON THE BASIS OF SERVICE, HAVE THEMSELVES FAILED TO SECURE THE QUALITY PEOPLE WHO ARE PRESENT IN EACH OF THE MAJOR FIRMS.

I HAVE, ON RARE OCCASIONS, MOVED DISCREET PIECES OF BUSINESS TO NICHE BROKERS THAT HAVE DEVELOPED A PARTICULAR SPECIALTY. FOR EXAMPLE, A PREVIOUS EMPLOYER HAD A RELOCATION SUBSIDIARY, A FIRM THAT FACILITATES EXECUTIVE MOVES FOR THIRD PARTY CORPORATIONS. AS PART OF THE BUSINESS, WE HAD A PORTFOLIO OF APPROXIMATELY 9,000 RESIDENTIAL HOMES THROUGHOUT THE COUNTRY. A REPRESENTATIVE OF A VERY SMALL CONNECTICUT BROKERAGE OFFERED TO BID ON THE PORTFOLIO. AS THE PROPERTY AND LIABILITY COVERAGES WERE PLACED BY A TOP BROKERAGE FIRM, I DID NOT EXPECT THE NICHE COMPANY TO BE SUCCESSFUL. HOWEVER, HE RETURNED WITH A THREE YEAR, NON CANCELLABLE PROGRAM, FROM A TOP RATED INSURER WITH ABSOLUTELY COMPELLING COST SAVINGS. AS THE MAJOR BROKERS CONTINUE TO TRY TO BE ALL THINGS TO ALL PEOPLE, THEY WILL REMAIN VULNERABLE TO THIS KIND OF POACHING AT THE MARGINS.

COMPARING BROKERAGE FIRMS IS LIKE COMPARING UNIVERSITIES. WHICH IS BEST? HARVARD, YALE, PRINCETON, OR WITHIN MY OWN FRAME OF REFERENCE, FORDHAM, COLUMBIA, NYU? ONE CAN'T GENERALIZE. IT COMES DOWN TO A COMPARISON OF SPECIFIC DEPARTMENTS AND INDIVIDUAL PROFESSORS, THAT IS, IT COMES DOWN TO PEOPLE. CAN AN EXCELLENT EDUCATION BE ACHIEVED IN ANY OF THESE VENUES? OF COURSE, IF THE RIGHT RESOURCES ARE ENGAGED.

I HAVE STRESSED THE IMPORTANCE OF AN ACCOUNT MANAGER WHO KNOWS THE FIRM'S RESOURCES AND CAN ACCESS THEM ON MY BEHALF. IF BECAUSE OF ANY

CULTURAL, POLITICAL, GEOGRAPHIC OR COMPENSATION ISSUE, THESE RESOURCES ARE NOT IMMEDIATELY AVAILABLE TO ME, THEN THEY MIGHT AS WELL NOT EXIST.

OVERCOMING THESE PAROCHIAL IMPEDIMENTS TO DELIVERING QUALITY SERVICE IS DIFFICULT WITHIN THE BROKERAGE FIRM ITSELF, IN PART, DUE TO A CONDITION WHICH A FORMER VICE CHAIRMAN OF J.P. MORGAN REFERRED TO AS “PROFIT CENTERITIS.” WITH RESPECT TO ENTERPRISE RISK MANAGEMENT, CERTAIN INSURANCE BROKERAGE FIRMS ARE NOW SUGGESTING THAT THEY WILL DRAW ON THE RESOURCES OF SISTER SUBSIDIARIES WITHIN THE GROUP TO ADDRESS A BROADER ARRAY OF RISKS. THIS IS AN EXCELLENT IDEA BUT WILL BE A CHALLENGING TASK TO CARRY OUT, PERHAPS REQUIRING A WHOLLY NEW COMPENSATION MODEL AND ORGANIZATIONAL CONSTRUCT.

IF THERE IS AN EXCELLENT ACCOUNT MANAGER, THE RISK MANAGER WILL NOT HAVE A GREAT NEED TO DEAL DIRECTLY WITH THE VARIOUS SPECIALISTS ON WHOSE EXPERTISE THE ACCOUNT MANAGER WILL BE RELYING. HOWEVER, BROKERS ALWAYS SEEM TO WANT TO INTRODUCE “THE TEAM.” ON SUCH OCCASIONS AS THE FIRST MEETING TO KICK OFF A NEW COVERAGE INITIATIVE, “THE TEAM” WILL BE ASSEMBLED. I USUALLY HAVE TO CHECK TO MAKE SURE THE CONFERENCE ROOM I HAVE RESERVED IS LARGE ENOUGH TO ACCOMMODATE THE TEAM AND ME.

INSURANCE BROKERS, WITH A HERITAGE OF COMMISSION BASED REVENUE HAVE DIFFICULTY IN DETERMINING THE COST OF THEIR SERVICES. FOR THIS REASON AND OTHERS, THERE IS A TENDENCY TO OVER RESOURCE PROJECTS. THIS IS NOT SURPRISING IN AN ENVIRONMENT WHERE THERE IS NO ACCOUNTABILITY FOR TIME AND EXPENSE. LACK OF ACCOUNTABILITY ALSO LEADS TO THE INCONSISTENT APPLICATION OF RESOURCES. I HAVE EXPERIENCED SITUATIONS IN WHICH ALL THE HEAVY HITTERS ARE TROTTED OUT INITIALLY, ONLY TO THEN HAVE THE MOST JUNIOR PERSON BE GIVEN A SWORD AND A SHIELD AND SENT OUT TO DO BATTLE.

AS I HAVE INDICATED, THE MEMBERS OF “THE TEAM” ARE SPECIALISTS, EXPERTS IN SPECIFIC COVERAGE AREAS: PROPERTY, CASUALTY, CRIME, MANAGEMENT LIABILITY, ETC. THIS BRINGS US TO THE SECOND MOST IMPORTANT REASON FOR DEALING WITH A BROKERAGE, THAT IS, THE EXPERTISE OF ITS SPECIALISTS. SPEAKING FOR SEASONED RISK AND INSURANCE MANAGEMENT PROFESSIONALS, WHO ARE BY DEFINITION GENERALISTS, I CAN’T TELL YOU HOW REFRESHING IT IS TO MEET SPECIALISTS WHO ACTUALLY KNOW THEIR SUBJECT AREA MORE THOROUGHLY THAN WE DO. I DO NOT REFER TO A KNOWLEDGE OF AVAILABLE MARKETS BUT KNOWLEDGE OF THE COVERAGE ITSELF, ITS NUANCES AND HISTORICAL DEVELOPMENT. HOWEVER, SUCH INDIVIDUALS CANNOT BE HOBbled BY SPECIALIZATION AND MUST BE ABLE TO THINK CREATIVELY ABOUT NEW AND DIFFERENT APPROACHES AND COMBINATIONS.

IN 1997, WE SYNDICATED A \$400 MILLION CATASTROPHE EXCESS PROGRAM WHICH COVERS LOSS ARISING OUT OF CRIME, DIRECTORS AND OFFICERS LIABILITY, CORPORATE PROFESSIONAL LIABILITY AND UNAUTHORIZED ACTS, INCLUDING UNAUTHORIZED TRADING; THE FIRST SUCH POLICY TO DO SO. WE INITIALLY HAD ATTEMPTED TO ALSO INCLUDE COVERAGE FOR THE SO FAR UNINSURABLE RISK OF BUSINESS INTERRUPTION NOT CAUSED BY PHYSICAL DAMAGE. AT THAT TIME, THE MARKET WAS STILL ANTICIPATING Y2K, THEREFORE, OUR TIMING WAS NOT GOOD ON THAT POINT. NEVERTHELESS, I WAS SURPRISED AT THE DIFFICULTY AND CONFUSION CAUSED BY INTRODUCING A PROPERTY INSURANCE CONCEPT TO CASUALTY BROKERS AND UNDERWRITERS.

I CONTINUE TO BELIEVE THAT BUSINESS INTERRUPTION NOT CAUSED BY PHYSICAL DAMAGE CAN AND SHOULD BE INSURABLE. BUSINESS INTERRUPTION COVERAGE DEVELOPED WHEN THE CORPORATION’S PRIMARY DEPENDENCY WAS ON THE PHYSICAL PLANT, AND INSURERS LEARNED HOW TO EVALUATE THE ADEQUACY OF SPRINKLER AND OTHER PROTECTIVE SYSTEMS.

TODAY THE PRIMARY DEPENDENCY OF MANY CORPORATIONS, IS OFTEN UPON TECHNOLOGY, WITH SYSTEMS FAILURE A KEY OPERATING RISK. THIS EXPOSURE WILL BE UNDERWRITTEN WHEN INSURERS LEARN TO EVALUATE THE ADEQUACY OF CORPORATE BUSINESS CONTINUITY AND CONTINGENCY PLANS. IF CONTINGENCY PLANS ARE SOUND, THE INSURER WILL ONLY BE EXPOSED TO THE EXTRA EXPENSE ASSOCIATED WITH ACTIVATING THOSE PLANS AND NOT TO A SERIOUS LOSS OF REVENUE.

IN TERMS OF EXPERTISE, IT IS ONE THING TO LISTEN TO THE VOICE OF THE CLIENT; IT IS ANOTHER TO BE ABLE TO INFORM AND ADVISE THE CLIENT. I ONCE WORKED WITH AN EXCELLENT MANAGEMENT LIABILITY SPECIALIST. I WOULD OUTLINE IN DETAIL WHAT I WANTED TO ACCOMPLISH AND HOW. HE WOULD OFTEN RESPOND BY SAYING, "OK, WE CAN DO IT THAT WAY BUT..." AND HE WOULD THEN LAY OUT THE PITFALLS, PROBLEMS AND POTENTIAL ALTERNATIVES. WE WOULD TOGETHER COME UP WITH A BETTER PLAN.

IDEALLY THE INTERACTION AMONG THE BROKER, THE RISK MANAGER AND THE UNDERWRITER SHOULD RESULT IN A SYNERGY, WHEREIN THEIR COMBINED WORK PRODUCT IS BETTER THAN THAT WHICH ANY ONE OF THEM COULD HAVE ACHIEVED.

THE THIRD NECESSITY IN A BROKERAGE, FOR ME, IS A GLOBAL NETWORK. IN LARGE PART, DUE TO A HISTORY OF PAROCHIAL INSURANCE REGULATION AND PRACTICE THROUGHOUT THE WORLD, INSURANCE BROKERS HAVE NOT DEVELOPED THE GLOBAL IDENTITY WHICH CERTAIN OTHER TYPES OF FINANCIAL SERVICE FIRMS HAVE ACHIEVED. INSURANCE BROKERS HAVE A GLOBAL PRESENCE BUT HAVE YET TO DEVELOP A GLOBAL IDENTITY, WITH PRODUCTS AND SERVICES DELIVERED CONSISTENTLY AND IN A SEAMLESS MANNER THROUGHOUT THE WORLD.

FOR MANY YEARS, THE ORGANIZATIONAL MODEL OF THE BROKERAGE SPLIT THE FIRM'S RESOURCES BETWEEN DOMESTIC AND INTERNATIONAL. AS A RESULT, GLOBAL CLIENTS HAD TO DEAL WITH TWO DIFFERENT SETS OF PEOPLE TO ADDRESS

THEIR GLOBAL EXPOSURES, USUALLY UNDER TWO SEPARATE PROGRAMS, THE DOMESTIC AND THE INTERNATIONAL.

SINCE OVERSEAS PLACEMENTS WERE OFTEN UNDER LOCAL COVERAGE FORMS WITH MORE RESTRICTIVE CONDITIONS, BACK UP “DIFFERENCE IN CONDITIONS” (DIC) POLICIES WOULD BE PLACED IN THE U.S. THIS LED TO A FAILURE ON THE PART OF INTERNATIONAL BROKERS TO SERIOUSLY ADDRESS OVERSEAS EXPOSURES. WHEN I WOULD BRING UP CONCERNS ABOUT FOREIGN RISK MANAGEMENT ISSUES, I WOULD TYPICALLY RECEIVE THE KNEE JERK RESPONSE, “DON’T WORRY, IT’S COVERED UNDER THE DIC.” WITH THE ADVENT OF GLOBAL PROGRAMS, OFTEN LED BY LARGE, AGGRESSIVE EUROPEAN INSURERS, THIS MODEL HAS CHANGED.

REQUISITE GLOBAL PRESENCE BRINGS US TO QUALITY NUMBER FOUR, THE ABILITY TO SYNDICATE INSURANCE PROGRAMS ON A GLOBAL BASIS. THE FACT THAT THE INSURANCE INDUSTRY IS SO FRAGMENTED GIVES GREATER IMPORTANCE TO THE BROKER’S ROLE AS SYNDICATOR. ACCORDING TO A.M. BEST, THERE ARE ABOUT 2,000 PROPERTY AND CASUALTY INSURERS IN THE U.S., AND ONLY ABOUT 70 HAVE POLICY HOLDERS SURPLUS OF MORE THAN ONE BILLION DOLLARS. WITH SOME EXCEPTIONS, EACH INSURER WILL ONLY TAKE A RELATIVELY SMALL PART OF AN OVERALL UNDERWRITING BECAUSE OF EACH INSURER’S LIMITED CAPACITY. THE 400 MILLION DOLLAR PROGRAM, TO WHICH I EARLIER ALLUDED, REQUIRED NO LESS THAN 30 PRIMARY INSURERS FROM ALL OVER THE WORLD, AND EXTENSIVE REINSURANCE.

EVEN WITH CHANGES IN FINANCIAL SERVICE REGULATION, PROPERTY AND CASUALTY COMPANIES MAY NOT BE ATTRACTIVE ACQUISITION TARGETS FOR OTHER TYPES OF FINANCIAL SERVICE FIRMS, BUT ONE WOULD THINK THAT INSURERS THEMSELVES WOULD CONSOLIDATE TO REDUCE INFRASTRUCTURE COSTS AND GAIN SCALE. PRICE WATERHOUSE COOPERS RECENTLY PROJECTED THAT OVER THE NEXT FIVE TO TEN YEARS, THE NUMBER OF INSURANCE COMPANIES OF ALL TYPES WILL BE REDUCED BY AS MUCH AS 50%.

IF SUCH MAJOR CONSOLIDATION OCCURS, THE IMPORTANCE OF THE BROKER'S ABILITY TO SYNDICATE ACROSS MANY MARKETS WILL DECREASE, AS FEWER INSURERS WITH GREATER CAPACITY WILL BE ABLE TO UNDERWRITE LARGER RISKS. THERE MAY ALSO BE POTENTIAL FOR LARGER INSURERS TO FURTHER REDUCE THE NEED FOR SYNDICATION THROUGH GREATER TREATY REINSURANCE, WHICH COULD IN TURN RESULT IN FURTHER DISINTERMEDIATION.

TO RETURN TO OUR LITANY, REASON NUMBER FIVE IS COMMUNICATION. THE BROKER'S PROPOSAL WILL BE JUDGED NOT BY THE COLOR OF ITS GRAPHICS BUT RATHER BY THE CHARACTER OF ITS CONTENT. THE PEOPLE FOR WHOM I HAVE ALWAYS WORKED, REALLY DON'T WANT TO KNOW MUCH ABOUT INSURANCE. HOWEVER EXTENSIVE THE BACKGROUND MATERIAL I MAY ATTACH TO A PROPOSAL OR REPORT, I KNOW I MUST MAKE MY CASE CLEARLY AND SIMPLY ON THE FIRST PAGE. SUCH REPORTS DON'T END WITH CONCLUSIONS, THEY BEGIN WITH THEM.

IN SHORT, I LOOK FOR COMMUNICATION THAT IS CONCISE, WELL EDITED AND WITHOUT BOILER PLATE. EXTENSIVE ATTACHMENTS AND ANALYSES MAY BE INCLUDED FOR REVIEW, BUT I DON'T WANT TO HAVE TO WADE THROUGH IT TO FIGURE OUT THE BASIC MESSAGE.

CLOSELY TIED TO COMMUNICATION IS NUMBER SIX, WHICH MIGHT BE CALLED TIMELINESS OR A SENSE OF URGENCY. HAVING BEEN INVOLVED IN THIS BUSINESS SINCE 1972, I HAVE SEEN INSURANCE COME A LONG WAY IN TERMS OF INCREASING PROFESSIONALISM, BUT THAT IS TO A GREAT EXTENT REFLECTIVE OF THE FACT THAT IT HAD SO VERY FAR TO COME. PERHAPS, IN PART, BECAUSE WE DEAL WITH ANNUAL AND MULTI-YEAR POLICIES AS OPPOSED TO REAL TIME ON LINE TRADES, THERE IS A LACK OF A SENSE OF URGENCY IN OUR BUSINESS WHICH IS NOT CONSISTENT WITH THE PACE AT WHICH GLOBAL COMMERCE IS CURRENTLY CONDUCTED. THIS IS FURTHER AGGRAVATED BY THE CONSISTENTLY LATE ADOPTION OF NEW TECHNOLOGY WITHIN THE INSURANCE SECTOR. INSURANCE HAS NEVER BEEN TECHNOLOGY DRIVEN,

UNLIKE OTHER TYPES OF GLOBAL FINANCIAL SERVICES WHICH MUST SPEND BILLIONS TO MAINTAIN AND CONTINUALLY IMPROVE UPON THEIR INFRASTRUCTURE.

THE SEVENTH ATTRIBUTE WHICH THE BROKER MUST POSSESS IS NEGOTIATING LEVERAGE, CLOUT. AS A RESULT OF INDUSTRY CONSOLIDATION, UNPRECEDENTED SCALE HAS BEEN ACHIEVED, SUCH THAT THE BROKER HAS ENORMOUS LEVERAGE BOTH IN NEGOTIATING COVERAGE AND SETTLING CLAIMS. AS MUCH AS BROKERS SPEAK ABOUT DISTANCING THEMSELVES FROM THE TRANSACTION, THEIR ABILITY TO INFLUENCE THE TRANSACTION HAS NEVER BEEN GREATER AND IS AN ADVANTAGE NOT ENJOYED BY NEW COMPETITORS IN THE MARKET SUCH AS MANAGEMENT CONSULTING FIRMS. THIS IS AN IMPORTANT POINT.

AS THE GLOBAL BROKERAGE INDUSTRY CONSOLIDATED INTO WHAT ARE NOW THREE LEADING FIRMS, SOME OF MY COLLEAGUES BEMOANED THE REDUCTION IN COMPETITION. I SEE THE DEVELOPMENT QUITE DIFFERENTLY. I THINK THE CONSOLIDATION WAS NECESSARY SO THAT BROKERS COULD ACHIEVE THE SCALE TO COMPETE WITH NEW ENTRANTS INTO THE MARKET, SUCH AS MANAGEMENT CONSULTING FIRMS OFFERING BROAD RISK MANAGEMENT ADVICE AND LARGE GLOBAL INSURERS AND REINSURERS WHICH WOULD DISINTERMEDIATE THE BROKER.

WHILE BROKERAGE FIRMS TALK ABOUT THE NEED TO GET BEYOND THE TRANSACTION AND TO BE ABLE TO ADVISE ON BROADER ENTERPRISE RISK MANAGEMENT ISSUES, THEY SHOULD NOT LOSE SIGHT OF THE FACT THAT THEIR GREATEST STRENGTH, TODAY MORE THAN EVER, IS IN MANAGING THE TRANSACTION: TO CREATE, OFFER AND EXECUTE MECHANISMS FOR FUNDING RISK AND TO NEGOTIATE CLAIMS.

PARADOXICALLY, BROKERS MAY TALK ABOUT CONSULTING ON A BROAD RANGE OF ISSUES BUT ARE GENERALLY NOT EQUIPPED OR INCLINED TO DO SO. THE REALITY IS THAT WHEN A BROKER IS PITCHING A FINITE RISK PROPOSAL, AND I ASK ABOUT THE

ACCOUNTING AND TAX IMPLICATIONS, THE BROKER SUGGESTS THAT I GET EXPERT ADVICE.

THE RELAXATION OF CERTAIN REGULATORY RESTRICTIONS ON FINANCIAL SERVICE COMPANIES LED TO DISCUSSIONS OF THE POTENTIAL CONSOLIDATION OF BANKS, SECURITIES FIRMS AND INSURERS. PERSONALLY, I THINK AN INTERESTING OPPORTUNITY MIGHT LIE IN STRATEGIC ALLIANCES AMONG INSURANCE BROKERS, MANAGEMENT CONSULTANTS AND DOT COM COMPANIES. MANAGEMENT CONSULTANTS HAVE FAR GREATER BREADTH OF EXPERTISE WITH RESPECT TO OVERALL OPERATING RISK AND ASSOCIATED ISSUES BUT LACK RISK FUNDING ABILITY AND TRANSACTIONAL LEVERAGE. A DOT COM PARTNER COULD KEEP THE ENTERPRISE AHEAD OF THE CURVE IN TERMS OF ITS PRODUCT DELIVERY INFRASTRUCTURE, MAKING E-COMMERCE AN ADVANTAGE RATHER THAN A THREAT. CLEARLY, TO THE DEGREE THAT ANY ASPECT OF THE BUSINESS CAN BE COMMODITIZED, E-COMMERCE CAN SERVE TO DISINTERMEDIATE IT.

ANOTHER ADVANTAGE TO THE BROKER OF AFFILIATION WITH A MANAGEMENT CONSULTING FIRM IS A CHANGE IN THE LEVEL OF ACCESS TO THE CLIENT, FROM MIDDLE TO EXECUTIVE MANAGEMENT, THE LEVEL FROM WHICH MAJOR CONSULTING ENGAGEMENTS ARE DERIVED.

THE ALLIANCE OF INSURANCE BROKERS AND MANAGEMENT CONSULTANTS COULD ALSO ENHANCE THE BROKER'S ABILITY TO PERFORM RELATIVE TO REASON NUMBER EIGHT, PRICING OF THE SERVICE. AS I BRIEFLY NOTED EARLIER, BROKERS STILL HAVE SIGNIFICANT DIFFICULTY IN DETERMINING APPROPRIATE COMPENSATION.

AS YOU KNOW, INSURANCE BROKERAGE COMPENSATION HAD HISTORICALLY BEEN BASED ON COMMISSION. YEARS AGO, ON CERTAIN LINES, THESE PERCENTAGES COULD SOMETIMES BE AS HIGH AS 15 TO 25 PERCENT BUT WERE APPLIED TO RELATIVELY MINIMAL PREMIUMS. HOWEVER, OVER TIME AS PREMIUMS BECAME LARGER, RISK MANAGERS BEGAN TO CALL FOR FEE FOR SERVICE ARRANGEMENTS,

FIRST ON NORTH AMERICAN PLACEMENTS AND ULTIMATELY ON A WORLDWIDE BASIS. THESE FEES SOMETIMES TOOK THE FORM OF MUCH SMALLER PERCENTAGES OF NET PREMIUM.

INSURANCE IN GENERAL IS NOT A CULTURE OF ACCOUNTABILITY. BROKERS, UNLIKE LAWYERS OR CONSULTANTS, HAVE NOT HISTORICALLY ACCOUNTED FOR THEIR TIME BY ASSOCIATING IT WITH SPECIFIC CLIENTS. IN FAIRNESS, A BROKER'S ACTIVITIES OFTEN RELATE TO A LINE OF BUSINESS, WHICH MAY AFFECT ANY NUMBER OF CLIENTS. WHEN ASKED TO MOVE TO A FEE BASIS, SOME BROKERAGE FIRMS CLAIMED TO HAVE METHODS OF DETERMINING EXACTLY WHAT SHOULD BE CHARGED BASED ON HOURLY CALCULATIONS AT VARIOUS STAFFING LEVELS. THESE METHODOLOGIES, NOT SURPRISINGLY, ALWAYS SERVED TO DOCUMENT THAT THE BROKERAGE FIRM WAS ALREADY RECEIVING JUST ABOUT THE RIGHT LEVEL OF COMPENSATION AND MAYBE NOT QUITE ENOUGH.

BROKERS LEFT THE COMPENSATION DECISION, BY DEFAULT, TO RISK MANAGERS. WE THEREFORE, DETERMINE WHAT WE THINK THE BROKER'S SERVICES ARE WORTH AND NEGOTIATE ON THAT BASIS. I SAID THIS IN ANOTHER BROKERAGE FORUM AND A SENIOR BROKER ASKED, "BUT HOW ARE WE TO BE COMPENSATED FOR OUR RESEARCH AND DEVELOPMENT EXPENSE?" I SIMPLY ASKED HIM WHAT THE R&D BUDGET WAS. OF COURSE, THERE WASN'T ANY. OBVIOUSLY THERE ARE EXPENSES OF THIS NATURE BUT AGAIN, NO ACCOUNTABILITY.

THE INDUSTRY HAS NOT EVEN BEGUN TO NEGOTIATE SERVICE LEVEL AGREEMENTS WITH CLEAR INCENTIVES AND PENALTIES. I AM HOPING THAT THE QUALITY INITIATIVES, SUCH AS SIX SIGMA, PRESENTLY BEING UNDERTAKEN BY CERTAIN FIRMS, WILL LEAD TO SUCH DEFINITION WITH DOCUMENTED PERFORMANCE MEASURES.

OUR PENULTIMATE QUALITY, NUMBER NINE ON THE LIST, IS SOME KNOWLEDGE BY THE BROKER OF MY FIRM'S BUSINESS. I HAVE FOUND IT MUCH EASIER IN RECENT YEARS TO DISCUSS NEW PRODUCT CONCEPTS WITH INDIVIDUALS, PARTICULARLY

REINSURANCE UNDERWRITERS, WHO HAVE BEEN HIRED FROM MANAGEMENT CONSULTING AND BANKING BACKGROUNDS. THIS HAS NOT OCCURRED, TO THE SAME DEGREE, IN BROKERAGE AND I DO NOT REFER TO INVESTMENT BANKERS HIRED TO CHASE, WHAT HAS SO FAR BEEN, THE ILLUSIVE PHANTOM OF SECURITIZATION.

WHAT IS OUR FINAL CATEGORY? WHAT IS LAST? WHAT IS ALWAYS LAST? CLAIMS. THE VERY REASON FOR WHICH INSURANCE EXISTS BUT WHICH, FOR BOTH BROKER AND INSURER, IS GENERALLY A NON-REVENUE GENERATING ACTIVITY. ARE THERE ANY CLAIMS PEOPLE IN THE AUDIENCE? I THOUGHT NOT... I'M SURE THERE WILL BE A SEPARATE CELEBRATION PLANNED FOR EXCEPTIONAL CLAIMS PEOPLE..... IN A LESS EXPENSIVE VENUE PERHAPS. A SERIOUS CLAIM IS THE ONE CIRCUMSTANCE IN WHICH THE INSURED'S SENIOR MANAGEMENT REALLY TAKES NOTE OF INSURANCE AND ASSESSES ITS VALUE.

NO CLAIM EVENT DERIVES GREATER EXECUTIVE MANAGEMENT ATTENTION THAN A SUIT AGAINST INDIVIDUAL DIRECTORS AND OFFICERS (D&O). WHEN SUCH CLAIMS ARE REPORTED TO THE INSURER, IT IS MY EXPERIENCE, THAT WITH EXECUTIVE MANAGEMENT WATCHING AND IN THE FULL GLARE OF THE SPOTLIGHT, THE INSURER STUMBLES ACROSS THE STAGE. FORTUNATELY, THERE ARE NOW SENIOR UNDERWRITERS AT LEADING INSURERS WHO RECOGNIZE THE NEED TO CHANGE THE CLAIM PRACTICES I WILL DESCRIBE.

WHEN A D&O CLAIM IS SUBMITTED, THE INSURED CEASES TO BE THE CLIENT OF THE INSURER AND BEGINS DEALING WITH THE INSURER'S LAW FIRM. OBVIOUSLY, THE LAW FIRM'S CLIENT IS THE INSURER, NOT THE INSURED.

IN THE CURRENT ENVIRONMENT, WHEN AN INSURED SUBMITS A NOTICE TO THE INSURER OF A CLAIM HAVING BEEN MADE AGAINST DIRECTORS AND OFFICERS, THE INSURED CAN EXPECT A VOLUMINOUS RESERVATION OF RIGHTS FORM LETTER FROM THE INSURER'S CAPTIVE LAW FIRM, ENUMERATING EVERY BASIS ON WHICH

COVERAGE MAY BE DENIED, DRAWING ON ALL LEGAL PRECEDENT BACK TO THE CODE OF HAMURABI.

BUT OUR SUBJECT IS THE ROLE OF THE BROKER. YOU REMEMBER THE BROKER: THE INDIVIDUAL WHO, ON BEHALF OF THE INSURED, NEGOTIATED THE TERMS AND CONDITIONS OF THE CONTRACT IN QUESTION, WITH THE FULL BENEFIT OF "THE TEAM." WHEN THE RESERVATION OF RIGHTS LETTER IS RECEIVED, THE BROKER WILL ADVISE THE INSURED TO GET A LAWYER. ADMITTEDLY, THIS IS ULTIMATELY NECESSARY, BUT I AM ALWAYS SURPRISED AT THE SPEED WITH WHICH THE BROKER DISENGAGES IN A D&O CLAIM SITUATION. THIS WAS ALSO MOST APPARENT RECENTLY RELATIVE TO Y2K REMEDIATION CLAIMS, WHERE I THINK SIGNIFICANTLY MORE GUIDANCE COULD HAVE BEEN OFFERED, ESPECIALLY WITH RESPECT TO THE MANNER IN WHICH THE HANDLING OF THIS ISSUE COULD EFFECT THE LIABILITY OF DIRECTORS AND OFFICERS.

IN TERMS OF PRESENT AND FUTURE CHALLENGES, THE NEXT MAJOR ISSUE, ALREADY BEFORE US, IS THE NEED TO ADDRESS OPERATING RISK. OPERATING RISK REPRESENTS ONE OF THE THREE ASPECTS OF ENTERPRISE RISK, WHICH IS USUALLY DEFINED TO INCLUDE MARKET, CREDIT AND OPERATING RISK. I BELIEVE THE RESOURCES AND TOOLS NECESSARY TO ADDRESS MARKET AND CREDIT RISK HAVE LONG BEEN AVAILABLE. HOWEVER, OPERATING RISK, I.E., ALL THE EXPOSURES TO LOSS ANCILLARY TO THE CORE BUSINESS RISKS, HAS ONLY BEGUN TO BE ADDRESSED. SUCH RISKS CAN RELATE TO PERSONNEL, TECHNOLOGY, PHYSICAL ASSETS, CUSTOMER RELATIONSHIPS, AND EXTERNAL FACTORS; MORE SPECIFICALLY, VIOLATIONS OF POLICY, SYSTEMS UNAVAILABILITY, POOR DATA QUALITY, ERRORS, SOFTWARE FAILURE, INABILITY TO ACCESS OR UTILIZE PHYSICAL ASSETS FOR ANY REASON, UNENFORCEABLE TRANSACTIONS, ETC.

IN ADDRESSING OPERATING RISK, I HAVE BEEN WORKING CLOSELY WITH INDIVIDUALS WHO HAVE EXTENSIVE CREDIT AND MARKET RISK EXPERIENCE. THEY BRING THEIR KNOWLEDGE OF MARKET AND CREDIT RISK ASSESSMENT AND MODELING WHILE I

BRING MY EXPERIENCE IN MANAGING AND INSURING OPERATING RISK. THE TWO DIFFERENT SKILL SETS COMPLEMENT EACH OTHER WELL.

FOR EXAMPLE, MARKET AND CREDIT ANALYSTS AUTOMATICALLY ASSUME THAT ANY POTENTIAL INSURANCE SOLUTIONS WILL REQUIRE EXHAUSTIVE ACTUARIAL ANALYSIS AND SCENARIO MODELING. WHILE THESE TOOLS ARE USED IN PROPERTY AND CASUALTY INSURANCE, THE BROKER AND RISK MANAGER CAN PLAY AN IMPORTANT ROLE IN COMMUNICATING TO CREDIT AND MARKET RISK SPECIALISTS JUST HOW FLEXIBLE AND PERHAPS UNSCIENTIFIC INSURANCE SOLUTIONS CAN BE.

SINCE HURRICANE ANDREW AND THE NORTHRIDGE EARTHQUAKE, PROPERTY INSURERS HAVE MADE MUCH MORE EXTENSIVE USE OF MODELING TO ASSESS THE DEGREE OF EXPOSURE IN CERTAIN GEOGRAPHIC AREAS. IN ORDER TO AVOID OVER CONCENTRATION OF RISK, INSURERS HAVE, FOR EXAMPLE, DISCONTINUED OR STRICTLY LIMITED THE COVERAGE WHICH WILL BE PROVIDED IN CERTAIN REGIONS, E.G., WINDSTORM ON THE COAST OF FLORIDA. HOWEVER, ACTUAL PRICING OF COVERAGE WRITTEN HAS BEEN AND REMAINS MORE A FUNCTION OF COMPETITION AND THE FEAR OF LOSING MARKET SHARE THAN OF THE DESIRE TO INCREASE UNDERWRITING PROFIT.

I WILL OFFER TWO EXAMPLES THAT SPAN A 25 YEAR PERIOD. IN 1972, WHEN I STARTED AS A CRIME INSURANCE UNDERWRITER, WE ALREADY HAD COMPUTER BASED PREMIUM RATING. THE CALCULATION FOR A BANK FIDELITY BOND, FOR EXAMPLE, REQUIRED THAT WE INPUT THE NUMBER OF EMPLOYEES, THE NUMBER OF BRANCHES, THE LOAN TO DEPOSIT RATIO, THE LOSS MODIFICATION AND SEVERAL OTHER RATING FACTORS. THE COMPUTER WOULD THEN PROVIDE THE 100% OF MANUAL PREMIUM. WE WOULD THEN ACTUALLY CHARGE FROM PERHAPS 20% TO 500% OF THAT NUMBER, DEPENDING ON WHAT THE COMPETITION WAS BIDDING. NAIVELY, I ASKED WHY WE WENT THROUGH THE TROUBLE OF PERFORMING THE CALCULATION IF THE PREMIUM QUOTE WAS ULTIMATELY MARKET DRIVEN. I WAS

TOLD THAT THE STATE WAS MORE COMFORTABLE KNOWING OUR PREMIUM RATES WERE ACTUARIALLY DETERMINED.

TWENTY-FIVE YEARS LATER, WE SYNDICATED THE \$400 MILLION CATASTROPHE PROGRAM I DESCRIBED TO YOU. MY MARKET AND CREDIT RISK COLLEAGUES ASK WHAT TYPE OF MODELS WERE CREATED TO ASSESS THE RISK AND ACTUARIALLY DETERMINE THE PREMIUM. THEY ARE SURPRISED TO LEARN THAT, EVEN BEFORE APPROACHING INSURERS, I SAT DOWN WITH THE BROKER, WITH WHOM WE WERE DRAFTING THE CONTRACT TERMS, AND DECIDED WHAT PREMIUM RATE PER MILLION WE WERE WILLING TO PAY. THIS WAS LARGELY BASED ON AN ASSESSMENT OF WHAT PRICE I PERCEIVED WOULD BE COMPELLING TO MY MANAGEMENT ON A COST/BENEFIT BASIS AND OUR ESTIMATE OF WHAT THE COMPETITIVE MARKET WOULD BEAR. WE THEN SOLICITED PARTICIPATION BASED ON THAT RATE PER MILLION, WHILE PROVIDING EXTENSIVE UNDERWRITING INFORMATION. ALTHOUGH WE INITIALLY SET OUT TO SECURE \$500 MILLION, WE FOUND THE \$400 MILLION WAS LITERALLY WHAT THE MARKET WOULD BEAR AT THE PRICING WE DESIRED. BEYOND \$400 MILLION WE BEGAN TO STRAIN THE CAPACITY OF THE MARKET AND ENCOUNTER HIGHER RATES.

IT IS IMPORTANT TO REMEMBER THAT THE INSURERS WE WERE APPROACHING WERE USUALLY FIRMS WITH WHOM WE HAD FOSTERED LONG TERM RELATIONSHIPS AND WHICH IN SOME CASES HAD BENEFITED FROM INVOLVEMENT IN OUR PROGRAMS FOR DECADES. IN PLACEMENTS SUCH AS THIS, WHICH INVOLVE MANAGEMENT LIABILITY, THE INSURER IS, TO A SIGNIFICANT EXTENT, UNDERWRITING BASED ON A CERTAIN LEVEL OF CONFIDENCE IN THE MANAGEMENT OF THE INSURED FIRM, WHICH NO ACTUARIAL ANALYSIS COULD SERVE TO CAPTURE.

IN ADDRESSING OPERATING RISK, I THINK THAT THE SCIENCE OF SOPHISTICATED MODELING AND THE ART OF LEVERAGING MARKET FORCES WILL BOTH BE CRITICAL.

OTHER EXTERNAL FACTORS ARE ALSO PRESENTLY CONVERGING WITH INSURANCE TO PROVIDE AN ADDITIONAL CATALYST FOR THE CREATION OF BROAD OPERATING RISK

COVERAGE. REGULATORS HAVE INDICATED THEIR INCLINATION TO ARTICULATE OPERATING RISK CAPITAL ALLOCATION REQUIREMENTS. AS A RESULT, FORWARD THINKING INSURERS ARE CONSIDERING THE CREATION OF INSURANCE WHICH MIGHT, IN WHOLE OR IN PART, ACT AS A LESS EXPENSIVE SUBSTITUTE FOR SUCH CAPITAL ALLOCATION.

WE ARE STILL IN THE PRELIMINARY STAGES OF THIS CONVERGENCE WITH SEVERAL VARIABLES YET TO BE DEFINED:

- THE AMOUNT OF THE CAPITAL ALLOCATION REQUIREMENTS.
- THE DEGREE TO WHICH INSURANCE MAY BE AN ACCEPTABLE ALTERNATIVE TO CAPITAL ALLOCATION.
- THE ADEQUACY OF THE CAPACITY OF THE INSURANCE MARKET TO ADDRESS THIS OPPORTUNITY.

DURING THIS DYNAMIC PERIOD, RISK MANAGERS, BROKERS, AND INSURERS HAVE AN UNPRECEDENTED OPPORTUNITY TO SIGNIFICANTLY INCREASE THE VALUE OF THEIR CONTRIBUTION BY GREATLY EXPANDING THE SCOPE AND LIMIT OF COVERAGE.

IF MEANINGFUL FUNDING IS TO BE PROVIDED FOR LOSSES OF THIS NATURE, FOR LARGE CORPORATIONS, THE FINANCIAL CAPACITY OF THE INDUSTRY WILL HAVE TO BE RADICALLY INCREASED. FUNDING TODAY, EVEN WITH SO-CALLED CATASTROPHE PROGRAMS, ONLY SERVES TO SMOOTH THE EFFECT OF LOSS ON THE P&L IN ANY GIVEN PERIOD. IF COVERAGE IS TO BE DESIGNED TO ADDRESS POTENTIAL LIFE THREATENING EVENTS AT MAJOR CORPORATIONS, IT MAY HAVE TO PROVIDE LIMITS IN EXCESS OF ONE BILLION. THE NEED TO RADICALLY INCREASE THE CAPACITY OF THE MARKET MAY FINALLY REPRESENT AN OPPORTUNITY FOR MEANINGFUL SECURITIZATION.

IN FACING THESE NEW CHALLENGES, IN AN ENVIRONMENT WHERE TECHNOLOGY WILL CONTINUE TO ADVANCE AT AN EXPONENTIAL RATE, RISK MANAGERS WILL BE RELYING ON PROFESSIONALS LIKE YOU: YOUR KNOWLEDGE OF YOUR FIRM AND ACCESS TO ITS RESOURCES, YOUR GLOBAL NETWORK AND ABILITY TO SYNDICATE ACROSS IT, YOUR CONCISE TIMELY COMMUNICATION, YOUR NEGOTIATING LEVERAGE IN BOTH UNDERWRITING AND CLAIMS, AND YOUR UNDERSTANDING OF OUR NEEDS.

I DON'T THINK TIME PERMITS ME TO ACHIEVE THE GOAL OF SAYING EVERYTHING I EVER WANTED TO SAY TO YOU. BUT IF YOU VISIT THE IFRIMA WEBSITE AND CHECK OUT THE SECTION DENOTED AS "PAPERS," WE CAN CONTINUE OUR DISCUSSION.

IN CLOSING, I WOULD LIKE TO OFFER ONE LAST WORD OF ENCOURAGEMENT ON YOUR REORGANIZATION. AS ONE WHO HAS BEEN ZERO-BASED, CONTROL SELF-ASSESSED, MCKINSEYED, ACTIVITY BASE COSTED, JOB FAMILY ARCHITECTURED, VENDOR MANAGED, SIX SIGMAED, AND DOT COMED. I WANT YOU TO CONSIDER THE FACT THAT YOUR EXPERIENCE DURING THIS REORGANIZATION WILL RESULT IN YOUR BEING SO MUCH BETTER PREPARED FOR THE NEXT ONE.

THANK YOU AND I HOPE YOU ALL HAVE ANOTHER GREAT YEAR.