

Growth and Discipline

by Ron Pressman, Chairman, President & CEO, GE Insurance Solutions
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The insurance and reinsurance industry is a critical foundation of the global economy, a fact that often is lost in our haste to deal with the challenges in our competitive markets. While our industry faces a myriad of challenges today from explosive loss cost growth, rising catastrophe costs and investigations, I believe we can build a promising future by addressing these issues directly and openly.

Because of the financial security and protection we provide for people, property and reputations, new buildings are built, planes fly, risks are taken and economies around the world grow. We have a joint responsibility in our industry to support free, fair and competitive markets. We also have an obligation to build businesses that provide security for our customers for the long term.

Nowhere in the world are our risk management skills more needed, and nowhere will they be more tested than in China. The China growth story is dramatic, as detailed in a recent *Newsweek*¹ magazine special section, "Does the Future Belong to China?" The statistics are astounding:

- Its population is currently at 1.3 billion
- Its economic output is USD 1.6 trillion
- It is the largest producer of coal, steel and cement
- It ranks second in energy consumption
- It is the third largest oil importer

China will experience the largest projected increase (2004 to 2014) of all emerging markets with close to 8 percent compounded annual gross domestic product growth. India is second with more than 6 percent projected for the decade.²

The property and casualty (P&C) insurance industry in China is also burgeoning, with non-life premiums estimated at USD 13.7 billion for 2004.³ They are expected to grow at 10% annually for the next five years. Expected increases in population, especially in urban centers, are likely to propel this growth as demand for insurance increases. Already, 39 foreign companies have entered the insurance market.⁴

¹ "Does the Future Belong to China?" Fareed Zakira. *Newsweek*. May 9, 2005.

² Primary Source: Oxford Economic Forecasting, Swiss Re Economic Research & Consulting. See also presentation at [Casualty Actuaries of Greater New York Spring Meeting 2004](#) titled "Indian Insurance Markets." Thomas Holzheu, Swiss Re, Economic Research & Consulting. June 2004.

³ "China Insurance- Premium Growth." BOC International 2004.

⁴ "Overseas Insurers Get Warm Welcome." Zhang Dingmin. *China Daily*. January 2005.

Fast growing markets may mean opportunities for insurers, but they also bring risks and challenges to an industry that must perform more consistently.

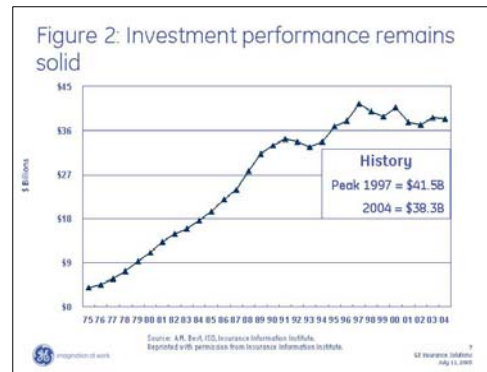
Our global industry

As insurers, we must recognize the broader, global reality in which our businesses are operating. For example, rating agencies such as A.M. Best, Standard & Poor's and Moody's have been recalibrating the industry during the past four years. A.M. Best has downgraded twice as many companies since 2000 as it has upgraded. This recalibration is, in part, due to rating agency concerns about lagging operating performance.

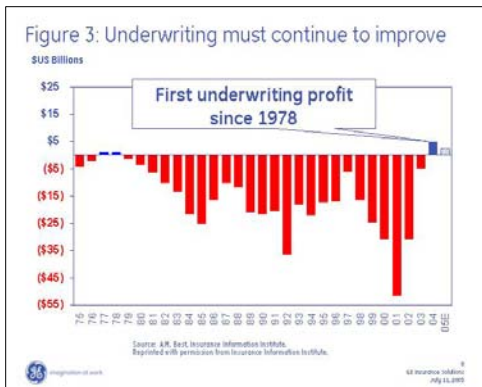


lagged behind the returns of diversified financial services companies (see Figure 1).⁵ While P&C insurers have provided investors with plenty of volatility, they have only delivered single-digit returns for most of the past 15 years, making insurance a less attractive investment for many investors.

Underwriting is at the heart of our challenge. In the United States, 2004 was the first year in the past 25 in which the industry in aggregate posted an underwriting profit. How does an industry that does not make a profit selling its core product survive?



The obvious answer is investments (See Figure 2).⁶ But investments cannot mask poor underwriting in today's lower return environment. Figure 3 indicates the need for disciplined underwriting has never been more obvious.⁷



Loss cost growth poses an ongoing threat to our P&C marketplace. Premiums have been growing at a relatively flat rate during the last fifteen years while loss costs have accelerated at much

⁵ A.M. Best, Insurance Information Institute. Reprinted with permission from Insurance Information Institute.

⁶ Ibid.

⁷ Ibid.

more rapid rates.⁸ The recent industry underwriting improvements and hard market have closed that gap, but we run the risk ahead of allowing discipline to erode, a formula for continued under-performance (see Figure 4).

In addition, our industry today faces an extraordinary level of scrutiny, which puts our credibility at stake. Although much of this has been centered in the United States, these issues are not confined to one marketplace. These are issues that have the potential to undermine the trust that is placed in us as insurers and reinsurers. Clearly we must stand — as an industry — for integrity, transparency and candor. Never has this been more crucial.



Delivering what customers want

So what do we need to do as an industry to improve our standing? We have to deliver what customers want:

- Consistency – not cyclicality
- Service – expertise to help manage risk
- Security and financial strength – restoring ratings to ensure long-term credibility
- Integrity – we must earn the trust of our customers

Our investors and rating agencies want the same focus on consistency along with a 13% to 15% operating return.

So how do we deliver?

First, integrity belongs at the top of our agenda. It is not just a matter of “checking the box” and doing what is required. It is a matter of being *trustworthy*. One action that we are taking at GE Insurance Solutions is an initiative called Challenge All Industry Norms (CAIN).

**Integrity
belongs at
the top of
our agenda.**

It goes beyond being compliant to digging into the gray areas in our business, and working as best we can to offer solutions that clarify rules and guidelines and help our business become more transparent for customers, regulators, investors and our own employees.

We are also focusing on customer service. It's at the center of our brand promise. Six Sigma rigor drives our business. In the traditional services area, we use Six Sigma to improve processes that are designed to make it easier for our

⁸ Compiled by GE Insurance Solutions internal research, AM Best Aggregates & Averages, ISO

customers to do business with us. Our “At the Customer, For the Customer” expert services and advanced risk analytics are some key areas where GE Insurance Solutions brings services to help make our customers’ businesses better.

What can we as an industry do about the central long-term challenges of loss cost inflation? Loss cost inflation is eating away at the fundamental fabric of our long-term financial performance as an industry.

Catastrophes – the worst year ever

In 2004, insured natural catastrophe losses rose to their highest level ever at \$50 billion. While it is virtually impossible to predict catastrophe trends, it is clear that as development increases in coastal, flood plain and other catastrophe-exposed areas, loss costs will continue to rise. We cannot control the weather, but we can control exposure to those losses, reduce property damage, and save lives by supporting stronger building standards and appropriate land use approaches.

We also must continue to upgrade our catastrophe models. These models have improved dramatically in the past decade, but they still remain less precise than we might desire. For example, companies using the leading models to assess their exposure after Hurricane Frances in Florida last year saw a wide span of outcomes. The actual losses ranged from 75% of what the model predicted to more than 11 times the modeled claims level.⁹ Last year’s storms can and should serve as a wake-up call for all of us.

Terrorism

The challenge of terrorism remains at the forefront of our thinking. The number of terrorist attacks around the world has — in general — declined in recent years. However, recent attacks have been among the most costly in history. While we can model the impact of a variety of terrorist attacks, our industry is not positioned to predict when or where they will happen.

We might think property losses are well modeled, but are they?

The U.S. faces some critical decisions about the renewal of TRIA, the government supported terrorism backstop. Our view is that it should be renewed, with the ultimate goal of establishing a program similar to the Pool Re concept used in the U.K.

⁹ Towers Perrin data presented to internal GE Insurance Solutions audience. Permission to use data granted by Towers Perrin.

Torts

Last, but not least, the rapid increase in tort costs continues to plague our industry and the economy in general. We must focus on bringing balance and logic to the U.S. tort system. It sometimes resembles a national lottery, with a few big winners and the rest of us big losers. At the same time, we must provide fair, even generous, civil awards for people injured by others' errors. This taxation without representation needs to be replaced with fair treatment for those truly in need.

The United States is not alone in facing these tort costs. The "litigation virus" has infected most of the developed world, hitting Europe and Asia. It would be naïve to think the rest of the world is insulated and exempt from these increasing cost trends.

Outlook

While we face daunting challenges, our industry has the capacity to overcome them. We are seeing progress in underwriting performance, changes in laws that may stem the rise of tort costs, in improved catastrophe modeling. These changes in our practices — from underwriting discipline to tort reform — reinforce an optimistic outlook.

In the end, our industry plays a critical role in the global economy. We have a noble cause to help people recover from loss of property, loss of life, even loss of reputation. We offer a promise of security, and we must honor the trust placed in us.

All of our stakeholders expect greater consistency and higher performance from us, and we can deliver on these goals. We must seize opportunities ahead to work together globally where we can to drive change in our industry that delivers consistency for our clients, our investors, our regulators and our employees.