

**“MEETING TOMORROW’S CHALLENGES”**  
**SPEECH TO INTERNATIONAL INSURANCE SOCIETY**  
**EDWARD CREASY, NEW YORK, JULY 2003**

Introduction

Good morning, I am delighted to be here with all of you all in New York this morning.

Our theme this morning – meeting tomorrow’s challenges – is one for our whole industry. As insurance providers, it is our job to react and respond to whatever is thrown at us. So however the world changes – and the last couple of years are as good examples as any of extreme change – the insurance industry only survives by continuing to offer protection against the vagaries of fate. In that context this morning, I am focusing on “Finding new risk solutions.” This seems an appropriate topic for a representative from Lloyd’s of London to address, since we have been in the business of responding to new and emerging risk for over 300 years.

First, I would like to discuss what we can do today to help us respond to tomorrow’s risk challenges. What are the current trends we should be taking note of? And what are we doing to develop products to respond? Second, I want to look at what the insurance industry needs to do collectively, to get our own house in order and enable us to meet the challenges tomorrow throws at us.

The comments I will make this morning are all very much from the perspective of the London market, and Lloyd’s in particular. However, the principles underlying these comments apply very much across the global industry.

## Calculating tomorrow' risk challenges, today

So, let's start with tomorrow's risk challenges. How can we go about planning and preparing for these? It seems to me that looking around us at the moment, there are a number of key trends where our experience today will help us in planning for our future.

First, we have a global culture which is increasingly concerned by fault and compensation rather than acceptance of accident. Back in the UK, we like to blame that trend on the United States. Let me say a little about why that might be. The US tort system cost \$205 billion in 2001, or \$721 per U.S. citizen, and at current levels, U.S. tort costs are equivalent to a 5 per cent tax on wages<sup>i</sup>. By 2005, it is estimated to have risen further still – to \$298 billion<sup>ii</sup>.

To add insult to injury, this system is highly inefficient to those it is meant to serve. It returns less than 50 cents on the dollar to people it is designed to help, and only 22 cents to compensate for actual economic loss<sup>iii</sup>. However, it might surprise you to know that these days New South Wales, not California, is considered to be the most litigious state in the world! And the trend is growing elsewhere too. In fact, recent Lloyd's studies point to a surge in demand in liability insurance across the entire Asia-Pacific region. In many parts of Europe, suing directors and officers of companies was virtually unheard of until recently. But that is all changing.

Second, the fast development of technology brings us new risks that neither supplier, consumer or regulator fully understand yet. Internet technology does two things. First, it brings some old risks and amplifies them in a new context. For example, exposure to fraud, potential third party liabilities, and copyright and jurisdictional issues; all of these were

present in your business before you went on line, but now they are re-emphasised, in a new form. Second, it brings a range of new risks. The risk of disseminating viruses to your clients and suppliers has changed the corporate risk profile. A recent CSI survey interviewed companies about their experience of computer crime and security. Nine out of ten organisations reported unauthorised use in systems and of those who were able to quantify the size of the loss, the average value was nearly \$1 million, not a figure to be sniffed at.

Third, shifting demographics are having an impact. People are living ever longer, raising issues about provision of means by which this is achieved, and the costs incurred. In addition, we are experiencing accumulation of exposure in catastrophe-exposed areas. Today, fifty per cent of the world's population lives in coastal areas exposed to flooding, rising sea levels and cyclone. Forty of the world's fastest-growing cities are located in earthquake zones. The risk posed to large numbers of people – and their property – is immense. Partly as a result of shifting demographics, insurance losses from natural disasters have increased 15-fold since 1960. If there were to be a Hurricane Andrew today, the cost of businesses interruption alone – in terms of lost revenue, payroll and tax receipts – could be enormous. One estimate is that non-property losses alone could be \$25 billion, much of it uninsured, and over 100,000 lost jobs<sup>iv</sup>.

And things are going to get worse. By 2050, mega-catastrophes, which used to occur every 100 years, are predicted to happen once every 25. The UN predicts that losses will then be 900 per cent higher than they are today<sup>v</sup>.

We, as an industry, need to think through what this means for our economy. Have we enough research to make proper judgements? Are we modelling and pricing risk accordingly?

Fourth, changing geopolitics. September 11<sup>th</sup> changed in one day the entire definition of war and terrorism. Terrorist attacks in 2002 further clarified – if clarification was needed – that terrorism is a global threat that affects us all. Additionally, the definition of what is a risky territory has shifted. And of course the nature of attack has changed.

Lloyd's is rightly viewed as the world's market leader in this field, with some 25% share of the world's stand-alone terrorism capacity, and 30% of global capacity for political risk. In the recent Iraqi war, Lloyd's provided coverage for a range of risks, from commercial aircraft and vessels using the area, to emergency repatriation and personal accident coverage of various groups, coverage for multinational corporations with operations in the Middle East, and protection of media crew equipment damaged by rioting, war or terrorism.

The last point I want to make concerns the size of risk. Today's commercial environment is a global one. Today's companies are multinationals. Some of the world's largest companies are the result of cross-border mergers and acquisitions. In fact, seven of the top ten companies in the Global 500 and five of the top ten Fortune 500 represent major cross-border activity<sup>1</sup>. Think of the Anglo-Dutch Royal Dutch/ Shell Group or acquisition of British retailer Asda by American Wal-Mart. Analysis of the wave of cross-border mergers and acquisition activity in the 1990s shows that, in real terms, it was at least five times larger than a decade before. These new, vast balance sheets create vast levels of risk.

Again, I am pleased to say that underwriters at Lloyd's are ready to take the risk. Today's global, multi-national companies successful companies depend on knowledge and know-how,

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<sup>1</sup> Fortune website, viewed March 2003.

on ideas and innovation for their success. Computer programmes, new drugs, genetically modified products – such products can take years of painstaking research to create, and many millions of dollars are spent on their marketing. And that is reflected in 21<sup>st</sup> century balance sheets. No longer are physical, tangible assets such as property and machinery in the majority. Today, intangible assets are worth more, and they must therefore be protected. Once on sale, new ideas or products can be copied. Governments can interfere, saying that this drug or that seed is going to be banned from their markets. And, of course, a sudden scandal can destroy a product's reputation: the brand can be irreparably damaged. Underwriters have risen to the challenge that these risks pose. You can now insure against them.

### Managing the insurance industry better

But as an industry, we must be able to do more than just recognise and respond to risk. The insurance industry cannot be viewed simply as a panacea for all of these issues, the fall guy who picks up the tab for an out-of-control legal system. Should this happen, there would be no-one willing to run any commercial insurance enterprise in the long-term; there will be no-one willing to take on the risk. And this brings me to the second part of my talk. What must we do collectively to maintain a robust, healthy industry in the face of the changing risk environment?

First, we need to manage the insurance cycle in a much better way. Management of the cycle will create stability in three main ways. Marketing theory always tells us to think of the customer first. Well, the truth is that the buyer benefits from stability of price, and a logical approach to pricing. Second, no guesses for what our investors want: consistent, strong

financial performance, without the dramas of the highs and – certainly the lows – that the analysts and shareholders react to so quickly. And third, insurers themselves will benefit. It gives our own businesses stability and continuity, enabling us to plan more effectively for the medium- to long-term. Furthermore, it will be better for our own image. We need to get our image right. The insurance market enables the rebuilding of New York after the terrible tragedy in 2001. The insurance industry creates economic growth.

So what action must we take?

We need to exercise much greater control over our underwriting. That means more focus on pricing dynamics – not just pure price but costing terms and conditions. It means greater attention to premium and profit in a disciplined way.

At the heart of Lloyd's reforms is the creation of a franchise, a new partnership between the businesses in the market and Lloyd's itself, which runs the market. It means a new role and focus for those charged with running the market. Under the franchise arrangement, we are introducing a whole range of new, stringent, commercial-quality standards to complement the regulatory ones set by our supervisor, the Financial Services Authority.

One of the problems we encounter in this industry is that changes – to pricing, to limits, to terms and conditions, to exclusions, to deductibles – happen so gradually that we don't immediately understand their impact. Then when the hard facts, the losses, the angst, come – it is always a surprise. Closer attention to detail and greater discipline must overcome that problem.

For the final part of my talk I want to focus on the people factor. We have talked a lot about trends, and about discipline, and about pricing. But without the right people, we will be unable to deliver new risk solutions for the future.

Investment in any initiative will be wasted if it is not grounded in people being prepared and willing to do things differently. Technology can revolutionise the business placing or claims process, but only if people want it to – most importantly those most closely involved in those processes. Risk modelling and analysis can tell us much about risk aggregation and correlation, but only if we invest in bright people to analyse the data. You need creative people to understand and assess risk. Closer underwriting control can help preserve pricing discipline, you still need the entrepreneurial flair of world-class underwriting teams. So we must invest in people too. Any change must be about people and behaviour.

So what are the qualities we need? I have selected a number of key qualities which are important for us Kiln, and in the Lloyd's market generally. I believe however, that these apply across the board.

First, a professional approach. For too long, insurance has been a poor cousin within the financial services industry. We need to raise and maintain the standard of our people. We must encourage and incentivise our teams to attain the best possible standards of professional education. We no longer have any excuses for failing to do so. Opportunities to train and to study for professional qualifications are available to us all nowadays.

Next, we need good communicators. By investing in communication when times are good, insurers and their clients can better work through any problems when things get tougher, and market conditions start to turn.

Next, expertise. It is important that our people have wide exposure to all aspects of risk management and insurance. I have mentioned already the importance of better communication between underwriter and risk manager. What better way to deliver this than to have a multi-skilled, multi-experienced team who can see an issue from another perspective? I will give you an example from Kiln: recently we have recruited a Risk Manager from Pearson's to head our Research and Development division. The perspective that he brings to our account management strategy is invaluable.

Last, we need people who demonstrate the confidence to take opportunities, the ability to balance risk and reward. I am talking about entrepreneurial spirit. That is certainly an important part of the Lloyd's equation and a quality that has marked us out through our long history.

Going back a century, aeroplanes are an excellent example of dramatic change in the world of transportation. Lloyd's wrote the world's first standard aircraft insurance policy in 1911, while Orville and Wilbur Wright were still experimenting. When commercial airlines and cargo carriers first flew, making aviation a true, new business risk, Lloyd's underwriters were ready to take it on.

Similarly, Lloyd's was the first major motor insurer. And the first major international insurer of motor fleets. We were first to cover the cargoes these newfangled forms of transport

carried. It wasn't very different, really, from 200 years earlier, when Lloyd's underwriters were insuring traders and their cargoes as they plied the waters just down in the harbour here more than three centuries ago.

That entrepreneurial spirit, that ability to consider and take on new, unusual and complex risk, is what still marks out Lloyd's of London today. And in today's rapidly changing environment, we need to ensure that approach exists and flourishes across our industry.

Allow me to finish with a cliché. After all, it is the plain facts which become the clichés in the end. Change is the only constant.

Technological change started perhaps with the spinning jenny, or maybe it goes back to the wheel. It is a matter of perspective. That is what has kept our insurance market strong: the ability to see new risk in familiar ways, and not be taken by surprise.

Risk is changing, but the way we are dealing with it – through insurance - isn't, and as long as businesses and their insurers can work in partnership together, we are well placed to anticipate, address and respond to any risk the 21<sup>st</sup> century business environment throws our way.

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<sup>i</sup> Tillinghast - Towers Perrin (Tillinghast) in *U.S. Tort Costs: 2002 Update*

<sup>ii</sup> Insurance Information Institute

<sup>iii</sup> Tillinghast - Towers Perrin (Tillinghast) in *U.S. Tort Costs: 2002 Update*

<sup>iv</sup> Insurance Information Institute, cited by Lloyd's press office.

<sup>v</sup> *Global Climate change threatens the insurance industry*, The Environmental News Network, August 27<sup>th</sup> 2002.