ADDRESS TO

THE INSURANCE INSTITUTE OF IRELAND

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"THE CHANGING HORIZONS - A LONDON VIEW"

INTRODUCTION

Our industry today faces a daunting catalogue of challenges.

Incidentally, are we an industry, a trade, a profession or a business?

Maybe only semantics but it does affect attitudes.

If we talk about products, consumers, market share, as if we were selling toothpaste or chocolate bars then there is an inevitable tendency to think that way.

Maybe it is all right for the mass market activities but I prefer to think of insurance as a sophisticated financial service provided to clients rather than products being sold to customers.

I am not sure of the relevance of all this to my topic but I always feel better when I have sounded off on this particular hobbyhorse.

I started out by saying that we face a catalogue of challenges.

They come in a variety of guises.

- there are economic challenges - Interest Rates/Inflation/Exchange Rates/Taxation

- there are socio-political challenges	- Government Interface/Regulation/De-Regulation/EEC/Europe 1992/Inner Cities
- there are legal challenges	- Absolute Liability/Tort reform/Consumerism/No fault
- there are commercial challenges	- Compeition/Shareholder demands/Client requirements/Internationalism/Eastern Europe
- there are technical challenges	- Information technology/Distribution/Administration/Client technological developments

You will be relieved that I am not going to talk about any of these. I am going to talk about escalating catastrophe exposures because it is possibly the one dimension where the London market perspective may present some new thinking.

CATASTROPHE CAPACITY

A couple of years ago I gave a talk to the Association of Corporate Treasurers - which includes in its membership the Financial Officers of most major UK corporations - many of them multinational. I sought to focus their minds on some of the major present-day risks that confront businessmen worldwide. I recounted horror stories of Chernobyl, Asbestosis, Bhopal - this was before Piper Alpha.

In the discussion that followed one participant put the rather obvious question.

"Are there exposures which are just too big for the insurance industry to cope with?"

The answer of course is yes and it always has been yes.

There are and always have been risks which are too big.

Let me illustrate

In the 30s - Queen Mary - market only provided £3m out of £4m

San Francisco Bridges - used not be able to get revenues insured.

Nuclear exposures capped by US Government

War of course has never been insurable except to some extent on Marine and Aviation risks.

As of today there are numerous risks, individual and cumulative, where the insurance industry can only provide part of the protection required.

Furthermore catastrophe exposures are escalating far faster than world GDP, than world PI.

In the corporate world more CEOs, more boards of directors, take a close interest in insurance and risk management today than they ever did a decade ago. Granted the traumas of the middle 80s, this is hardly surprising. There is now a realisation that insurance can often be a licence to trade.

I know of

- an aircraft manufacturer in the US who went out of business because of the cost of product liability.

- a UK motor manufacturer who seriously considered discontinuing exports to USA because of non-availability of acceptable product liability limits.

- a European pharmaceutical company who has so structured its corporate entity that its USA subsidiary could liquidate in the event of a major claim.

- an insurance broker who sold out because of the cost of Professional Indemnity.

I repeat - insurance today is often a licence to trade.

Lets look at some of the catastrophe exposures that underlie these and other horror stories and then try and suggest some responses.

Few of the hazards are new in themselves but the scale of the losses they generate has rocketed.

CATASTROPHE EXPOSURES

Products Liability - Aircraft, Auto, Pharmaceutical

Professional Indemnity - Accountants, D&O, Insurance brokers

Pollution - Food/Farm, Water, Oil, Chemical, Nuclear

Computer - Fraud, Breakdown

Natural - Flood, Earthquake, Wind

Political/Terrorism/Confiscation

and

After Asbestosis - ? the next one ? Toxic Waste

Add to these hazards the increases of values, implicit in giant vessels, aircraft and oil rigs, and the whole subject of major loss takes on new dimensions of frequency and severity.

In many cases it is not the single risk but the accumulation that creates the catastrophe dimension. In addition too there is the consequential loss that flows in so many cases.

RISK

Of course the commercial world is all about risk - trading risk - investment risk. Risks are run by investors or by taxpayers, by shareholders or by the state and conventional insurance can only respond to a very small area of total risk.

The catastrophe areas I have listed are dangerous, they are high risk, they are difficult and they are INCREASING

- they actively discourage insurance capacity rather than attract it.

The global portfolio is increasingly unbalanced.

Small wonder that many insurers around the world are adopting strategies designed to avoid overexposure - they have contracted out of high hazard business - and bear in mind that much of what was normal, assessable, containable risk a few years ago is now on the danger list or banned list. Many insurers in their prudence have decided that their shareholders' interests point them towards simple business - personal lines - low hazard commercial lines - rather than expose their capital and assets to the slings and arrows I have listed. Big is not beautiful. Medium is magnificent. For different reasons many brokers too have ceased to focus on the very large and are aiming at the medium sized prospect and the mass market.

Losses of £1 billion are almost commonplace - losses of £5 billion have occurred and will occur - and I am not talking about inflation.

RESPONSE

What is the response? Who should respond? Who can respond?

Consider the dimensions of the challenge.

- What is the capital and surplus base necesary to absorb an insured loss of £5 billion - maybe 2 or even 3 such losses in the same year?

- How much of an insurer's capital and surplus should be exposed net of reinsurance on a single catastrophe? 1% 5% 10%

- What percentage of annual premium income should an insurer be prepared to lose on a single loss.

- How many insurers, reinsurers and syndicates are involved in a loss on a single risk - Piper Alpha - over 1000 - Pan Am Lockerbie probably the same sort of number.

One imaginative response born of necessity has been syndication, ACE, X/L and many others. May I make the point that most such schemes are broker devised, broker led and broker driven.

These and captive insurance companies have come into being to fill a gap, some would say a gaping hole, left by the commercial insurance markets. There has been the urgent pressure of expediency for the corporate buyer to respond in these ways as a matter of necessity - one might almost call it self-preservation.

Do conventional, commercial insurance markets themselves have a responsibility to respond at all? Our business has a proud and proper reputation for responding to challenge and change and fulfilling its role of spreading loss and protecting investment. I believe and submit that the insurance industry worldwide does have a duty to respond. That may sound jingoistic but I believe it.

Having said this there must be a rationale for the commitment and exposure of resources, and the assumption of risk.

The rationale can be self-preservation for the corporation - profit for the insurer - public need for governments and legislators.

Of course there is no instant solution, no macro wand waving solution - but there are ways in which an informed and thoughtful approach can at least point towards the establishment of more catastrophe protection than currently exists.

What are the ingredients?

I suggest the two key words are "cooperation" and "understanding" and both of these involve a third "communication".

Who should co-operate with who? What understanding is needed? How should they communicate?

COOPERATION

Cooperation is needed between those who need the capacity

- the buyers of insurance and the buyers of reinsurance

- and the suppliers of capacity - underwriters of every sort, direct/reinsurance, mutuals, Lloyds.

  Many participants are on both sides. Insurers are suppliers of capacity and are also buyers of reinsurance.

  Industrial corporations need capacity on one hand and themselves supply it on the other through captives, syndicates and mutuals.

Incidentally cooperation between all these participants throws up an immediate paradox.

Major exposures have always been dealt with by coinsurance and reinsurance - in other words by competitors cooperating. It is a simple reflection of the need to marshall the capital and capacity of numerous insurers to match major exposures.

However cooperation between competitors is a delicate matter - it raises the hackles of regulators and those who fancy themselves as champions of consumer interests.

In our business cooperation is historic, it is inherent and it is essential in the arena we are discussing if there is to be a sense of partnership and a community of interest.

UNDERSTANDING

The other ingredient is understanding.

There must be wider recognition that

- Underwriting catastrophe exposures requires a very high level of financial skill and judgement.

  Bankers, investment managers, accountants and stockbrokers and corporate treasurers all need financial skills of a very high order, but I put it to you that underwriting is the most sophisticated of all financial skills. I am referring not to the mainstream domestic type business which can be dealt with from a statistical base, householders, motor, most fire insurance, workers' compensation - but the individual big commercial risk.

Why do I say that underwriting is such a sophisticated skill? It is a combination of art and science. The underwriter has to decide first the scope of cover that he is prepared to grant, second the price he is going to charge and third the size of his acceptance.

The scope of cover granted by an Underwriter might at first sight seem straightforward. We all grew up with the principle that it was the underlying intent that mattered and not the precise language of the policy.

However in recent years we have found ourselves in a deeper and deeper semantic quagmire

- "accident" versus "occurrence"
- "sudden" and "accidental"
- "claims made" versus "losses occurring"
- what is a riot?
- when is a fire not a fire? - when it follows a riot - or an earthquake?

How many policies were written on an "all risks" basis which have had to pay consequential loss when no physical damage occured - perhaps as a result of drought bringing a hydroelectric plant to a halt?

The examples are endless and with the attitude of the Courts superimposed on the principle that doubt is interpreted in favour of the policyholder, no Underwriter of a manuscript policy can afford to be other than meticulous and pedantic. Even then he is exposed to having the goalposts moved.

Now to price: as I have mentioned, I am talking about types of risk for which there is no statistical base. Let me give a few illustrations:

- A policy for $50m excess of $50m professional indemnity for a large international firm of accountants.

- Towing an oil rig across the North Sea.

- The risk of a Mexican earthquake having aggregate damage of more than $1bn.

- The war risk for a plane flying into Beirut.

My point, of course, is that pricing involves a very high degree of "guestimation" and judgement. It is further complicated by exchange rate factors - taking premium in at one rate of exchange and paying the claim years later at another. Inflation of course creates still further uncertainties.

I repeat - We must recognise that underwriting in these areas demands a very high order of financial skill, knowledge and judgement. This was sadly overlooked - neglected and forgotten in the early 80s and indeed more recently in soft markets the era of Gadarene underwriting and the scramble for cash flow.

We must also all recognise that

- meeting catastrophe exposures can only be soundly done on a long term basis
- the margin of profit on catastrophe business must be very substantial to attract capacity and to permit the accumulation of reserves.
- Governments must recognise the need for "fiscal sympathy" where catastrophe reserves are concerned.
- Governments and legislators must also recognise that slavish consumerism is counterproductive and drives insurers out of the marketplace.

Granted this recognition and understanding and willingness to cooperate what then?

These ingredients need to be stirred - they need a catalyst for successful responses to evolve. Who better to provide the lubrication than the international brokers? Brokers are after all the arch communicators - the catalysts of capacity. Communication is our stock in trade - the bringing together of supply and demand, the buyer and the market. The ingenuity to devise a sophisticated programme coupled with the labyrinth of contacts necessary to marshal support is the hallmark of the broker.

Leadership will also continue to come as it already does from reinsurers and from Lloyds both linked by brokers. It will not be structured or formal. Indeed it will be fragmented. Different initiatives in different forms will address different needs

- tort reform - pollution - risk management
- white collar crime
- Some initiatives will call for involvement of government and legislators, others will involve mutuals or industry captives. Others will evoke a direct response from insurers.

Progress will be made. Solutions or part solutions will evolve.

At last year's conference of the Reinsurance Offices Association, I, as a broker, had the privilege of chairing a session on which a professional reinsurer and a risk manager from a multinational were exploring how each could help the other. I repeat - a risk manager - the ultimate buyer - and a professional reinsurer - the ultimate supplier, were exchanging views as to how each could help the other. Twenty years ago it could not have happened so perhaps it was symbolic - perhaps increased understanding of each other's problems was the catalyst for cooperation. Was it perhaps a pointer towards the response to the most significant challenge we face in our business today?

I am very much aware that I have said nothing new, nothing very original. Everything I have said has been a blinding glimpse of the obvious.

If, even so, I have put the challenges of catastrophe exposure into perspective then I will have achieved my purpose. Thank you.

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