Industry Under Siege: Will We Thrive?

Remarks of
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at the
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Good afternoon.

You know….by all rights, I shouldn't be here today.

No, not because I took a late August holiday on a drilling platform in the Gulf of Mexico.

No, I'm here despite some advice that comes down through GE Insurance Solutions legend. Some of you may remember one of my predecessors of what was then known as Employers Reinsurance, an elegant British gentleman named Mike Fitt.

Mike was as savvy a practitioner of this peculiar game as exists.

And when he retired more than a decade ago, after several successful years as part of GE, the story goes that he took his successor aside and, like Polonius, passed on this advice: "Stay away from London. They're smarter at this game than anyone else, but their operations are based more on art than science."

I don't know whether this story is true, or just the stuff of legend.

The advice was clearly ignored…and GE Insurance Solutions today is a significant player in London. And with leaders like Tim Carroll and Alberto Izaga, more than $2.5 billion in net written premiums in our U-K life and non-life operations, and a team of more than 450 risk experts, we believe in the London and UK markets.

But that old piece of advice about art and science does continue to weigh on my mind even today. Art vs. science.

After all, this is an industry under siege on many fronts: regulators, investors, rating agencies and our customers are all crying out for change.

Perspective from Peter Drucker

Jeff Immelt, the CEO of GE, like myself and virtually all the senior leaders of GE, are in a sense, creatures of Jack Welch. Welch was and is his *own* creature, but he was very much influenced by the legendary Peter Drucker…particularly by the painful Drucker aphorism that asked:

"If you weren't already in this business would you enter it today? And if the answer is 'no', what are you going to do about it?"

My answer to "what are you going to do about it?" is this: "We are going to make GE Insurance Solutions the premier risk solutions company of the 21st century.

This is no easy task. Running an insurance company for the long term is challenging. Getting investors to provide capital for the long term is even more challenging. Just think of what leaders must say as part of a sales pitch to today's rational investor.

As part of your sales presentation you would have to mention that the industry's core activity… underwriting…has gone a quarter century with only one year of profit and sometimes-grievous losses. Thank goodness for investment income.

But even with it, you'd have to mention that the return on equity for this entire industry has been single-digit or less for more than a decade, much lower than our diversified financial services cousins and much more volatile to boot.

Data from A-M Best and the Insurance Information Institute show that in 1987, the U-S P&C industry generated a 17% ROE. But last year, despite what was arguably the best underwriting year in history, the industry scrambled to make just 11%.

You'd have to make this presentation to investors who watch the news every night, news which now seems to feature endless hurricanes, earthquakes, tsunami, plane crashes, and terrorist attacks.

What other industry has to deal with this?

Getting back to your little presentation designed to "sell" insurance and reinsurance as a business, you would want to end on a hopeful note, and lay out as I often do an ambitious plan to get to a 12% or 13% return on equity, someday.

All the while, you have to keep in mind that your audience is a rational investor who sits up like a lifeguard chair over an icy, transparent pool in which thousands of businesses swim, businesses with ROE's of 15-25% and excellent growth prospects.

Against that backdrop, the insurance and reinsurance business, I'm afraid, comes across as the Jude Law of the pool.

A Challenge

So why am I here today, violating that advice of lore, "Don't go to London"?

I'm here to offer you a challenge.

London leaders and underwriters: Take back the mantle of global leadership in insurance and reinsurance that you have allowed to slip from your shoulders, and lead this industry back to greatness!

I LOVE the *panache* and aggressiveness of Lloyds and the London markets, the home of so many global risks, and often the last resort of risks no one else will touch.

I believe a lot of your dash and boldness may have even rubbed off on some of the GE financial services businesses, where I've spent many years of my career.

GE took some measure of pride in being "the LENDERS of last resort", and we basked in that admittedly macho reputation while losing sight at times that customer service might just be a victim of that attitude.

We understood that we were not the most pleasant entity to do business with on a tough deal, and our customers were aware of the harsh consequences of default.

But we were always there for the tough, but good risks, providing lending capacity when most would not. And we rigorously assessed those deals so that the terms reflected the risks.

When I first came to London, I wondered if London and Lloyds were the insurance markets of last resort. In some ways, you are. But I'm not sure you fully utilize your market insight and judgment consistently.

Are you paid appropriately for assuming these big risks? Is our industry today really capable of pricing those risks? Or do we let Keynesian market dynamics overwhelm rigorous underwriting and better judgment?

London in the 90s when I lived here was one of the most remarkable place in the world to be in financial services.

"Lloyds, Lloyds of London" as an introduction had the same ring to it as "Bond, James Bond".

But the decade of the 90's was tough on Lloyd's and our industry. There's no more compelling fact than the transition from 400 syndicates to today's 60.

Pretty amazing. How many would you guess there will be after the trough of the next cycle? Or even after Katrina and Rita's toll is extracted from us?

I ask you the same Peter Drucker question: "If you weren't part of this business today…is it something you would choose to get into?" Is this a business you would advise a son or a daughter to make a career of?

What an industry.

And yet… I find myself using the word "noble" to describe it without a trace of irony or sarcasm. Even with its maddening flaws and its cyclical display of an apparent death wish, it is a business that I love to tell my children I am a part of; a business I am proud to be a part of; a business whose purpose is to support the engines of commerce around the world and to heal and restore and comfort the victims of misfortune and tragedy.

We are a critical foundation of the global economy.

I was forewarned that you might be a bit cynical about such comments, and cynics you may be. But at your core I bet you feel at least a bit of the pride I do at being part of one of the true underpinnings of modern industrial society.

Our industry may pay $50 billion dollars or more to help New Orleans and the Gulf Coast recover from Katrina and Rita. These storms have utterly devastated an entire region. And you and I are going to help restore it.

For the most part we are succeeding by meeting our obligations to our customers and to society.

But the people we *are* failing are our *investors,* our *employees,* and *ourselves* by allowing this industry to run the risk of sinking further into cyclical dysfunction, and in some cases insolvency.

<u>Understanding Our New Realities</u>

Anyone who whines about natural or unnatural disasters doesn't belong in insurance. Our industry motto should be "stuff happens" because if "stuff" didn't happen there'd be no reason for us to exist, professionally anyway.

Rather than whine about what we don't control, I prefer to whine, or maybe the better word is challenge, my colleagues and all of you to focus on what we *do* control.

Rigorous underwriting based on sound actuarial modeling is critical to our future…and to deciding the very real issue of whether or not we *have* a future.

Based on what we have seen with this year's storms coupled with last year's typhoons, hurricanes, and other disasters, we have to re-think our technical models.

Our underwriting at GE Insurance Solutions will be driven by a new understanding of our exposures. Katrina has given us a new benchmark for the types of losses that are possible, so we are re-thinking our exposures around the world.

For example, a Katrina-sized storm was modeled by many as a one-in-100-year event…or more. But didn't Florida get hammered by events just last year that were supposed to one-in-100?

If you re-look and re-value major storms like Andrew and Betsy with the explosive population and development growth on the coasts, will we get a 100-year event every 10-15 years?

It's clear that Katrina and other recent events have changed how we think about realistic return periods.

Today's models might be close to right, if you have a 250-year time horizon. But we don't! We live in quarterly and annual financial time horizons.

We live in five- or ten- or fifteen-year environmental cycles. We must deliver technical underwriting appropriate to the environmental cycle we are in. Otherwise, long-term investors will continue to lose faith.

Important loss factors in Katrina and Rita—such as the storm surge—were not significantly factored into most current risk models. And there is a question about whether demand surge was sufficiently calculated. And what about mold and environmental clean up? We believe in modeling because it can help us understand our exposures. But the limits of the existing models have been stretched in these storms, and we must continue to strengthen the science behind our underwriting, as well as the common sense and art of our decision-making. What we've learned in the past six weeks is that the range of loss possibilities has dramatically increased.

Long-Term Risks, Long-Term Challenges

Of course, our industry faces several other challenges. And there are few easy answers for some of these. See if my list approximates yours.

Loss costs which have risen at a faster pace than underlying premium growth for more than a decade.

Lawyers. I'll put our American swashbucklers up against your barristers any day as far as sheer creativity and brazenness go. America is approaching a population of 300 million people, while at the same time careening toward the 300 *billion* dollar level in annual tort costs.

American radio and television is now infested by adverts inviting you to call lawyers if you've ever been anywhere near asbestos, benzene and other solvents, a lengthening list of what we used to call miracle drugs, breast implants, pacemakers, and now a current favorite: mold.

One decision, one choice, was easy for GE, a decision on pharmaceutical liability. How do you price the liability costs of a new drug coming on the market today? We've concluded the risk if beyond our ability to manage. So, GE will not insure pharma liability.

The tragic issue of asbestos liability is worth mentioning.

The scorecard on this issue, at least so far, is that 730,000 claimants, *only ten percent of whom were actually ailing from asbestos exposure,* have sued 8600 defendants with the result that 73 companies have been bankrupted and 60,000 American jobs have been lost. The trial-lawyer "jolly roger" now waves triumphantly over a wasteland of ruined businesses and lives.

We can do something about tort and asbestos if we are willing to take united stands on these issues in the halls of Washington, D.C. and Brussels, but will we?

But I came here today not to whine, but to challenge.

Daring To Be Dull

Today, we face a complete re-underwriting of global reinsurance business. We have to make smarter, better, exposure-driven decisions. The recent trend in rising catastrophe losses means it is time to reconsider the often unquantifiable exposures insurers pass along to reinsurers, how we assess them and underwrite them.

Our industry must return to its roots: rigorous… informed…actuarially based…analytically sound underwriting, balanced with common sense.

It's un-glamourous. It's not fashionable. It's downright boring.

But after flings with Rita and Katrina and Frances and Jeanne… …we must dare to be dull.

And you…London…must lead.

Why you? Why London?

Let me speak both respectfully and candidly.

The insurance world still looks to you for direction and leadership. But in the late 90s instead it saw sloppy underwriting and bad example. The world saw it from us as well.

We, as an industry, cannot be respected by our investors, by analysts, by rating agencies, or even by our customers when we abandon our analytical touchstones and better judgment.

We admire you for your courage in assuming risks that are the most daunting and needful of syndication. If London can figure out how to do things many of the world's underwriters cannot and generate good returns for investors, it will be deserving of the mantle of world leadership in insurance that I am trying to slip back upon your shoulders this afternoon.

The keys to success, in my mind, are strong technical underwriting and effective capital management.

I have this deal with Jeff Immelt, our CEO. My part of the deal is to invest capital profitably and at reasonable risk, and to *return* capital we cannot invest wisely to GE for use by higher ROE GE businesses.

Even with the storms, there is so much capital around in this industry, more than there has ever been, and it's likely to pressure some people to do stupid stuff. "Stupid stuff", in our business, is what the *actuaries and tough-minded underwriters* say is "stupid stuff".

Jeff Immelt's part of our agreement is not to sack me if I do what I just told you…and provide me and my team capital when it's the right time to grow.

Many of us paid for our sins of the late nineties for a very long time. I know my business did.

Our investors and our customers are imploring us to be more consistent and more predictable in our underwriting. And our investors are demanding stronger and less-volatile returns.

These concerns are echoed by regulators and rating agencies.

For our part, the GE Insurance Solutions team is seeking to turn our business into a model of discipline, transparency, and CONSISTENCY with an unyielding commitment to integrity. Believe it or not, we *love* this business for its noble purpose and for what it could be some day for investors.

We are thrilled by the upturn in the London market in recent years, including the turnaround at Lloyd's… with the enhancements in governance and improved performance. We'd like to see more action on improving the speed, accuracy and consistency of London Market processes and contract certainty. And we'd certainly prefer voluntary action.

The approach that the Lloyd's leadership team is espousing, Lord Levine, Nick Prettejohn and Rolf Tolle, Andrew Beazley, Tony Holt, Stephen Catlin and so many of you, is noteworthy. It's with deep respect that I say, "My, how dull you've become."

We cannot adequately serve our customers or investors unless this industry gets its act together, particularly on underwriting.

Concluding Thoughts

Katrina and Rita serve as tragic reminders of our human frailties and limitations…and they may serve as a turning point for our industry. A point at which it achieves the consistency and rigor that our customers and investors are demanding.

At GE Insurance Solutions, we've worked hard for five years to put our business in the right position. A position to weather a Katrina, deliver on our claims promise, and be ready THE NEXT DAY to deliver capacity to the forward insurance markets. With eight-point-two billion in statutory capital as of the end of June—up 58% since 2000—we are ready.

We will play with confidence and strength in the markets ahead, including our support for you here in London.

But I'm just a mere CEO of one modest enterprise.

For centuries, London and Lloyds of London of London have led this industry. And you must lead again.

For if you do lead, we will emerge from the ashes of ruinous cycles and the muck of New Orleans to achieve a sustainable destiny to support and secure the global economy, while helping people and communities recover from the world's great tragedies.

I'm not exaggerating when I tell you that the achievement of that destiny may well be in the hands of the people in this room today.

As our friend Peter Drucker says, the only way to predict the future is to create it.

Thanks for inviting me, and thanks for listening.

I'll be happy to take your questions.

[Q&A]

Let me offer a concluding thought.

I hope that we can all acknowledge that this is an industry with a great and good purpose, that of helping protect people, property and reputations, and to support global economic expansion.

We also have an obligation: to generate returns for those most honored of our stakeholders, our investors.

We can fulfill our noble function, and generate appropriate returns as long as we remember that what we do has tremendous value, and that rigorous, analytical, common sense underwriting is the key to delivering value for all of our stakeholders: our customers, our investors, our regulators, our employees and our communities.