

JOE PLUMERI, CHAIRMAN & CEO, WILLIS CREATIVE DESTRUCTION AND OUR GOLDEN OPPORTUNITY



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Thank you Premier Brown, and thank you to all my colleagues. I am honored to deliver the opening keynote address for the third annual *Insurance Day Summit Bermuda* event. In these few years, Summit Bermuda has grown into one of our industry's leading gatherings. I'm delighted with the opportunity to share some thoughts about this extraordinary moment for our world, our industry and this island nation, whose importance in the global economy stands in inverse proportion to its size.

My theme is simple. Turmoil breeds opportunity, and we in the insurance industry face an unusual if not unprecedented opportunity. This is a time for re-evaluation in so many ways, for consumers, for governments, for businesses. As the world emerges from the depths of this startling recession, new business models will emerge, and so will new risks. We must be ready to address these new risks. New calls for regulation may drive government leaders to over-react. We must be ready to make our voices heard in the public debate. New calls for transparency echo what some of us have been saying for several years – transparency is good for us as well as for our clients. All of this puts us in an exceptional position to lead. In a time of fear, we offer security. In a time of scarce credit, we provide capital. In a time of newfound risk awareness, we are the risk professionals. Our challenge is to make the most of this opportunity by doing what we do, but doing it better. Let's continue to transform ourselves as we have for the last 30 years. The value of insurance is greater than ever and if we seize this moment, the world may finally recognize and fully appreciate the value we provide.

My agenda today is to briefly discuss the state of the world economy as a whole. Then we'll look specifically at financial institutions and how they got themselves into the mess they're in today. And then we'll look at our industry. One of the reasons the world doesn't really understand what we do is because we don't do a good enough job of explaining it – which is nothing short of underpinning and enabling virtually every economic interaction in the world. We will look at some of the lessons we have learned from moments of adversity over recent years, and how that has set the stage for this extraordinary moment for all of us involved in the business of risk.

I turn now to the words of Joseph Schumpeter, a Czechoslovakian economist who began his teaching career a hundred years ago, but was far ahead of his time. "The opening up of new markets, foreign or



domestic...the same process of industrial mutation...incessantly revolutionizes the economic structure *from within*, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism."

Schumpeter understood that the evolutionary development of capitalism was not for the faint hearted. He also saw that the inevitable cycles of expansion and retraction, of success and failure, are not only survivable, but are in fact the secret of capitalism's extraordinary power to inspire innovation and progress. At the moment, however, the Destructive side of Creative Destruction is all too easy to see.

Consider this: Up to 45% of the world's wealth has been destroyed by the global credit crisis. That's a lot of destruction. Blue chips have been hit, and hit hard. General Motors left the Dow this month. Citigroup, where I worked for 32 years, left the Dow this month – to be replaced by Travelers, a company it spun off not long ago. An insurance company, I might add. Across the pond, Lloyds Bank's share price was down 30% in the first five and half months of this year. Sales are down. The GDP in the OECD countries fell 2.1% in the first quarter of 2009, the largest decline since OECD records began in 1960. This followed a decline of 2.0% in the previous quarter. The major stock indexes are down 40% from their high in the fall of 2007. And global unemployment has risen to 239 million, from 179 million in 2007.

To get an idea of how this recession looks in a broader context, let's look at a list of U.S. recessions since the founding of the country. There are lots of them, many with "Panic," appropriately enough, in their names. The Panic of 1819, the first major financial crisis in the United States, brought widespread foreclosures, bank failures, unemployment, and a slump in output. Sound familiar? In the Panic of 1937, the American economy plummeted after a series of bank failures and a sudden drop of confidence in the paper currency. In the Panic of 1873, upheaval and economic problems in Europe led to the failure of Jay Cooke & Company, one of the largest banks in the United States, which burst the post-Civil War bubble. The Panic of 1893 – another stock and banking collapse; 1907 – a severe monetary contraction; and of course the Great Depression – which by the way technically lasted only until 1933. There was in fact, modest growth until the Recession of 1937, which was one of the worst of the 20th century. There were recessions in '43, '48, '53, '58, '60 and '69. Then came the first Oil Crisis and the 73/74 stock market crash. More recessions followed: in the early 80s and 90s, and less than a decade ago, we all recall the popping of the dot-com bubble.

What distinguishes this recession? First of all, severity. This is bad. This is the worst time most of us can remember. We have no idea how history will look back on this moment, but already it's been called the Great Recession,

and for good reason. But perhaps the most significant fact is that this is the first truly global recession, the first since all of the world's major economies have become inextricably linked. We're all in this together, and we're going to have to come out of it together.

In asking how all this came about, we must focus obviously enough on the financial sector. What went wrong? First of all, there was an unusual abundance of cheap money that ushered in an age of excess – a period marked by irresponsible lending practices and the repackaging of subprime mortgages into Collateralized Mortgage Obligations (CMOs) and Collateralized Debt Obligations (CDOs). M&A activity soared to all-time-high multiples. Inordinate amounts of corporate leverage became commonplace. Through securitization, investment banks became financial superstores – but no one was minding the superstore! Internally, there was little management of risk. Externally, buyers of these products were relying on rating agencies that gave the thumbs up. And the regulatory overseers did not perceive a problem in any of this. As a result, some didn't stick to their knitting. They got away from their core business. They swore by the Quantitative Analysts or "quants," as they are commonly known, the financial mathematicians who helped create the complex and opaque financial instruments. Few people, even the bankers selling them and the investors buying them, really understood what these instruments were about. Banks that were once scrupulous about checking the creditworthiness of borrowers lent to high-risk customers, played in the money markets and used derivatives to bolster their balance sheets. The temptations of quick profits were too powerful, and these temptations outstripped the operational capacity to manage risk. Profits were built on products that helped neither people nor companies. Here's another way to look at what went wrong. Some did not listen to their mothers.



Never question Mom. Mom was right – there *can* be too much of a good thing. The kids say, “Ma, it was all fun and games.” Ma says, “Yes, it’s all fun and games – until someone loses an eye – or a pension.” The kids say, “Ma, that’s what all the neighborhood kids were doing.” Ma says, “I don’t care what your friends’ parents say, we have rules in this house.” We can see now where and how things began spinning out of control. Unfortunately, the damage may not be over with.

There is talk of recovery. Markets across the world have shown signs of life. Many of us believe, however, that the markets might be ahead of themselves, that the underlying economy may still be weak, and that things may still have to get worse before they get better. The number of foreclosures in the U.S., for example, fell last month from the previous month – but that number remains near all-time highs. Unemployment is not rising as fast as it was, but it is still rising. Some are wondering if the signs of recovery are a superficial response to the various stimulus and bailout packages of governments around the world.

The stimulus and bailout packages certainly *should* have an impact. Their size is nothing short of incredible. At the end of 2008, the U.S. federal government pledged money to bail out the financial services sector – and potentially other industries as well. The amount pledged adds up to more than the U.S. spent on the Louisiana Purchase, the New Deal, the Marshall Plan, the Korean War, the Race to the Moon, the Vietnam War, the Savings and Loan Crisis, Operation Iraqi Freedom and NASA’s lifetime budget... COMBINED! The number of dollars now committed by all the various programs is now \$10.5 trillion dollars. Here’s another way to put that in perspective. It’s more than the U.S. spent on every major war we’ve fought: the Revolutionary War, the War of 1812, the Spanish-American War, both World Wars, the Korean War, the Vietnam War and the Iraq and

Afghanistan wars. It’s true that of the 10.5 trillion committed, only 2.7 trillion has been invested. Listen to the sound of that: *Only 2.7 trillion.*

Students of the Great Depression usually agree that government inaction in the early stages made things worse. That’s not a problem the world is going to have now. In fact, while most agree that government involvement has helped stabilize the financial situation around the globe, there is still much concern about the risks of over-reaction. When is government involvement too much? Governments have stepped in to run struggling businesses and there is concern, for good reason, about governments moving in to the corner office. Governments run countries, they don’t run businesses. They don’t have to turn a profit. They don’t face competition for customers and market share. The track record of governments running businesses is frankly terrible. Providing capital through central banks has been a better bet – although many of us are also concerned about the long-term impact of deficit public spending. We welcome the stabilizing force of government involvement and of course hope for the best outcome from these unprecedented efforts. We also remain deeply concerned.

Another area where over-reaction is a concern is in regulation. We in the insurance industry understand very well the place for prudent government oversight in the conduct of business. I’ve pointed out already that there are clearly places where regulatory authorities should probably have been involved in the financial industry. But we don’t want to throw out the good financial products with the bad. Financial products are good when they serve clients. Financial products should fund growth – they should not balloon balance sheets. We hope that governmental financial authorities keep that principle in mind.

What will it take for the economy to recover? First of all, credit markets need to open up. That allows businesses to grow and jobs to come back. Then consumers need to begin spending again. Yes, many were spending beyond their means, and getting into debt far beyond what they should have. But we need to

have confident consumers again driving the world's economies. We need investors to buy treasury bills. We need banks to be banks again. We need investment banks to do what investment banks should be doing: promoting investment and growth. Investment banks need to return as agent, not principle. They must provide a service, for which they are appropriately compensated, and not look simply to inflate their balance sheets. The way they do this is simple: stick to their knitting. For the most part, that is what we have done in the insurance industry, and that's why we – for the most part – have avoided the worst of these terrible times.

Let's now look at our industry. Let's first of all understand and appreciate what we do. Insurance is the DNA of the modern world. Nothing happens without insurance. Without us, buildings don't get built or rebuilt, victims don't get compensated, loved ones are not provided for, modern medicine doesn't work miracles, planes don't fly, ships don't sail, goods don't trade, careers aren't saved, poor people don't get help, towns aren't rebuilt, modern global economic life is finished and millions of people remain in poverty.

What portion of the \$62 trillion GWP, Gross World Product, does insurance account for? I would say the correct answer is 100%, because nothing happens without insurance.

We're not perfect. Far from it. But we have learned our share of lessons over recent years. We've let adversity do what adversity should always do: make us better. In 1984, the Casualty market collapsed, and ACE and XL formed here in Bermuda to help fill the void. The asbestos claims of the 1990s offered some lessons on the bad bank concept through Equitas. Hurricane Andrew shocked us into getting our act together in terms of exposure management, which led to the birth of modeling. In 1995, the advent of the Realistic Disaster Scenarios testing system at Lloyd's revealed an accumulated exposure of over \$100 billion. The attacks on 9/11 highlighted the issues of aggregation and contract certainty, but also showed the critical role played by insurance in recovery from disaster. And again, Bermuda was a critical part of our collective response. In 2004, Spitzer ushered in the age of transparency, and Willis, I'm

proud to say, was leading the charge from within the industry. In 2005, Katrina taught us we could not rely exclusively on models – or on the New Orleans levee system. And yet again, a call for capacity was answered in Bermuda. As for what we learned from the events of last fall, the lesson is clearly this: stick to what you know and what you do well.

If there's an overall lesson we learn from all the lessons I've just listed, it's that turmoil in the long run is in many ways better than the status quo, because turmoil breeds opportunity. What opportunities do I see? Many. The world now sees what some of us have been seeing for several years: the need for greater transparency in business transactions. For us in the insurance industry, this will provide the perfect opportunity to showcase all that we do and the value we provide, because we will need to explain why we charge what we charge and what it is they get for their money. We're not just buying policies at the best price. We offer analysis and analytics. We offer advice. We fight for the best possible terms. We are responsible for contract delivery. There's more, too: alternative risk transfer, loss control, claim management – these are hugely important services we provide.

Another opportunity I see is the chance to get rid of contingents once and for all. Contingents represent manufactured revenue, not value added, and in the age of transparency that I hope is coming, clients of every kind will buy on value because they will see and understand the value we deliver.

I believe the current turmoil gives us a chance to lend our voices to the debate over how our industry will be regulated. The principle- versus rule-based debate must intensify, and I for one will be on the side of principle-based rules.

The current recession will make organizations rethink the way they operate. As new business models emerge, new risk assessment will be needed. We must be ready to answer that need.



We may finally have reached the moment when true Enterprise Risk Management is something that clients will demand – and they *should* demand, because they need it. We will need to apply the analytics and modeling sophistication that we’ve developed in the reinsurance sector for the retail side.

We need to stick to our knitting, but do more colorful knitting. We have the opportunity to be creative, to produce new products for new risks. These could include pandemics, cyber risks, global warming, credit risks and political risks.

More will be demanded of us as an industry and as individuals. As much talent as we have, we need more, and we must go out and find it. We need underwriting expertise in new regions and in all lines of business within those regions. Only then can we deliver clients the service they need in a global economy, where the risks are global but the realities are also local.

As brokers, we want to be more in the business of giving advice, moving our focus beyond insurance transactions. The current environment should allow us to do that. And perhaps the greatest opportunity of all is for us to begin selling on value, not price. We are selling an experience, not a commodity. When you go to a restaurant, you’re not just buying food. You’re buying atmosphere, service, décor. You’re buying a special evening, a unique experience. If you were looking for calories, you could have gone to a take-out window or a supermarket. Insurance is more than a retail transaction. Insurance is a partnership.

The financial crisis has helped create this list of opportunities in large part by validating the insurance paradigm. We deserve a thunderous stamp of approval for the way we do business – our conservative investments and our focus on the business of risk transfer. Where we got away from the basics, we got in trouble. The message: boring is good. The financial crisis has also validated the way

we think of risk. The financial institutions that touted major risk management programs built on sophisticated models obviously did not have it right. We have it right – not all of the time, but *more* of the time. The way companies think of risk is changing. Risk assessment and management – not just insurance, but a true assessment of all the things that can go wrong – has now gotten the attention of the C-suite. Some of us have recommended the formation of risk committees on company Boards. Perhaps that will become more common, which will be helpful to those companies and to us. Many have painted us with the same brush that they paint the struggling financial institutions sector. To those people I say, consider this: Of \$700 billion of TARP money, insurance companies have taken *none* for P&C activity. Not a dime.

Perhaps the greatest source of our value right now is the fact that we represent a stable, affordable source of capital. The transfer of risk from investors to the insurance market is built on the provision of contingent capital, and this will be essential to driving growth, recovery and prosperity. Always necessary, insurance becomes even more important during times of economic duress because companies need to aggressively manage risk. The cost of the contingent capital we provide is reasonable. Take, for example, a \$500 million construction project. If the premium rate is 3%, the cost for a half a billion dollars is \$15 million. That’s a pretty good deal. The point is that the value of insurance – of the products, services and capital we provide – is greater than ever.

We have before us an opportunity for leadership we have not had before because across the globe, insurance is going to be one of the essential building blocks of recovery. We are ready for this role. We find the “Creative” in Creative Destruction. After 9/11, we rallied the markets to support the rebuilding of Ground Zero. After Katrina, Liberty Mutual and Zurich helped set up a new mediation program with attorney Ken Feinberg that would result in fairer settlements. Swiss Re and Munich have led efforts to better address climate change. The Institute for Business and Home Safety,

modeled after the Insurance Institute for Highway Safety, will lead to a safer world

The Willis Research Network, devoted to the study of disasters, is the largest collaboration between our industry and the academic community. But most importantly of all, we must take a leading role in helping each client rethink its risk strategy in a changed world.

I would also suggest that we are in an ideal position to address the issue of what to do for those who can't get insurance. All of these are ways we can help create a better world.

This is a moment for partnership at many levels. We've seen it in the ways governments are working with businesses. We are experts in partnership. Let's continue to set an example for business and government everywhere. In Bermuda, you are particularly good at creating effective partnerships. The Bermuda Monetary Authority has a compelling track record of 40 years of effective regulation. A risk-based approach has helped create a global insurance and reinsurance hub that is unrivaled. You have created the world's single largest reinsurance market outside of Lloyd's. The right touch has made Bermuda an incubator for innovation, yielding new capital, new products and better management of global risk. Bermuda is a world model for effective partnerships and thoughtful regulation.

If we take this opportunity, if we push ourselves to do better, to grow, to rise to the moment, I believe we will not only have success, but sustainable success. Instead of the adversarial model of client vs. market, and market vs. broker, we can move toward a culture of partnership. The client wins, the intermediary wins and the market wins. We can enjoy more sustainable pricing, and avoid the troughs and spikes of the hard market/soft market cycle that has such a grip on our industry. We need to continue our market reforms, promoting new technologies and processes. We need to work with regulators to create the right environment, the right balance, a set of rules of the road that are tough, but principle-based. We have an incredible opportunity to recruit new talent. It used to be that when I addressed a roomful

of graduates, every one of them wanted to be investment bankers. There are no more investment banks. The field is open, and insurance is more attractive as an industry than it's ever been before. This is the perfect moment to educate the world about the value we deliver.

I believe the world is ready to see us with new eyes, and herein lies our golden opportunity. Insurance has never been more important. Every nation needs insurance. Every business needs insurance. Every person needs insurance. Be proud to work in the insurance industry. It's cool. It works. We are capital providers and risk advisers in a time of scarce capital and huge risk. In a world that moves forward through a process of creative destruction, we remain a creative force. Let us build on that legacy and rise to new creative, constructive heights.

The best of times is now.