JOE PLUMERI, CHAIRMAN & CEO, WILLIS GROUP

COMMERCIAL SUSTAINABILITY AND THE GOLDEN AGE OF INSURANCE

REMARKS PREPARED FOR DELIVERY
INSURANCE DAY SUMMIT
BERMUDA – JUNE 14, 2011

Thank you, Brad, and good morning, everyone.

I'm very happy to be back for Bermuda Insurance Day.

A lot has happened in the 10 years since Willis listed on the New York Stock Exchange.

Let's go back in time for a minute, to ten years ago, to see how much has changed.

My two initial months on the job were focused traveling around the world to our offices and learning our business.

Then, in the third month, on the morning of September 11, everything changed...

The New York Stock Exchange did not open that day. When it finally did, on September 17, the Dow Jones Industrial Average fell 684 points, or 7.1%, to 8.921, at the time a record-setting one-day point decline. By the end of the week, the Dow had fallen 14.3% – U.S. stocks lost $1.4 trillion in value, then the largest one-week drop in history.

Not until the 2008 global financial crisis would that record be surpassed.

But it would still be another few weeks until the insurance implications of the disaster would come into focus.

On Friday, September 28, 2001, the Independent newspaper blared a headline: "Insurance row brewing on Trade Center claims."

The story went on. Now, ten years later, with a lot of hindsight and learning on all of our parts, we can look back on that story with a greater degree of objectivity. Here's how it went:

"Insurers are threatening not to pay out on claims created by the devastation of the World Trade Center after it emerged that crucial details of the $3.4B (£2.3B) cover had not been determined when the terrorist attacks took place on 11 September.

"An argument is likely to erupt over the claims between insurers in the UK and abroad and Willis, the broker that placed the insurance, over the interpretation of whether the flying of the hijacked planes into the World Trade Center constituted one or multiple events."

It was nail-biting time at Willis, and no one was biting their nails with more ferocity than its newly-appointed CEO. The tab for losses to the insurance industry would be over $40 billion.

But the truth is, it turned out to be a story with a satisfying ending. We worked hand in hand with the leaseholder of the site, Silverstein Properties, and the many carriers who took on the risk.

Yes, there were contentious discussions. Yes, there were fortunes made by lawyers engaged in the case. But at the end of a decade, as I look out the window of my office at World Financial Center, I see the largest construction project in the U.S. moving ahead briskly.

In a few months, the memorial fountains will be flowing. And before long, there will be gleaming new skyscrapers housing hundreds of companies and thousands of workers. When the project is complete, Lower Manhattan, which a decade ago stood in ruin, will once again be a mecca for global commerce and the shining star of New York City.

And something else happened in those closing months of 2001 that means so much to this audience gathered in Bermuda.

Primary insurers paid about 36% of the September 11 losses on a net basis, with most of the remainder paid by reinsurers. Munich Re alone reported about $1.8 billion in claims. There was an immediate need to replace the capital that was lost, and Bermuda filled in the void.

All together, Bermudian capital initiatives added up to almost $10 billion as of the beginning of December 2001, replacing so much of the lost capital and capacity in the industry and cementing Bermuda's place for the decade to come as the world's center of reinsurance activity, a position it holds strongly today.

That's not all that's changed in ten years – the whole way we look at insurance has evolved...

It used to be a necessary evil. You'd have to get insurance to make sure that if one of your plants or offices burnt down, it didn't put you out of business.

It was **transactional**. Unless something bad happened, you rarely talked to your broker.

Then we moved to a **risk management** model. Instead of reacting with a claim or a denial when something bad happened, you helped your client build a risk management function... and you worked with them to anticipate what could go wrong and build coverage.

Things got better, but a lot of firms that built up risk management still ended up with huge problems.

One big reason: they lacked expertise and experience with the range of risks that can hurt companies – plus they took a short-term view.

The world has changed. Over the past 50 years, the number of risks that threaten the average business has exploded. And globalization is increasing the number and type of risks.

At Willis, to address this new world, we're building a new approach to insurance. We call it **Commercial Sustainability**, and it's based on two ideas.

First, that insurance sits at the center of a company's security and survival. It's not just about coverage and claims.

And second, the only right way to look at a company is holistically – as something embedded in a community with stakeholders of every kind.

When we talk about sustainability at Willis, we're talking about whether our business will exist in the future. **Will we be here next year? In 10 years? In 50 years?**

It's too easy to define sustainability as your impact on the environment. The environment is critical, but sustainability is about much more than that.

It's an envelope within which the safety of the company is secured. It's achieved by anticipating and managing risks to which it's exposed: legal risk, reputational risk, operational risk, terrorism risk, environmental risk, legislative risk, political risk...and so on.

Now that's a **different** way to look at sustainability and insurance. To me, it's a more **useful** way because it encompasses all the issues that businesses have to get right in order to survive.

This is all about taking a long-term view – and again, nobody does that better than Bermuda.

When other markets are dysfunctional, Bermuda – under the leadership of the Bermudian regulatory authority – is a hotbed of insurance and reinsurance innovation and development.

As we all know, the insurance market is always changing. There is a constant need for new risk transfer or mitigation models. Bermuda over the years has refined and pioneered the development of generations of new risk transfer companies, products and approaches.

That role continues today. Bermuda, for example, is positioning itself as both a *takaful* (insurance) and *retakaful* (reinsurance) market, providing the world's 1.2 billion Muslims with another source of protection. It is another example of the innovation that is the hallmark of this island.

Quality is also a hallmark of Bermudian insurance, as this recent Greenwich Associates Survey demonstrates.

Now it's true that Bermuda also faces challenges – the threat of U.S. taxation...new global solvency models... and of course, the usual market cycles.

Nevertheless, I believe that the future of the industry is bright – in Bermuda and throughout the global economy.

In fact, I believe that the best is yet to come, for the reasons I am about to discuss.

The global economy is actually a tale of two economies. What's interesting about this is that the best of times are happening in the developing world, while some of the worst of times are happening in the developed countries.

The plain truth is that the industrial world of the 20th century is not in great shape to compete in the 21st century. Although I'll focus on the U.S., in the interest of time and because I know it best, that overarching fact applies as well to the EU and Japan.

Mary Meeker of Kleiner Perkins Caufield & Byers recently produced a shocking report called "USA Inc." I recommend it to anyone who is concerned about the state of the U.S. economy and national budget, and their ripple effects on the global economy.

The report looks at the federal government as if it were a business with a proper balance sheet and income statement. When you accrue for entitlement plans the numbers are simply shocking.

In fact, the numbers give you an insight into the competitive problems the industrial world faces competing in the 21st Century. Again, in the interest of time, let's just look at cash flow, net worth and entitlements.

If you accrue like a business, the U.S. has **MINUS $44 trillion** net worth:

- It's had negative cash flow for the past nine years
- Negative net worth for much longer than that
- And even if you assume no new debt – an imaginary scenario, obviously – it would take 20 years of U.S. income just to pay off the existing debt

No business leader in this room would run their business like the government runs the United States.

What's causing the problem are unresolved structural issues – mainly the runaway cost of entitlements.

And in only 14 years, the cost of those entitlements plus the interest on the national debt will exceed the entire income of the United States – leaving nothing for defense or other non-entitlement expenditures, including all the insurance backstops created over the decades.

Some of the figures are absolutely amazing:

- Public debt has doubled over the last 30 years to 62% of GDP
- It is expected to surpass 90% of GDP in ten years

- If entitlements continue to soar, within twenty years public debt could reach 150% of GDP, and
- If government health care spending continues to grow two percentage points faster than per capita income, the red ink will get even worse

How can we avoid this train wreck? There are a limited number of solutions, all of which you are familiar with:

- Raise taxes – Medicare, Social Security, Income tax
- Reduce coverage and optional benefits
- Subject all benefits to a means test
- Raise the retirement age
- And cede programs to the private sector if they can be done better and more efficiently there

There are some very interesting implications for the insurance industry.

The current course is clearly unsustainable – it's not a question of **if** it will change, it's a question of **when**.

Public insurance may no longer be an uncontrolled growth industry. The private sector may reassume its role as a provider of such products.

As the public sector inevitably retreats, this will create opportunities for the insurance industry in many sectors. I'll just quickly cycle through a few of them:

There's already public talk about scaling back the Terrorism Risk Insurance Act of 2002.

And, despite this being the deadliest year for tornado fatalities since 1936, there is no political will to take this insurance out of the private sector.

The U.S. government seems to be realizing that the National Flood Insurance Program is unsustainable.

It has called in insurance and reinsurance executives to discuss the possibility that flood insurance has to be privatized to survive.

Finally, Deepwater Horizon has reinforced the general realization that government does not have the expertise, equipment, and resources to manage the many complex issues each nation faces.

As the industrial world undergoes reform, opportunities will emerge for our industry. But even **greater** opportunities will be created by the BRIC nations and other emerging economies – where it is already "the best of times."

In the second half of 20th century, hundreds of millions of people moved out of abject poverty and into the middle class. This dramatic improvement in the lives of millions was not the result of government decrees – it came about because of trade and globalization.

The big story of the 20th century was the emergence of this global middle class – but the **bigger** story will be how this expanded middle class will transform the world in the 21st century and beyond.

What kind of new world will they create through the power of their numbers? How will they protect their gains – their foothold in the middle class?

We can see some of the more obvious answers emerging today: The *Financial Times* reports that the pent-up demand for new housing in Asia and the Middle East is staggering. China and India for example will have to build cities, housing, transportation, and new industries to support this growth. This will take insurance.

The opportunity is enormous.

Goldman Sachs says that two billion more people will join the middle class by 2030. That's approximately six times the current population of the United States.

This will create demand for all types of insurance products from life and health to marine and aviation to professional liability to all types of property and casualty for both personal and commercial lines.

The new middle class will need brokers that understand them and their industries. They'll need carriers who are innovative, financially secure, and who are there when they need them – carriers with a reputation for paying legitimate claims quickly.

Last year the UN estimated that 50% of the world's population lives in cities. Over the next three decades we are going to see an expansion of urban development unparalleled in history. Cities are and will be the economic powerhouses of the 21st century.

China and India will account for two-fifths of the world's urban growth. The infrastructure to support this urbanization will be enormous and will cost tens of trillions of dollars.

It took the United States 200 years to achieve this level of urbanization and the necessary governance and infrastructure to support these cities. India and China are going to do this in two decades – and on a much larger scale. The 21st century Asian construction boom is going to help power the world's economy. For insurance, it will truly be a golden age.

An article in *Foreign Policy* magazine last September detailed some of the work China and India will have to do to support their growing middle classes.

It is estimated that these two countries will need mass transit for over 200 cities, almost 36,000 kilometers of rail, almost eight billion square meters of newly paved road and a huge amount of raw materials.

All of this will require insurance!

The World Bank just came out with a report that argues that "the world economy is in the midst of transformational change" and that it is likely that by 2025 emerging economies like Brazil, China, India, Indonesia and the Russian federation will be major players in the global economy. By 2020 the world's economic power will be more evenly balanced between developed and developing countries.

It is clear that, with their large populations and rising household incomes, the BRIC countries are going to provide enormous opportunities for consumer goods, services, and insurance. In 2010 the population of the BRIC countries stood at 2.9 billion versus 737 million for the G-7 countries. In China alone the number of households with annual disposable income of more than $10,000 will quadruple from 57.1 million in 2010, to 222 million in 2020.

When you think about the demographics and what they might mean for the future of the insurance industry, you have to get very passionate.

This new middle class is going to build cities, transform agriculture, build factories, insure lives, buy health insurance, ship raw materials, fly, buy boats, consume all sorts of goods and sue each other. They will want to insure all of it.

And we'll be there to help! Over the course of the 21st century, the wealth and insurable value that this exploding global, coastal and urban middle class will create will be unprecedented in history. Unprecedented both in terms of its global scope and scale. The resulting global demand for insurance will dwarf the capital and capacity of today's insurance market.

There will be opportunities for those of us in the business today, opportunities for insurers not yet envisioned, and opportunities for innovative leaders like Willis Capital Markets & Advisory to harness the strength of the global capital markets to provide tailored insurance products for home and business.

We can provide tremendous value to the global middle class –

- Who else can provide the expertise?
- Who else can draw on the hard lessons of prior experience?
- Who else can build the capacity to keep up with this explosive growth?

People looking back at the 21st century will marvel at the wealth created in the "Roaring 2020s." It will be a golden age of insurance.

Anything is possible. We're privileged to live in an exciting time. The opportunity is almost limitless.

I personally have no doubt about it:
The insurance sector in this country will transform itself, as it's done many times before. It will help lead the way into a new golden age for our industry.

And I promise you one thing: Willis will be there with you every step of the way. Thank you very much.

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