

Houston – Monday 19th September

2005 Houston Marine Insurance Seminar

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Good morning ladies and gentlemen! Thank you for allowing me the honour of addressing you today!!! Let me commence by expressing sincere condolences to all Americans in this room following the tragic events resulting from hurricane Katrina. The scale the scope of human suffering has filled our television screens – our newspapers for each and every day since the storm struck.

Property buildings can be rebuilt replaced people's lives the loss of and the suffering of loved ones these are lasting issues

Last week I was in Monte Carlo attending the so called Reinsurance Rendezvous – the annual meeting of Insurers and Reinsurers from around the Globe. The purpose of the meeting is to commence negotiations of the likely scenario for the next renewal season at 12/31 for the following year! Katrina dominated all conversations – all meetings.

I well remember watching events unfold four years ago on 9/11 as the twin towers collapsed! We stood in disbelief – in denial, knowing some of our colleagues, our friends in Aon occupied one of those buildings. Tragically we in Aon lost many in that tragedy as did Marsh, so we in the insurance world are not simply detached spectators!

We do not just count the dollars and cents!!!

Now, I do understand that many of you may have questions relating to Katrina and so I shall try to keep my formal remarks as brief as possible to allow as much time as possible for questions. The subject I came to talk to you about today is that of regulation – broker regulation in particular. A subject most if not all of you will think of about as exciting as watching paint dry or grass grow!!! Even the most enlightened among you will only think of the subject as a potential cure for insomnia! You may well be right!

BUT – BUT think of this the largest single market in the world for Marine insurance, for Energy insurance and the reinsurance of both classes is London.

Until very recently, much of the market had operated in pretty much the same way for 300 years! Not any more!!

I would like to start out by making it as clear as I possibly can that the views and observations that I shall offer today are entirely personal. Nothing I say today should be construed in any way as representing the views of Aon Corporation..... the officers of Aon Corp, or subsidiary companies owned in whole or in part my doctor, my dentist, my psychologist, my mother-in-law, my dog, my cat, or my canary!

Deleted: observations which I shall offer today

To begin with then some general observations from a personal standpoint. All the evidence seems to indicate that wherever markets thrive and prosper, they are also well regulated. Clear, fair, proportionate regulation is an absolute pre-requisite to providing an environment in which buyers, sellers and intermediaries can all deal in an atmosphere of openness, honesty and fairness. A place in which the rules are well understood and accepted by all parties and are supported and ultimately enforced by suitably qualified bodies.

Markets, be they fruit and vegetable markets in a provincial town in the UK, or a fish market on the Algarve coast or a rialto in Latin America, are all clearly fulfilling a very genuine need and as such are as old as time itself; human beings coming together to transact commerce. So it is easy to see that markets are necessary, desirable and that the characteristics for them to thrive and prosper

are remarkably similar, regardless of the product or service being offered. We human beings hate uncertainty, which is why we hate the dark, the unknown from childhood. Rules and boundaries to behaviours are necessary to create and mould civilised society.

Since nobody would disagree with the foregoing, the issue then is what is the right level of regulation, which balances the interests of all concerned and what is excessive regulation which might serve to stifle the prospering of a market, or even at the extreme threaten its very existence. Of course, these things go in cycles. It could be argued that regulation of the brokers by Lloyd's was never really very much more than a Gentleman's Club, managing Gentlemen. Some of you may question the word gentlemen!

Some would argue that subsequent developments such as the IRBC, Insurance Brokers Registration Council, and then more latterly GISC, General Insurance Standards Council, were well intended examples of self regulation, but were neither mandatory nor had really sufficient teeth to truly safe-guard the interests of consumers. Clearly regulation by the Financial Services Authority following the European Intermediaries Directive is very different. Just take a look at the FSA rulebook – it is thousands of pages long!

It has always been the case that any bad behaviour by one participant in a market, casts a pall over everybody else. The regulator will tend to automatically assume the problem is endemic in the market, as will the members of a market, the press and the outside world. In reality therefore all members of a market are all beholden to each other, all have a vested interest in the welfare of the community.

And how far could regulation go if we, the participants, do not show ourselves to be worthy of trust by clients and regulators? Could we end up having to log, and record, all phone calls with clients and underwriters? Or will we have to insist that all questions, and responses, are in writing? How do we not end up in that world, without making appropriate use of technology in our business processes?

Now however there is something else that is worthy of observation. Not entirely dissimilar to the different worldwide methods of accounting, we see very real differences in market regulation. For example the Sarbanes-Oxley legislation in the US which is truly prescriptive, versus the FSA approach which is based upon guiding principles and is anything but prescriptive. I am not suggesting for one moment that one is good and one is bad, or even that one is necessarily better than the other, I am simply pointing out that their fundamental approach is totally and completely different.

Now, if you happen to be employed by an American owned broker, you will have, or you should have, already been through the process (which is an exhaustive process) of becoming Sarbanes-Oxley compliant. Thus, the American owned brokers have now been through a second wave of regulation, qualification and preparation for the Financial Services Authority; oh joy, oh fun, oh bliss!

Additionally the European Commission announced on 13 June 2005 their decision to launch a sector enquiry into business insurance services in the EU. The reason for the launch of this enquiry is the Commission's belief that in some areas of business insurance competition may not be functioning as well as it could. One of the areas for concern is the apparent limited amount of cross border competition.

The Commission plans to look at different types of business insurance and nothing is excluded. However, it will almost certainly involve property and casualty insurance and reinsurance, and insurance and reinsurance intermediation. Insurance intermediaries will be part of the enquiry as they are the predominant channels of insurance distribution in Europe.

In the meantime of course, we have had the New York Attorney General's investigations into some of our industry's practices. Given the ongoing nature of those investigations, it would not be appropriate for me to comment in any way, shape or form. I would simply make the observation that the insurance broking industry is certainly getting all the attention that it could possibly ever require from various regulators.

There is of course a cost to all of this. There are the obvious costs involved in bringing in outside consultants, reviewing every aspect of your operations from A-Z, reconsidering everything that you have ever taken for granted or considered the norm because that is how it has been for perhaps 300 years; and installing new systems, training employees and coming to grips with the massive cultural change to be faced by every single individual in the organisation. It was recently estimated by Grant Thornton (an accounting practice) that Britain's top 50 brokers have spent almost £20m - £35m plus on FSA regulation alone. My own experience would suggest that this figure is actually a substantial under estimate.

As part of our preparation at Aon we had a video made by John Tiner, the CEO of the FSA, to introduce the FSA and its key principles. This video was shown to all senior management and made available for them to cascade down to all staff. On this video John Tiner spoke about the close and open relationship we must have with our regulator – I assume he meant his hands around my neck!

It is interesting to note by the by, that HSBC recently calculated that the cost to their company to comply with different rules and regimes around the world was approximately US\$400m. BP announced that the cost of complying with US requirements would be up to US\$125m. So, I guess the brokers should perhaps take comfort from the fact that we are not the only ones that are suffering. Good or bad, right or wrong, excessive or not, we are in a new world, and regulation is here to stay.

Some observations then from 60,000 feet and ground level:

From 60,000 feet – is there a danger that some people might see FSA registration as akin to passing their driving test, so that they learn how to pass the test and then proceed to get into bad habits and drive dangerously thereafter, until such time of course as they have an accident?

I believe this to be a very real danger and we all need to therefore be sure that in qualifying for FSA registration we do not fail to understand that our work has only just begun and that the necessary cultural change throughout our business will have to be constantly monitored, reinforced and managed.

One of the messages we at Aon have been constantly repeating to our people “the compliance department is not responsible for compliance, you, the management, all are”. And “if it is not written down, it hasn't happened”.

Still at 60,000 feet - will we see any fall out such as the number of non-US companies that have applied to leave the New York Stock Exchange, rather than continue to bear the costs of Sarbanes-Oxley compliance? ~~If this turns out to be a phenomenon of any size, will it therefore lessen in any substantial way the incredible success of the NYSE and could it result in less liquidity and less effective capital provision? So a less deep and liquid market?~~

Deleted: compliance.

In the UK might we could see the cost of regulation causing consolidation in the broking industry and would that be good for consumers?

Still at 60,000 feet, given the speed and thoroughness in which the FSA has picked up the ball and run with the European Directive, are we in danger of having an unlevel playing field if only for a relatively short space of time before the same rules apply to the rest of the broking community in the European Union? What is a relatively short space of time?

At a more prosaic level, in the new world of utmost transparency and fairness, I pose the following question. Is our beloved way of doing business, the placing slip, in fact potentially anti-trust behaviour? By which I mean that most markets here in London have insisted that brokers put the same premium terms and indeed conditions to all markets on a given risk. Given that the vast majority of risks are to a greater or lesser extent over-subscribed, should not the allocation of shares to individual markets be based on differentiated price. So the lowest price obtains the largest share. This apportionment or rationing of premium to capacity is surely no different to what happens in a so called hard market in which capacity is scarce and that capacity goes to those prepared to pay the highest price. Given that the technology already exists today, why would we not have a blind auction in which each participant would quote their terms and conditions

individually and allow the client to select those with the lowest price and best terms? Whilst there may indeed be common terms there would not be a common price.

On the same subject in a similar vein, how should the broker advise his client in a situation in which a placing is increasingly likely to be over-subscribed? Should the recommendation be on the basis of credit ratings? There are those that would argue that the credit ratings have become discredited ratings, but assuming that in the new world of transparency the clients themselves would have to be transparent to their masters in demonstrating the rationale they used when apportioning their orders. Thus, the triple A's always sign in full, double A's somewhat less and so forth, but then does the ability to pay have any correlation with the willingness to pay? So, should the broker and his client be considering a more subjective approach based on their experience with various carriers? Should the brokers collectively through their trade association compare their experience of insurers' willingness to pay?

Interesting questions I hope you will agree.

Going forward, can we all tear ourselves away from the past, a past in which the relationship between the brokers and underwriters was very much a symbiotic partnership?

It is worth reminding ourselves that in the Lloyd's and London market, the two have successfully co-existed and co-operated for more than 300 years. The first Lloyd's broker was not publicly listed until the late 1960's. Some of you may be old enough to remember the anguish that ensued when the first non-UK company, i.e. US company, applied to the Committee of Lloyd's for permission to purchase a Lloyd's broker back in 1973. This was Frank B Hall's acquisition of Leslie and Godwin. Some of you, like me, are old enough to remember when the brokers had to pay to go into Lloyd's. It surely seems very strange to today's younger generation of brokers and underwriters that this was ever the case. It is through the history of that symbiotic relationship that we suffer from some of the duality issues that we do today.

Brokers have always been paid by commission and even today in an increasingly fee versus commission world we often see some correlation between what might be termed the "usual" commission on a given risk and the negotiated fee.

The reality is that perhaps uniquely in the global world of insurance and reinsurance the Lloyd's brokers and underwriters have operated differently for hundreds of years. There can be no question whatsoever that the broker is the advocate of the client – the buyer. It is his absolute duty to obtain the best possible terms for that buyer. In the London market, which has historically been the centre of so called subscription business, (some may call it a syndicated or fractionated approach), it has been the brokers' role to bind together the various insurer participants to deliver singularity of product. So we might think about the broker being the mortar between the bricks, the glue that holds the package together. Thus, it is the broker that performs many administrative tasks for the underwriters, that are actually performed in other markets by the underwriters themselves. It strikes me that as the various changes have occurred, perhaps the most significant one being the 1986 Lloyd's Act, which resulted in divestment, we did not, any of us, at the time think through the full implications of that change.

The conflict in this case was not one involving buyers, e.g. the policy holders but conflict of interest between brokers owning underwriting agencies and the interests of the names or capital providers on those agencies.

To give you one very straight forward example, it is still the brokers today that typically appoint underwriters' representatives in the event of a loss. These representatives may be Loss Adjusters or Lawyers, it is the brokers who then distribute reports to the market on behalf of the Adjusters and Lawyers, it is the brokers that collect from Underwriters the professional fees to be paid to those same Lawyers and Adjusters. Interestingly enough, we, the brokers wrote on this subject to Underwriters back in 1996, proposing that this was no longer appropriate.

*"Letters dated 18th September 1996 to Mr Hannan, Chairman of LPC and Mr Wetherell, Chairman of the Lloyd's Claims Supervisory Board.
Re: Direct Settlement of Fees*

I am writing on behalf of LIBC to advise that our members are resolved to change the basis of fee collection in London by removing the broker from the settlement process.

There has long been a concern over the conflict of interests inherent in the brokers' collection of fees, where he is acting for both underwriters and his principal. Moreover, the market and brokers have been under criticism periodically from the appointed representatives over delays in fee collection. By removing the broker from the equation, it is hoped that it will lead to a more appropriate direct communication between the market and its appointed representatives. This decision has been the result of detailed and extensive discussions within LIBC committees since 1987.

We strongly believe this action is in the best interests of all parties involved and we are aware that Lloyd's and bureau markets have existing systems which could be developed or adapted to assume the role currently undertaken by brokers."

I think that by near universal consent in the London market the biggest issue that we face is the question of Contract Certainty.

Contract Certainty implies a pre-agreed certainty of interpretation of the Policy, which I do not think anyone believes to be realistic. Since insurance by definition is there to provide cover against unforeseen and unforeseeable events, it follows that the policy in question may or may not pay a loss depending upon the particular circumstances.

Although it has been termed Contract Certainty I think we can all agree what we mean is Contract Delivery, i.e. let's give the client a Policy at, or before, inception and not some months or even years later. Lloyd's has been in operation since 1668 and we are hoping to issue the policies from that year shortly!

Delivery of Contract on time alone does not address the issue of the quality and performance of the Contract.

I very well remember an old Monty Python comedy sketch in which a priest is sitting with an Insurance Executive trying to understand why his motor claim had been rejected, to which the Insurance Executive replied "look – under Condition 14C you will see it says we don't actually pay losses"!

In any event, I am in no doubt whatsoever that the FSA will drive the London market to deliver on the deadline that has been set, i.e. by the end of 2006.

I know the FSA to be deadly serious in their intent, and I hope that all of us in the London marketplace have understood that message and will move with much greater cohesion and sense of urgency than we have for example on the LMP process.

Back in 1999 two of my senior and very experienced colleagues came to me to express their excitement and enthusiasm at the advent of LMP 2001, so badged because that was when delivery was anticipated. They could not understand my gloomy visage. Why they said, would you as someone that has long preached reform in this market not greet this latest initiative with more enthusiasm? Three years later they both sat with me and said basically you were right, we were wrong – as usual the luddites (the flat earth society) have stalled the march on progress. Here we are in 2005 and the objectives of LMP 2001 have still not been achieved. I do not believe our new regulator the FSA will allow this to happen yet again.

I do believe, and I do hope that this regulator, supported by all of us, will deliver what we so badly need to do. For me personally therefore any of the costs of regulation by the FSA will be more than worthwhile in the interests of my clients, if it delivers on contract certainty alone.

As I have pointed out to my CFO in the UK, as I sign our Sarbanes-Oxley and FSA returns, I now have two chances of going to jail. I tell him that there will be a strong correlation between the length of time I spend in Jail and the time that he will spend in hospital after I get out of jail!