Gulliver Travels to Houston

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Good afternoon. When I was asked to speak about our industry from the underwriter's point of view, my thoughts traveled to Gulliver's Travels and the experiences Gulliver had while journeying to different lands. You might ask, why Gulliver's Travels? To be totally honest, my first thought actually was how in God's name can I possibly make this interesting and the least bit exciting. Then I thought about dear old Lemuel Gulliver and his travels and travails. Like the Canterbury Tales, we are all familiar with Gulliver's Travels. We're supposed to have read it. Some may actually have done so. At least we've heard of it! But regardless of our familiarity with the story, it will serve as a cultural icon and will provide a framework where none existed before.

It seems to me that Gulliver would have found our industry very interesting indeed, and would have been able to draw some parallels between the lands that he visited and what I think of as the land of Oz, the land of marine insurance.

First, a little about our hero. Lemuel Gulliver was a travelling man. And when he started out on his travels to Lilliput and Brobdingnag he fully expected to meet some unusual characters and some different lifestyles. What he wasn't prepared for was the extremes, the self-inflicted pain, the torments, and the simple lack of common sense that these lifestyles perpetrated. The way these people lived, he thought, was kind of like whacking yourself with a hammer. All you'd have to do is stop and the pain would go away. But they didn't. It reminds me more than a little of some parts of today's marine insurance market. I, obviously, can only speak for myself and what I have observed. Others in this room, wiser perhaps than I, may have a different view.

Now, let us invite Gulliver to visit us in Oz, the land of the marine insurance seminar, where he can measure the state of our market against his own adventures. From the parcel of land that I momentarily occupy, I'm pretty sure Gulliver will find similarities with the other lands he visited, where pain, it seemed, was a way of life. Of course, whether we wish to acknowledge it or not, we all inhabit this land together¾ underwriters, brokers, lawyers, adjusters and insureds. We're all here together. Although it must be said that, while we represent the diversity of interests within our industry, and we are all eating at the same trough, some of us, perhaps, are feeding more equally than others.

Now, editorial judgments aside, let's take a look at what Gulliver sees as he looks at our business from the marine underwriter's point of view:

He sees that, like the Lilliputians, we've been whacking ourselves with a hammer for a long, long time. Possibly long enough that we no longer recognize what a headache feels like. This market, thinks Gulliver, can only be described as in the tank. That may lack Jonathan Swift's elegance of language, but it is not an unfair judgment. Gulliver is right. We are in the tank, and we've been there for a lot longer than the brief respite of the early to mid-1990s might have led us to believe. The cycle¾ remember the cycle?¾ has been virtually non-existent for the best part of 15 years. Up until a few years ago, we still believed that the cycle would balance the sting of the downturn in pricing. A couple of lean years followed by a.sustainable period of prosperity and general well being. This hasn't happened for a long time and maybe never will again.

Notwithstanding the optimists who are proclaiming that the worst is over and that pricing is beginning to strengthen, as a reasonably alert marine insurer and as someone who talks to a lot of folks, and reads a bit, I can say with some certainty that Gulliver was right, and never have things been worse.

If we look at "Lloyd's Syndicate Results 3rd Quarter 1999", it provides us with an estimate of 1998 results. Of the 163 stamps reported on in the summary, 74% felt that on a **worst** case basis they would have negative results for 1998; on a **best** case basis 45% indicated that they believed they would have negative results. What does this mean? Only that in respect of a fairly green year there is little optimism and there is little doubt that it will get worse. One can only wonder how bad '99 will be?

Not to be xenophobic, we can turn to the American Institute of Marine Underwriters, whose members admitted to a 103.7 % combined ratio for 1998. That was calendar year so there was the benefit of earning premiums on prior years' higher prices. I'd expect that if we were able to see 1998 on a policy or accident year basis it would be dramatically worse.

Capacity is **a¾** if not **the¾** major culprit of course, buoyed by the almost decade-long Wall Street bull market._Getting money in the door and throwing it into a seemingly inexhaustible stock market has become the critical measure of success. Couple this with extraordinarily low reinsurance costs and you've got an invitation to both new and old players to jump in with both feet. The old timers are ignoring what their hard-earned experience tells them, and jumping right in after those who have not yet developed their own scar tissue. One would hope that the old timers are at least jumping into the deep end, but I'm sorry to say that after all this jumping and diving, it is unlikely that there is any water left in the pool.

Take this example of an account I recently saw. It is a sizable account, although not a household name. Three years ago the account was paying well in excess of $2,000,000. The account just renewed for $850,000, after incurring one and three quarter million dollars in losses in the '98/'99 year. While that is the worst year they've had, the renewal premium is less than the burn for the seven prior years. The account did not go to the UK, or anywhere else; it's being done here at home.

From any point of view, this is not good business. But from the perspective of a good account it must be galling to realize that there is virtually no distinction between winners and losers. The first tier insured realizes that each incident has a material cost not covered by insurance: deductibles, downtime, potentially damaged client relationships, management time and effort redirected to claims, so they will continue to do the right thing. However, it might occur to the most desirable insureds that there might be little value in spending time and money on training and maintenance to prevent losses, when those with poor experience can obtain significantly more than a 50% reduction.

For brokers, in addition to simply wanting to serve mankind, the name of the game is retaining business at almost any cost and frequently the cost is very dear indeed. Meanwhile, the market itself is shrinking as clients merge and as ship owners reduce their risk through prudent loss-control activities, mandated at times by government and classification societies, but more often than not, spurred by economic self-interest, coupled with deeper forays into the alternative risk arena.

You would think that all the mergers, acquisitions, gobbling up, and plain going out of business that has become almost our daily diet, would reduce competition and capacity. It doesn't seem to be working that way. No sooner do companies fold than others rush in to take their place. Nature abhors a vacuum. As the mortally wounded fall by the wayside, there are all too many waiting to replace them.

It wasn't so long ago that quite a large number of brokers competed with each other for global companies' dollars. Now, of course there are only two mega-brokers and a handful of visible but significantly smaller players. The merger and consolidation trend is occurring up and down the food chain. In fact, it's been reported that one in three agencies with revenue exceeding $5 million acquired another agency in recent years. The forces that drive the larger mergers also drive the lower levels. Most mergers occur to achieve expense savings, greater efficiencies, more efficient distribution systems and better use of personnel. Whether real or illusory these goals drive the process. Of course, this frequently means that many experienced people are lost to the market, because you save the most by lopping them off. That leaves the market poorer, for far more underwriters have received valuable training and insights from their broker cousins than they might like to admit. The inexperienced leading the inexperienced doesn't seem to add up to prosperity. We continue to whack ourselves with the hammer.

And, of course, on the company side, we see the same merger and acquisition activity. Most recently, to mention only two of the more visible ones, we saw Fireman's Fund acquire McGee, and Ace acquire Cigna. And no doubt there are more to come. And, now our non-traditional competitors, such as banks are also on the food line, with open hands and appetites, in an environment where adequate nourishment in the form of premium is ever-shrinking.

For the marine underwriter, at the end of the day, so long as there are ships and people working on ships, we'll continue to exist. But clearly, not all of us. It's a question of who will survive and who will fall by the wayside. Who will get the business? Who will be the predator and who the prey.

When it comes to take-overs, I can speak from personal experience, since I was a part of a company that is no longer here. We called it a merger, or an acquisition, and truthfully, we called it a number of other things, too. I learned first hand that there were more euphemisms to describe the gobbling up process than I might have imagined.

And it's not all necessarily bad, especially if you believe, as I do, that the property and casualty industry as a whole is grossly inefficient, with each of us having our own production, actuarial, claims, accounting and support staff, each finding more and more inefficient ways to recycle an insured's money.

I was looking at the latest Best's the other day, and noted that it was 4,993 pages long. Do we really need some 3,000 P and C companies? I doubt it. That is roughly one company for every 83,00 people in this country! That statistic should make it a bit harder for us to complain about the number of attorneys…well maybe not.

The need to expand globally has also been driving companies to expand through acquisition and merger. As we've seen borders dissolve and free trade agreements take hold, we've also witnessed U.S. global expansion. Leaving U.S. insurers with no choice but to follow the lead of their customers. Our traditional international companies¾ AIG and CIGNA¾ are being joined by a growing number of entrants.

Paradoxically, while we poise ourselves to take advantage of these opportunities for growth, which represent a vital infusion of new business for the ailing insurer, we're seeing customers increasingly assuming higher retentions and otherwise looking at alternative risk mechanisms such as self-insurance, captives, risk retention groups. In fact, you might say that the alternative risk market is the only part of the insurance market that is thriving¾ providing you equate growth with well-being. Certainly its growth has easily outstripped that of the traditional insurance markets, now accounting for 40% of the nation's commercial lines market with about $80 billion in premiums. Of course, multi national customers have long used alternative risk mechanisms to curb insurance costs, but this kind of growth is staggering.

Nothing is sacred any more, it seems. Not even safety at sea. Look at the ISM code. It was developed with the best of intentions by the International Maritime Organization, with the aim of ensuring that vessel operators adhere to certain safety standards. The first stage took effect over a year ago and addressed tankers, bulkers and passenger ships. This included some 19,000 vessels. Yet, according to some estimates as many as 20 percent are still not ISM certified. The next stage takes effect in July, 2002 and covers all cargo ships and mobile offshore drilling units of 500 gross tons or more. Underwriters could be using this as a new and powerful tool for mitigating risk. Yet, fearful of losing business we are reluctant to demand that effective and enforceable exclusionary language be placed in the policy. The reason is our paranoia, the fear that someone else won't.

On the other hand is the ISM code flawed? If ISM certification speaks to the condition of the vessel at the time of inspection, there could be a situation in which the standard achieved is temporary and not sustainable. And it may still be unclear as to whether ISM certification would be held as proof that a vessel was seaworthy. No doubt, this will eventually be the subject of a lawsuit¾ actually many lawsuits.

Now let me give the home team a plug. With a view to raising the standards of safety management higher, ABS has developed an integrated management system that also addresses quality and environmental issues. The system combines the principles expressed in the ISM Code, the ISO 9002 quality management standard and the ISO 1400l environmental management standard, and supplements them with industry specific requirements for marine management. Since ABS is headquartered here in Houston you won't even have to make a toll call to learn more about it.

Cargo, of course, is another story, since a cargo interest normally doesn't have control over whether a vessel is seaworthy. In this case, the common sense of the insurer should prevail. For example if an insured can prove that they did everything they could to ensure that their goods were put on an ISM certified vessel, and those instructions were not followed, then the underwriter should still pay the claim.

Even if an insured and the carrier do the right thing and cargo is transported on an ISM certified ship, as we all know, there's little guarantee that the cargo's going to arrive at its destination safely. It may be on a safe ship, but that means nothing when the thieves¾ who are not yet subject to ISM, IMO or IACS certification¾ go to work. And go to work they do—to the tune of some $10 billion annually, (some estimates are as high as $20 billion). And it's thought that those billion dollar figures account for as little as 40% of actual losses. Consider the thief's profit: the value of a single container load of laptops or cell phones, perfume or apparel—the most popular targets for thieves--could run as high as $16 million. That's one container. $16 million. And those figures are considered conservative. Understandably, but disastrously, ocean carriers and shoreside facilities are unwilling to admit they have a security problem¾ it's not considered effective marketing to admit to this, although it's fairly well documented that most of the thefts occur at cargo terminals, and as much as 80% of stolen cargo involves insider knowledge.

Carriers and cargo facilities have tremendous technological tools available to them to stem this burgeoning tide of crime. At Chicago's O'Hare, for example, smartcards are in use for truckers, which include finger and thumb print information. In Dallas, FedEx's security system comprises an integrated digital video camera system with electronic tagging. These tactics have a cost, of course, but it is truly fractional compared to the potential savings.

Unfortunately, the criminals, too, are technologically savvy. There are hacker sites on the Internet that will tell you how to break into a carrier's e-mail. Step by step—they'll tell you how to do it. There is a message here. I'm not bright enough to subvert the system, and the crooks are too smart to become underwriters.

But, there's hope on the horizon. Some 50 high-tech companies have banded together to form the Technology Asset Protection Association, whose charge is to push carriers to tighten their security and allow their operations to be audited for compliance. I'm glad to say that these audits will include background checks on staff. I'm even happier to say that I will be exempt from such checks..

Is the world coming to an end at midnight, December 31st, 1999? Some people think so, and if you listen to the dire predictions about planes flying out of control and crashing, heart-lung machines ceasing to operate during life and death operations, banks spewing out zero balances on retirement accounts, you may be persuaded to think so too. And the marine insurance industry is by no means immune from predictions of disaster. The specter of ships crashing into each other, or circling aimlessly in mid-ocean, cargo rotting at unidentified locations, oil rigs exploding and maritime workers lost, have all been vividly and urgently warned against.

Yet, we've all known about the potential pitfalls of Y2K for years now and we've talked about it for as long. I almost walked away from this topic. Yet no discussion on the state of the marine insurance market would be complete without at least addressing the subject, especially in an industry that relies on technology as heavily as ours does. Let's see if we can break it down into a couple of elements as they affect the marine insurer:

First, we must realize that the marine insurer is a commercial enterprise whose owners have some reasonable expectation of a profit. In light of that they are concerned with providing maximum protection for customers without placing the insurance company in danger of bankruptcy. An underlying principle of that hope is the simple principle of providing protection against fortuitous events. This may not apply in the case of Y2K claims, insurers and their legal counsel are already stating, because some insureds know that they have¾ or could have¾ a problem and that it could be avoided. Consequently, if an insured does nothing¾ or not enough¾ to make sure its operations are Y2K compliant, it follows that a resulting loss would not be fortuitous and would not, therefore, be covered.

Sounds simple enough, but even the Coast Guard in a recent about face backed off its threat to close or restrict access to US ports for arriving vessels, which are not Y2K compliant. Instead, the Coast Guard will require ship operators and ports to provide them with information that assures that the Y2K problem will not affect maritime safety. Such information may or may not be reliable.

What about the cost of remediation? The Port of Seattle is filing a lawsuit claiming coverage for the cost of fixing its Y2K problems. The Port of Seattle is arguing that, under the Sue and Labor clause the insurer expects the insured to take necessary precautions to avoid losses that can be anticipated. Therefore, shouldn't this incurred cost be covered? It wouldn't be an overstatement to say that we're awaiting the outcome of this case eagerly. From a purely personal point of view, I'm certain that the city fathers in Seattle might be disappointed.

There's news on the P&I front, too. The Clubs, whose reserves topped some $1.6 billion last year, are encountering some serious competition from an expanding group of commercial insurers who are aggressively offering fixed cost cover with useful limits. Providing the premium isn't too high, a significant number of owners, particularly dry cargo operators, could well prefer a fixed, known amount rather than facing the uncertainty of calls. This year has seen several new entrants in response to what have been described as 'requests from clients'. However, we do know that mutuality has worked and worked well for the most part, for a long time. We, and in particular the owners, will need to see how the resurgent fixed cost market works over a decade or so. I say it is resurgent because MOAC was a major fixed cost market for many years, with a specialist claims handling facility, the USP&I Agency, and they threw the towel in some 25 years ago. Maybe we'll get it right this time.

On the other side of the table, Swiss Re, one of the world's largest reinsurers and Chartwell Re's Lloyds marine syndicate have announced a joint hull venture, which will be managed by a large broking firm with substantial P&I interests. I guess what's good for the goose is good for the gander.

So if this is the state of our industry today, what do we have to do to make things better? How do we stop whacking ourselves with that hammer?

The Lilliputians had a solution for Gulliver. Rather than seeing an outsider as an opportunity to assess their lifestyles and make needed changes, they wanted to blind Gulliver so as to make him fit into their environment. Are we proposing the same thing by blinding ourselves to the complexities and varieties of our industry? Are we blind to the opportunities that are all around us because we want to keep doing what we're doing in the same way as we've always done it? Are we doomed to put up with cargo theft, irrational competition and self-immolating pricing simply because we don't want to change? Don't know how to change? Or, because we are afraid to change. I become more and more convinced that fear is the significant limiting factor in our lives. Somehow, a recognizable pain is better than the alternative, simply because the alternative is unknown and thus lacks the certainty of what we already know.

But, if we continue doing the same thing, we can definitely expect the same results. If we continue to whack ourselves with the hammer, we know it will continue to hurt. If we could only stop¾ even for a little while¾ we might surprise ourselves and actually find that the pain had stopped.

Gulliver observed during his travels that entrenched cultures are the greatest impediment to change. Might he take a look at the marine insurance industry today and see a culture so entrenched that we are blinded to what we need to do to sustain our industry and simply survive ourselves?

To answer that question, we must suppose for a moment that we have been given back the gift of sight along with absolute fearlessness so that we could go about changing our behavior to fit the 21st Century.

The first thing we will do now that we can see clearly and are fearless is to look for and welcome opportunities. In the days of sailing ships, a vessel had to wait for the flood tide before it could sail into port. The Latin term for this situation was ob portu; that is a ship standing over against a port¾ waiting for the right moment when it could ride into harbor. The English word 'opportunity' comes from this original meaning. I believe there are several places where we'll see the tide change and the opportunities for our industry become apparent.

When we accept the fact that we will be fundamentally changed, we will realize the opportunities that are in today's environment. We will realize that opportunity has indeed come to the marine insurance industry. All we have to do is look at the changes that have preceded us and the successes reaped. General Electric is not the company that Thomas Edison founded. Microsoft isn't the company of the Disk Operating System. 3-M often says they don't know the products they will be selling five years from now. They haven't been invented yet!

With technology advancing at the speed of light there are certainly some areas of our business that have yet to be invented. But there are also some hard and fast rules that we must apply to the business. Most important of all, we must remain steadfast to solid underwriting principles¾ and practice them too¾ even in the face of a weak and irrational pricing environment. We must seek to raise pricing to fit the risks we're asked to take on. We must act differently from the way we did in the correction that began in the 4th quarter of 1990. Then, we got money from everyone¾ the good and the bad. We did so in a frenzy of self-righteousness and with an utter lack of discrimination. And we made some enemies. If we do it again, we will make even more enemies and we will compel more insureds to search out alternatives in what they buy and how they buy. They will learn to live without us , or at the very least with less reliance on us.

We must welcome change in our industry. We can't simply bury our heads in the sand and hope for a catastrophe or a downswing in the equities market to reduce capacity.

At the same time, as we address pricing , we need to make sure that we're not charging shipowners so much that they have to look for ways to cut their costs in areas that can touch upon maintenance and safety. Certainly, an undesirable consequence.

The maritime industry is already highly computerized. Ships rely on Global Positioning Satellites for example. Also, the cargo industry is a natural for moving into the land of e-commerce. We're already seeing electronic cargo certificates that allow the insured, the broker and the underwriter speedy access to shipment information and facile reporting capabilities. Now, we're also hearing about electronic bills of lading with electronic signatures as acceptable as the written versions. And these are just part of the packages planned by forward thinking companies. They're also promising secure electronic delivery of all global trade documents including letters of credit, certificates of origin and insurance certificates. Next will be secure electronic availability of customer data. It's already here.

Now, who wouldn't embrace the convenience, time saving and money saving that all of this represents? In today's world, it is critical that all of us embrace these innovations and see them as opportunities for us to provide our customers with better service, efficiently and economically. The company that anticipates best, will do best. And when the cost of doing business goes down, everyone benefits.

What about e-commerce? While it may be difficult for us to envision a situation in which marine insurance can be conducted on line, nevertheless, it's an area that we can't ignore, lest we get blindsided by it. Take GM, for example. They recently announced that they have set up a separate division to develop e-commerce. What format this will take, and how the car dealer will fit in is yet to be seen. But, they've recognized that their customer¾ the ones who actually put the money down for the car¾ are becoming increasingly involved with e-commerce. GM doesn't want to miss out on e-commerce. And neither should we.

We also need to look at the things we're already very good at. We need to look to the specialized services that we provide our customers. To focus on providing service rather than just products. This means really getting to know our customer. To do this we need to become creative, innovative, customer-focused. We need to find the need and figure out a way to meet that need. We already do this many times a day, but we need to stay focused on it so that we get even better at it. I submit that if we want to count ourselves among the survivors, it is critical that we know our customers' markets¾ as well as they do. Not just for convenience, but because our customers will demand it. And the company that knows its customers markets best will be a survivor..

Look at our advantages: we've got loss control experts, claims specialists and, of course, underwriters who honestly know our trade, in spite of our desire to prove otherwise. When it comes right down to it, that's what our customers want. Our customers want a stable market of experienced professionals who will be around next year and the year after, and who will partner with them as they grow. I submit that our customers, the best customers, want this even more than they want low prices. Do any of your clients regret doing business with Weavers or Anglo-American etc., etc? We just have to keep reminding them so that they don't lose sight of why they needed insurance in the first place¾ to mitigate their losses, and not incidentally, get them paid.

As marine underwriters, we must know our customers markets as well as they do. At the same time, we must know who our audience is. If the whole world shopped at Tiffany's it would be Walmart.

All of this represents common sense more than anything else; something Gulliver saw entirely lacking in Lilliput, Brobdingnag, and on that island where the only thing they studied was music and mathematics, ignoring everything else in life. In the marine insurance industry, too, we need to look at our world as a totality, and to realize that experience and common sense are real and valid. Coupled with clear-sightedness and the ability to embrace innovation, they make up what will mean our success in the world. The old networks, understandings and responses of the past cannot stand alone because they will not be sufficient to succeed now or in the future.

But what we need to do represents change. And change is tough. A few centuries later than Jonathan Swift wrote Gulliver’s Travels, Mark Twain said, ‘Habit is habit, not to be thrown out the window by anyone, but rather coaxed down the stairs a step at a time.’

The present and future offer many opportunities for the marine insurance industry to reinvent itself a step at a time¾ a process that will result in a different outcome from the malaise we’re suffering from today.

Gulliver was appalled at the misery he encountered during his travels where people kept doing the same thing and expecting different results. If Jonathan Swift had lived a century later, no doubt he would have had Gulliver travel to the London of Charles Dickens where he could have been well pleased to hear Mr. Micawber’s philosophy: " annual income 10 pounds, annual expenditure 9 pounds, nineteen shillings and sixpence; result: happiness. Annual income 10 pounds, annual expenditure 10 pounds and sixpence; result: misery". Now can the marine insurance underwriter learn something from this?

Gulliver returned home vowing never to revisit the lands of little or no common sense. Can we, too, leave behind the land of insanely low premiums and cut-throat competition that are sucking the life out of our industry? I believe we can do it. All we need are some leaders to take the first steps and coax the rest of us down the stairs, one step at a time. Will you join me and be among the leaders?

Thank you.