In the News: The Reinsurance Industry From the Media's Perspective

Milbank Private Client

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Panel Discussion
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Milbank, Tweed, Hadley & McCloy LLP

In the News: The Reinsurance Industry From the Media's Perspective

Perspectives of noted journalists on how the current challenges to reinsurance will shape the industry

Panelists: *Bill Coffin, Publisher & Editorial Director, Risk Management Magazine*
Sam Friedman, Editor-In-Chief of the Property & Casualty edition of National Underwriter,
David N. Pilla, Senior Associate Editor, BestWire/BestWeek/Best's Review
Michael Loney, Editor, U.S. Insurer

Moderator: *Linda Dakin-Grimm, Partner, Milbank, Tweed, Hadley & McCloy LLP*

Bill Coffin is the Publisher and Editorial Director of *Risk Management Magazine*, which is produced by the New York-based Risk and Insurance Management Society (RIMS), Inc. Bill has been covering insurance, reinsurance and risk management issues for 13 years, working initially with the A.M. Best Company in Oldwick, New Jersey as a technical editor for *Best's Underwriting Guide* and a reporter for *Best's Review* magazine. He spent several years doing corporate research for the American Re-Insurance Company in Princeton, New Jersey before enjoying a brief spell as a freelance writer while raising his family. He joined RIMS in 2002 as the managing editor for *Risk Management*, rose to editor-in-chief, and was recently promoted to his current position. In addition to his career in business journalism, Bill is a published author of science fiction novels and numerous role-playing game books. He is an honors graduate of Washington and Lee University. Bill lives with his wife Allison and his children, Fiona and Connor, in Oakhurst, New Jersey.

Linda Dakin-Grimm is a partner in the Los Angeles, California office of Milbank, Tweed, Hadley & McCloy LLP. She received a B.A. *cum laude* from Yale University and a J.D. from Harvard Law School. Her legal practice includes a variety of complex reinsurance and insurance matters, on behalf of major property/casualty and life insurers and reinsurers. Ms. Dakin-Grimm has handled numerous trial and appellate cases as well as mediation and arbitration proceedings across the U.S. Ms. Dakin-Grimm recently represented eight U.S. insurers and their European parents in a well-publicized dispute with the California Department of Insurance, over the Department's purported regulation of European life insurers and reinsurers who do no business in the state. The U.S. Supreme Court ruled in favor of Ms. Dakin-Grimm's clients in 2003. Ms. Dakin-Grimm has repeatedly won victories for a major U.S. property/casualty insurer in a number of disputes with Lloyd's and other London reinsurers. She recently obtained full rescission (and other relief) of a reinsurance treaty on behalf of several major reinsurers in a fraud dispute with their cedents, a group of workers' compensation insurers that were seized by the Department of Insurance. Ms. Dakin-Grimm represents parties in several contentious disputes involving finite issues and reinsurance pools.

Ms. Dakin-Grimm is a frequent speaker at conferences and seminars. She has chaired numerous Mealeys conferences on Reinsurance and other issues. She spoke at the ARIAS 2003 Spring Meeting in Bermuda, the ARIAS 2004 Fall Meeting in New York, the ARIAS 2006 Spring Meeting in Florida and at numerous conferences sponsored by the ACI, the ABA, Cambridge Group, Mealeys, Euroforum and Hawksmere. Ms. Dakin-Grimm has been recognized by *The International Who's Who of Business Lawyers* as a leading reinsurance litigator and arbitration lawyer, and has been named as one of the top women lawyers in California in 2003, 2004 and 2006. She is admitted in CA and DC.

Sam Friedman, Editor-In-Chief of the *Property & Casualty* edition of *National Underwriter*, is celebrating his 25th anniversary at the nation's leading insurance industry newsweekly. He is in charge of day-to-day editorial operations at the magazine, as well as *National Underwriter*'s online daily news service. He also comments on industry developments both in his weekly opinion column and blog, "*A View From the Press Box*." Sam joined *National Underwriter* in 1981 as a staff writer covering the independent agent beat. He became Managing Editor in 1986 and Editor-In-Chief in 2001, while also serving as Interim Publisher in 2003.

Before joining *National Underwriter*, Sam was Associate Editor at *Modern Grocer* for three years. Prior to that, while in college he edited a number of community newspapers and completed an internship at the Associated Press. He graduated from Brooklyn College in 1979, completed the Professional Publishing Course at Stanford University in 1997 and attended Northwestern University's Advanced Media Management course in 2003. He is a member of the Society of Professional Journalists, the Deadline Club, the New York Financial Writers Association and the American Business Press Association.

Michael Loney is Editor for *U.S. Insurer*. He has been an insurance journalist for four years. He joined *Reactions*, the global insurance and reinsurance magazine, as a graduate trainee in 2002, working in its London office. He was made a staff writer six months later.

In 2005, Michael was promoted to US Editor of Reactions and Editor of *U.S. Insurer,* a quarterly publication covering the American market. Subsequent to the briefing, Michael was promoted to Editor of *Reactions*. He works in *Reactions'* New York office.

David N. Pilla is the Senior Association Editor for *BestWire/BestWeek/Best's Review*. He joined the news division of A.M. Best Co. in 1999 after 11 years as a reporter and managing editor in the general newspaper business. He covers reinsurance, capital and alternative markets, and international insurance markets for A.M. Best's three news publications.

Ms. LINDA DAKIN-GRIMM (Milbank), moderator: We're videotaping this. It's for the panelists' knowledge, so that we can put up a link and perhaps broadcast your comments to more people than we have in the audience right now. And we can also make that available to your various publications. I hope, also, as I've just briefly discussed with you -- to transcribe this and publish your interaction amongst yourselves.

Let me introduce the panelists. If I have you in order. Let me make sure. Yes. Bill Coffin, to my immediate right, is the publisher and editorial director of *Risk Management* magazine, which is produced by the New York-based Risk and Insurance Management Society. Bill has been covering insurance, reinsurance and risk management issues for 13 years, working initially with the AM Best Company. He also spent several years doing corporate research for American Re. In addition to his career in business journalism, Bill is a published author of science fiction novels and numerous role-playing game books.

That's fascinating.

Mr. BILL COFFIN (*Risk Management* magazine): It's a geek thing.

Ms. LINDA DAKIN-GRIMM: To Bill's right is Michael Loney. Michael began his career as an insurance journalist in 2002 when he joined Reactions in London as a staff writer. In 2005, Michael was appointed U.S. editor of *Reactions* and editor of *US Insurer*, based here in New York.

Reactions is a monthly magazine that covers the global insurance, reinsurance and associated financial markets. U.S. Insurer is a quarterly publication that is dedicated to the senior executives running insurers and reinsurers in the U.S.

To Michael's right is David Pilla, he's the senior associate editorof *BestWire*, *BestWeek* and *BestReview*. David joined the news division of AM Best in 1999. After 11 years as a reporter and managing editor in the general newspaper business, David covers reinsurance, capital and alternative markets and international insurance markets for AM Best's three news publications.

And last but not least on the far right -- or your left -- is Sam Friedman, who's editor-in-chief of the *Property & Casualty* edition of *National Underwriter*. Sam has been with that publication for 25 years, and I see his photograph, I think -- quite frequently, it crosses my desk with the publication.

Sam's in charge of day-to-day editorial operations at the magazine as well as the *National Underwriter*'s online daily news service. Sam also comments on industry developments, both in his weekly opinion column and blog, "A View from the Press Box." Sam joined *National Underwriter* in 1981 as a staff writer, covering the independent agent beat. He became managing editor in 1986 and editor-in-chief in 2001, while also serving as the interim publisher in 2003.

Our panelists have had a pre-meeting, and they have some ideas about what they're going to discuss. I'll give you a few ideas, and then they are open to questions from the audience as well, and I would invite you to challenge them and give them your toughest questions. But what they intend to discuss, among other things, are how foreign reinsurers cushioned the blow from Hurricane Katrina and whether they'd be able to do so again, capital market and reinsurance issues, the emergence of "cat" bonds and sidecars. Michael Haravon of Milbank just eluded to that in his presentation.

Do specialty reinsurers and catastrophe startups have a long-term future, or will the large, multi-line reinsurers consolidate the industry? Is reinsurance compatible with tight or uniform regulation? Will offshore reinsurers, particularly in Bermuda, fare well if the regulatory barriers fall in the U.S. and the European Union? And anything else that you want to present them with.

So with that, I'll turn it over to you.

Mr. SAM FRIEDMAN (*National Underwriter*): And I guess I'll just get started. I want to make a couple quick points, though. Very interesting presentations, by the way, preceding ours; I found them very interesting.

Just a couple of quick comments on them. In the regulatory discussion that we led off with, there was all this talk about federal regulation and the possibility for that. And it was laid out very nicely for us, what we might be facing if there was a federal bureaucracy. And as Linda Dakin-Grimm was describing it, it was getting scarier and scarier for me as you think about all these offices being set up, all the people you're going to need to staff it, all the money you're going to need to finance it.

And one of the questions I posited in a recent column and to launch on my blog this week was that this is all well and good to have this discussion while there's a Republican in the White House and Republicans are running Congress.

But of course, as we know, the American public loves to mix things up politically. And quite frequently, we'll go from Tweedle-Dee to Tweedle-Dum, and the next time around, it might not be a Republican who actually executes a federal insurance regulatory scheme. It could actually be a Democratic appointee, and I raised what might have been the scary specter if you have as your possible insurance czar someone like Eliot Spitzer.

That's unlikely, because he'll probably be too busy running this state to take a lower-level job like that.

But you have plenty of other candidates out there; like John Garamendi who was mentioned. I'm sure if he loses the lieutenant governorship, he'd be more than willing to head to Washington; he's liked to have done it in the past. You also have someone like Bob Hunter who -- even though he's an outspoken critic of federal chartering, I'm sure if it became a reality and the job were offered to him that he would take it.

So, I don't know how enthusiastic the backers of federal regulation would be, depending on who the grand poohbah is for federal insurance. So I thought that was a very, very interesting point-of-view there.

The other thing that was fascinating was Milbank attorney David Cohen's presentation about the challenges of the electronic age with the document management. And, of course, you all do realize that the real basis of Eliot Spitzer's case against the industry were emails. I mean it was very interesting.

I was on a panel; the Insurance Marketing Communications Association had a panel back in June on how to restore the industry's damaged reputation. And I was there with someone from the Council of Insurance Agents and Brokers and someone from the Property Casualty Insurers Association of America, and I can only imagine I was there because I might have helped destroy the industry's reputation with our coverage. I don't know.

But it was very interesting that my two colleagues from the industry pointed out that Eliot Spitzer pretty much employed an army of legal interns who cut their teeth in his office essentially reading emails.

That's essentially 'how did I spend my summer vacation? I read insurance company emails and insurance brokerage emails.' And they found a lot of smoking guns in there. It was really remarkable what people would say in an email. You know, 'Do this or else.'

Or, you know, were almost like laughing about what they were pulling off. So, I thought those were both very interesting points.

But at least the matter at hand -- what we're talking about --you guys probably have much more expertise in the reinsuranace business than I do, I would think. And none of this, I don't think, is going to be new to you, but I thought there are some interesting trends.

I'll just get started with the discussion about how the reinsurance industry really came through during the catastrophe year last year. Record catastrophe losses.

Total for the year worldwide, they estimate around $80 billion or so, and supposedly the reinsurance sector absorbed about half of that, which was much more than at least Moody's thinks is common. Moody's believed that the average was about a third that the reinsurance market might pick up in a typical catastrophe year.

That rose to half, and that really helped cushion the blow for the primary insurance market. And even though rates have soared in catastrophe-prone areas on the property side, you know, overall, the market -- it's been a little bit of a blip, and you saw the kind of profitability that the primary U.S. market reported this year which really belied the kind of catastrophe losses they faced. And given the fact that the investment markets were relatively, at best, sort of flat, you didn't have 20 percent returns in the stock market, if you owned anything.

They did quite well, and a lot of that was because they were writing insurance for a living again. They were actually looking for them to be writing gains. So, that worked out very nicely.

The other thing that sort of surprised me going forward, though, is that the industry has recapitalized very quickly. It looked as if the latest reports were that the reinsurance industry was able to raise about $27 billion that will go a long way towards replacing the $40 billion that was lost.

In Bermuda, the latest figures I saw were that the Bermuda market specifically for the storm season last year lost about $11 billion and was able to recapitalize with an additional 10.

Of course, the 10 they gained to replace the 11 they lost was gained at a much -- much more difficult terms and conditions in terms of interest rate environment, expected rate of return, things like this.

But the industry did very well in cushioning the blow against the "cat" losses last year. It did very well in terms of recapitalizing. It has not fully recapitalized, which leads to the hardening of the market, especially in property. But it really did its job.

And absent of another major loss this year - and my colleagues will talk a little bit about what that implication might be. If you do not have another Katrina this year, you would think that competition among the reinsurers will increase next year, perhaps even in property, to a rational extent anyway.

And also, as a number of reinsurers are trying to get more diversification in their portfolios if they're too heavy in property, they're pouring more money into casualty lines, and that's causing this -- that's leading again or fueling the softening in the casualty markets. So, the reinsurance market, as usual, is driving stuff, and there's a whole other sector to talk about, which is the alternative markets, and my colleagues will be picking up on that.

But I think the reinsurance market has done very well. They took a huge hit last year, but they recapitalized quickly. They're sort of calling the tune, in terms of conditions, at least on the property side. And it's been -- it sort of has done its job. It's worked, so it's been good.

Anybody else want to pick up, maybe on the alternatives that are out there?

Mr. DAVID PILLA (AM Best): I think I'll just make some comments on that, and our analysts estimated that the reinsurance market did take a big hit on those storms last year. Our people estimate about 60 percent in losses.

Mr. FRIEDMAN: Sixty, wow.

Mr. PILLA: To be absorbed by reinsurance. I think it's interesting the way the reinsurance business is evolving now. We have all of these, smaller specialty reinsurers being started in Bermuda mostly and the reinsurance sidecars and a lot of this capitalized by hedge funds, private equity funds, investment money that is known to move quickly in and out of whatever markets it is interested in and what that might mean for the future stability of certain lines of reinsurance, particularly catastrophe.

At the other end, you have the large reinsurers, particularly the Europeans, Winterthur, Swiss Re. And we've seen Swiss Re pick up GE this year, and they're going to be the largest reinsurer in the world now because of that.

I think, as far as property catastrophe, at least in the U.S., those large reinsurers are still going to be setting the tone for the market. They could still be very selective in what risks they underwrite and what price they demand.

They're looking at life reinsurance and other options to offset any catastrophe risk they may take on or even as an alternative to writing catastrophe at all. And as they get larger, I'm wondering if they're going to drive market consolidation more quickly.

Then you have some of the mid-term reinsurances like Scor, France's Scor and Converium, who basically started to withdraw from the U.S. market altogether.

AUDIENCE MEMBER: Can I stop you there, please?

Mr. PILLA: Yes.

AUDIENCE MEMBER: That is not correct.

Mr. PILLA: What's that?

AUDIENCE MEMBER: I'm the general counsel at Scor; we have not withdrawn from the U.S. market at all.

Mr. PILLA: No, I'm sorry, I'm talking about catastrophe. Catastrophe.

AUDIENCE MEMBER: I don't want a rumor running around about it.

Mr. PILLA: Yes. I'm thinking of catastrophe specifically, I think.

AUDIENCE MEMBER: OK.

Mr. PILLA: I'm sorry. Yes, that's true.

But some of those Europeans are looking more toward European markets and even the developing Asian markets. So, I think there's a lot of movement going on as far as strategy, and I think it will be interesting to see, particularly with these specialty companies that are backed by venture capital, you might say: where they're going in the future and whether or not they're going seem to be reliable over the long run.

Mr. MICHAEL LONEY (*Reactions*): Yes, I just wanted to pick up and I'm kind of interested in what effects the new startups will have, according to catastrophe. But I'm interested in whether, in the long-term, they plan to move into other lines and whether that poses a danger to the rest of the industry.

We all know the industry's been hit hard by the "cats." And all indications are that we're in a higher-frequency-and-severity era. That means that rating agencies have also come down hard on them and that makes the life of a "cat" reinsurer a lot harder. They've got to put a lot more money up in capital requirements, so it costs a lot more to be in the game.

This has left quite a few people to claim that the concept of a pure "cat" reinsurer as dead. I know Robert Hitchcock, chairman of Hitchcock and Lloyd's insurer and reinsurer; he's called it a dead duck before. He believes you need to have a balanced book to survive in the industry these days.

And even Don Kramer, chairman of a startup called Arial Re -- he's got plans to move out, because he thinks that the "cat" business, once you reach your optimum level, there's not really anywhere you can go.

So I wonder whether the concept of a pure "cat" reinsurer has suddenly gone bad. Three years ago, it looked like a great life. They'd gone 12 years with very little losses and raked the money in. So one, one and a half bad years. They didn't get hit too badly by 2004; I don't know if that suddenly makes it such a terrible idea.

Certainly, two smallish "cat" reinsurers were taken out in Rosemont Re and PX Re, but the other ones are still surviving, and if you look at their profits since 2001, if not breaking even, some of them even made a small profit overall. So certainly that combined ratio looked a bit scary last year, over 200 percent for the pure ones such as OPC Re, Montpelier Re, PX Re, but that's in contrast to combined ratios in the '60's and '70's and years before.

But more than that, I'm concerned as a skeptical journalist about, where they do diversify, what effect that will have if they all pile into areas such as casualty. I'm frankly get horrified if people think that casualty is the savior if they can just look at what it's done to them in the last 10 years or so. It's only that's what's hurt reinsurers the most. They knew "cats" were coming; whether they prepared for them or not, I'm not sure, but they knew they were coming.

They certainly didn't know that asbestos was coming, and they might not have known they were under-pricing business quite as badly as they were in the last soft market, which is very recent, so you can't even claim that that was really someone else's fault. So I'm worried about that and you only need to look at American Re and the former Employees Re, how much help they needed from their parents just to keep going -- how badly casualty business can hurt you.

They needed billions to rectify. So, that's what I'm worried about. The industry isn't talent-rich, and who you're hiring from, I'd be extremely careful where these underwriters are coming from. I certainly see people cropping up from companies that no longer exist, and you wonder whether they were the ones responsible for the company not existing anymore. Anyway, that's kind of certainly one that I'm interested to see.

As a journalist, you hear every reinsurer and insurer harping on about discipline, but I have to say I get skeptical about just how disciplined they'll be when they need to grab market share and get into a market.

Mr. COFFIN: Yes, as somebody who worked at American Re at a time when it got to the end, it was quite an interesting view from the inside, because you often got the sense of people on death row sort of waiting for the executioner to come down. And people would openly talk about the Germans and when they're going to come and -- you know, Munich was going to kind of come calling.

It was kind of a weird time, because there had been -- one underwriter had called it an orgy of underwriting for about 10 years. And the company just made this mad scramble for market share, and underwriter discipline had really slacked off a bit. And then -- they found themselves with all of these incredible, long-tail exposures; that was just a nightmare. So, see, I very much agree that. No, fleeing to casualty as kind of high ground against --

Mr. LONEY: This is another point. Certainly in the "cat" business, you can write your business, hide under the sofa and hope that the season's OK, where as you write casualty and then it's years later before you know just how good or bad the business was.

Mr. COFFIN: Yes, and there with casualty, that's the gift that keeps on giving. You get stuck with asbestos exposure and you end up paying that group for 20, 25 years.

With a natural catastrophe, it can be awful, but it is over. You know, when the storm clears, the storm clears; then it's gone. And there may be some residual effect, but it's not like that claim keeps rearing its head in the same way certain long-tail exposures like asbestos did; or (unintelligible).

What I find interesting -- you know, you say casualty, and perhaps it might spur the rise of certain alternative vehicles, and what I've been speaking to you guys earlier about is the rise of sidecars, which is something that we've been sort of following. It is very -- (unintelligible) -- curiosity. I'm sure everybody here probably knows more about sidecars than I can actually tell you about.

But just as an industry observer and especially as somebody who puts out a magazine that's aimed at purchasers of insurance, people who often see the reinsurance industry from a very distant vantage point --are primarily the buyers of primary insurance. And for them, the wall is the primary insurance company, and they know the reinsurance industry is there, but they don't have a whole lot of direct interaction with it all the time.

It kind of feeds into the impression I've often had that the reinsurance industry is probably the biggest industry in the world that nobody really knows about. It's got enough money to blot out the sun, but there are a lot of professionals whose lives are touched by reinsurance that don't have a really firm understanding of what it is, how it does what it does, how they can be part of the process.
So, anyway I was trying to connect that with our readers; we have a story following this a little bit more, and I find the rise of sidecars to be a really interesting trend, and I'll tell you why.

To take this to a little bit of a personal anecdote, I like to take my summers in Cape Cod. You know, I like to go whale watching. When you go look at a whale, it's a massive creature, sort of lazily -- humpbacks, especially -- sort of lazily float through the water. And you think, 'Well, I guess that's all they do. They're a 60-ton animal that floats in the water, does nothing.'

And then, bam, it moves in a flash. And it jumps out of the water, and you never thought something so big could move so fast and make such a splash.

And when you look at the insurance industry and the reinsurance industry, they're often seen as these big leviathan-type industries -- they take these very big, slow hundred steps that leave craters everywhere they go. You don't think nimbleness or the speed of action necessarily would be the hallmarks of the industry, especially reinsurance, because the financial numbers are so huge.

But when you see the way that industry reacted after -- especially after 2005, it was really quite astonishing how well it recapitalized and how they were able to kind of come back to their feet. Bermuda took a hell of a beating, but still, it actually came back a lot better than some people may have thought possible. And it's a very encouraging thing and a very exciting thing to see an industry react with that sort of resilience and that sort of flexibility.

And when you see something like sidecars come up as this really interesting alternative way of funding risk -- I mean you've got -- you're able to access the financial markets directly. People were able to bring huge amounts of money in and out very, very quickly; it's a very nimble, very kind of loosey-goosey way of financing risk compared to other ways.

That shows a real interesting spirit of innovation that I think maybe some people kind of thought gets lost in the industry, especially when you have a bunch of good years and the prices in the reinsurance industry -- also the primary insurance industry as well -- people feel that things are kind of ossified a little bit.

I think it's kind of encouraging to see the rise of something like sidecars to be used with something bigger and kind of -- I can't think of -- a bit of a splash.

Now, that said, they're not the savior of the industry or anything like that. They still comprise a pretty small portion of the business, and I think that, to a certain degree, sidecars are the result of a converging of a couple different factors at once. I think the circumstances were right for sidecars; circumstances are not always going to be right for sidecars.

And I think one day, they probably will go away. You know, if you have an investment -- a stock market that returns to the go-go '90's, I think you're going to hear a lot of investors go, 'Well, why are we getting involved in underwriting against hurricane risk? Why bother? Why don't we just buy Microsoft and just call it a day?'

I think that you have a kind of a lackluster investment world right now where people are looking at how can we make a buck in new and interesting ways, frankly. And rolling the dice on whether or not, you know, Hurricane Katrina does it or does it not level another city, you know, is -- that's where our rules come to. That's become a compelling business decision. But these are all very, very interesting innovations.

And for me, as an observer, this is kind of an exciting time to be looking at the reinsurance world and seeing what it's doing, what it's capable of. And it will be neat to see where it goes from here.

The hurricane season this year is still young, and as Sam was mentioning, it's quiet season; some people I think are going to have to ultimately kind of explain themselves, like why do they have such massive, massive profits.

And, you know -- (unintelligible) -- rates, and they are. But it's a long time until November, and we're all just one bad storm away from another $30, $40 billion loss. So, we'll wait and see, see what happens.

Mr. PILLA: This is sort of on the alternatives, sidecars and "cat" bonds as well. Both relatively untested in some ways. It will be interesting to see what would happen. You have this hedge fund money -- investor money -- in these instruments; what if a few of them failed in one season and a bunch of investors lost their shirts? What kind of disputes might arise? That's relatively uncharted water, I think.

Mr. FRIEDMAN: And you had your first total loss this past storm season, right? There was one that was actually a total loss to investors. And it wasn't enough to swoop the market; it looked like in the first six months that they were able to float, what, a couple billion dollars worth of "cat" bonds or something like that? Which is still, again, this -- what are we looking at, 10 percent of the market, 15 percent of the market total for the alternatives?

Mr. PILLA: Yes, I think it was 10 percent.

Mr. LONEY: I'd say that the capital market is still untested. I know everyone was claiming that that was the big test, but it was 190 capital -- cap re. 'I think you should buy Swiss Re' and backed by zero. But that's just one bond out of many, and I'm sure people are willing to take one hit. It's when a few of them go off that I think we'll see just how --

Mr. PILLA: Yes, three or four in one season or from one event. And what kind of pressure would that put on the "cat" modeling agencies which form the basis of the construction of these "cat" bonds, more or less? And what kind of pressure would come on them, criticism of their methods if a few of these things --

Mr. COFFIN: Well, especially since "cat" modeling agencies are already under the microscope, because so much weight has been put upon their models, but they have historically underperformed a bit, haven't they?

I mean, certainly Katrina, the 2005 season, they never really fully gauged the losses -- the casualty losses there. I think that there are some people that look at the "cat" models a little bit. But not with as skeptical an eye, but they're not delivering everything that some people had kind of hoped about the --

Mr. FRIEDMAN: Everybody sort of upped the ante. The "cat" modelers have really increased what their expected maximum probable losses may be. And, of course, the rating agencies, including an investor, will also raise the stakes in terms of demanding much more of the companies that they're examining, in terms of what your enterprise risk management system is, which is a relatively new development with them.

So it's sort of ironic. At the International Insurance Society meeting in July, there was this big panel on enterprise risk management. And they had the head of Aeon. And they had Evan Greenberg, I think, from Ace. And they had, I think, it was one of the competing rating agencies.

I forget who it was. Fitch or something like that.

And they were talking about the importance of establishing a culture of risk management in your organization and about everybody buying into this and seeing this as not a nuisance but an opportunity. They were doing all the great, cliche buzzwords, and I was thinking, 'I wish,' you know, Bill, for your audience, 'I wish risk managers could have been at that meeting.'

This was not a meeting for corporate buyers. This was really for international insurers. I said, 'I would love buyers to sit here and see after all these years of being lectured about we're going to take a look at your risk management program and your "cat" management' -- there's been a lot more buzz on enterprise risk management at your end, and to hear these guys finally talking the talk about how we have to get our act together on enterprise risk management was pretty funny.

Mr. COFFIN: It probably would have led to a very terse Q&A section there; I can guarantee you that.

Mr. FRIEDMAN: But the stuff we're talking about, the catastrophe stuff here, both natural with -- and some of the things we were talking about with the debate within the industry about trying to mutualize the losses through national funds -- and then we went on and had the discussion of TRIA, the manmade disasters.

And it's interesting to see how this stuff is playing out, because the industry is violently split on natural catastrophes right now. And it's starting to get ugly out there.

You can see the rhetoric is really starting to get heated, and you have protectingamerica.org, primarily backed by Allstate. But PCI recently came on, which was a big step for that group, because PCI is headed by Ernie Csiszar, who used to be the head of NISA.

So you have a person who's heading up a major insurer trade group is now and was a -- the national representative for insurance regulation -- is on board. So that was quite a coup for protectingamerica.org.

Unfortunately, Liberty Mutual, which is one of PCI's biggest members, is violently opposing anything along these lines, and Mr. Kelly, their very soft-spoken CEO -- anybody who's seen him in action knows that he's pretty blunt.

He had an Op-Ed piece in *The Wall Street Journal* not too long ago where he really laid out the idea that people have to start taking responsibility for where they live and where they're building.

Local governments have to take responsibility for making sure that properties are not overly concentrated in "cat"-prone areas and that what is constructed there is built according to much stricter building codes that are much more vigorously enforced and that the last thing the country should do is subsidize these properties by making it easier to spread the risk to the rest of the people who really don't have very many of these exposures at all.

However, you juxtapose that with the TRIA debate, and the industry is pretty much united as far as I can see on TRIA.

We want TRIA or some form of TRIA going forward. We want some government backstop. And in essence, a lot of the arguments that are being made against the national catastrophe funds could be made against TRIA.

You could say, 'Well, it's really just New York, Los Angeles, Chicago.' I mean we could pick out a handful of cities, let them form a terrorism pool. I mean, 'I live in Kansas; this isn't going to happen to us. I live in Alabama, nobody's going to' -- you know, it -- may be domestic.

Well, we know what happened in Oklahoma City, but that wouldn't be covered by this anyway, right?

Mr. COFFIN: No, it wouldn't.

Mr. FRIEDMAN: So --

Mr. COFFIN: Frankly, if you had an Al-Queda franchise in America of homegrown boys from Iowa who said, 'You know what? We're going to be pro-Osama' and they blow something up, I'll bet you anything they'll figure out some way to disqualify that as homegrown terrorism.

Especially if they carry off -- I don't know, they somehow get a truck bomb in at Union Point and detonate the -- that's (unintelligible), obviously. But if they were to create another 9/11-style attack, certainly people would be scrambling every which way to split hairs: 'Is this homegrown? Is this not homegrown? Yes, they were born here, but they were corrupted by some sort of sinister alien influence.' I mean, that would not be a clear-cut --

Mr. FRIEDMAN: And the thing is, too, with TRIA, the rhetoric from the opponents of TRIA is that it's a government bailout. I keep hearing, 'bail-out, bail-out.' The government shouldn't be subsidizing private industry like this. Well frankly, FDIC is a federal form of this type of -- 'People should put money in banks. If the banks fail, it's not my problem.' You could make that argument.

You can also say that this is quite a bailout. Look at the numbers that you presented. And you see what the individual company retentions are. You're talking, what, 15 to 20 percent of earned premiums. What the industry-wide retention is -- we're talking about -- again, what was that number for 2007?

AUDIENCE MEMBER: Twenty-five.

Mr. FRIEDMAN: $25 billion, right? Before any of this is triggered. So it's not like the first time somebody sets off a car bomb, God forbid, outside a department store that the government's mangled the claims --

Mr. PILLA: Right.

Mr. FRIEDMAN: I mean, this has to be a pretty serious attack.

Mr. COFFIN: It's better to reserve for the super-terrorism that people had long suggested could never possibly happen. But once it did happen, that's all that people ever concern themselves with. For a long time, experts were going, 'Yes, somebody's going to hijack an airplane, and they're going to fly it into a big building. It's going to crash; it's going to be horrible.' And a lot of people just went, 'OK, right. Well, we'll see you later.'

And it actually happened; then people went, 'Jeez, there's a lot of airplanes in this country.' And all they could think about was just that. And they had the focus of that completely skewed in that regard.

But you know, I actually agree with you, though in the sense that when people look at TRIA as a bailout, they're forgetting the fact that there's a decent threshold there. And there is still a pretty strong expectation from the private industry to step up to the plate and cover the losses before the government gets involved.

So it's not like the whole industry can just wash their hands of terrorism risk. This is just offering that kind of extra layer, in case things really go off the charts, so that the industry can continue to be in this business.

What I'm finding with TRIA is that there's a real strong struggle between perception and reality of what TRIA actually is.
And I'm not entirely sure if all of TRIA's supporters have really done the best job in making sure that the reality of TRIA trumps the negative perception of TRIA which is that of a questionable government bailout.

A bailout, by the way, of an industry that doesn't have a whole lot of public support to begin with. People love to bash insurers. They just love to do it. And people are like, 'Well, wait a minute. Hold on. We're going to pay taxes so that insurance agents have better lives?' And already the perception gets completely warped and skewed. And God forbid, if the average person on the street had any idea of the scope of the reinsurance industry, there would be even less sympathy for that, just because these are the people that bail out the insurance industry, for a job, frankly.

So, if people would just not care to hear about it.

Mr. FREIDMAN: You know, politics makes such strange bedfellows, because normally you associate the insurance industry with Republicans. It's pro-business, anti-regulation; it's pro-tort reform, et cetera, et cetera.

Republicans have been anything but good friends of the industry when it comes to TRIA. And in fact, one of TRIA's biggest champions in the Senate is Hillary Clinton, who made a major policy speech where she said that TRIA is a matter of national security. And I'm thinking, 'Boy, when the insurance industry is depending on Hillary Clinton for our security, we're in a bunch of trouble.' But that's how it works out. And it's going to be very interesting to see how it turns.

And you mentioned about how the insurance industry is not a well-liked business, especially in Washington. It's going to take, I think, your audience to make the difference. I think corporate buyers are going to make the case that, hey, this isn't a bailout. You guys have got to make sure these guys have a backstop, so I can get affordable coverage.

And that's one of the things that I'd maybe like to throw out at the panel. Let's say the odds are not good of the TRIA extension. We still don't know -- and who knows what's going to happen? We could have a change of administration. Congress could have a different leadership at some point. Who knows what's going to happen two years -- a year and a half from now?

But let's say, the worst-case scenario for the industry is TRIA expires, there's no replacement. I don't know what the Treasury Department's going to report at the end of this month, but I can't imagine there's going to be a vigorous, aggressive reinsurance market for terrorism to replace the TRIA backstop.

It's going to really get nasty out there in the market. Do you guys agree with that?

Mr. LONEY: Yes. You really have to look at what was happening pre-the first TRIA. It looked like contractors and what have you were going to be in deep, deep trouble, insurers were going to run amok, which is why the industry is confident that something will happen. But it's a matter of what happens.

Mr. COFFIN: You have to ask yourself what incentive the reinsurance industry has to stay in the market, quite frankly. I mean, they basically said, 'We can't really underwrite against this.' It's not like you've got natural patterns of geologic activity or climatic activity you can somehow possibly gauge. Terrorism is just people against people.

And these are non-governments reacting to other non-governments or other governments. It's just such a dynamic set of circumstances and complicities that how do you possibly underwrite? I mean, if you can't underwrite well against a storm coming in the Gulf of Mexico and leveling a city that is at or below sea level, how in God's name are you going to effectively underwrite against a bunch of guys with RPG's hanging out in Pakistan who hatched some plot to bring down the world's mightiest financial institution?

It kind of beggars belief. I have a lot of sympathy for the reinsurance folks up there going, 'I want no part in this.' And the grim reality of terrorism insurance -- and this is my very personal point-of-view -- is that, after 9/11, certainly in this country which is so affluent and so laden with large monuments to our affluence and to our culture, everything looked like a terrorism target.

But the reality of terrorism, of global terrorism and of the super-terrorism on 9/11 is that the reason why they hit the World Trade Center and not a packed stadium with ten times as many people -- they weren't looking for a body count necessarily. They were looking for an icon that the farthest corners of the world could still go, 'Yes, I can't actually write, but I do know that's the World Trade Center." There's that icon. They wanted to hit something that translated to everybody they could have possibly wanted to reach. And the truth of the matter is that there aren't that many places like that in the world. I mean, there are. There are some, and they need to be protected.

They need to be insured. But not everything has the weight that the World Trade Center has.

That's the reason they went after it, you know.

Mr. PILLA: That and economic destruction. I think that's one of the reason a federal backstop is really needed for terrorism risk is that -- and this is, I think, why Hillary Clinton would back it -- is that we are right now sitting in the midst of one of the prime targets as far as areas go in the United States as far as a strike by terrorists that would, economically, disrupt this country as much as possible. So, yes, I can't imagine there would be enough of a private market reinsurance appetite for reinsuring risk in lower Manhattan, say, without any kind of government backstop.

Mr. FRIEDMAN: You know, that's undoubtedly the way this will play out, it will be an 11th-hour decision as it has always been.

Mr. LONEY: Yes.

Mr. FRIEDMAN: There is no way they'll say, 'Look, let's get this out of the way this year, so we don't have to rush.' You know, 'Let's do something sensible and rational.' Congress just does not work like this, especially now.

You guys have a lot of people in D.C., taking the temperature of the Capitol now, it's nuts there.

Mr. PILLA: Yes, it is.

Mr. FRIEDMAN: People are really scared in Congress right now. And in fact, they might actually hold the deadline. They may want to get out by September 29th. They're desperate to get out and campaign. Lieberman didn't even attend the opening session yesterday. He stayed home to campaign. I mean, 'I've got to have a job first. I'll govern later.'

So insurance issues on the whole are not going to take the highest priority. This Congress can't even come to grips with something as pressing as the flood insurance problem where all it takes is just raising the debt levels, so they can pay their claims. Or let alone reforming the system.

But once you start to get away from the essentials -- 'OK, it is the national flood insurance program, so I guess we have to do something about it. It's our program -- they start looking at federal regulation.

'Oh, God, then we have to create another bureaucracy; we can wait on that one.'

Or they start going further and further out. And then they look at TRIA: 'Well, that doesn't expire till the end of 2007.' Yes, but you don't get it. There's contracts that are going to go into effect starting, 1/1/06 -- 1/1/07, they're going to go into effect. There will be repercussions throughout, as coverage extends beyond that deadline.

Well, I don't know; they're not going to say, 'Well, we better get on that right now.' You know, they're not Dudley Do-Rights with this stuff. They're not very diligent. So right now, their primary concern is getting re-elected.

We have no idea how the House and Senate is going to turn out after November 11th, I guess it is. And then the year down the road, you're going to have -- you already have a lame-duck president. He's going to be -- I don't want to say he's going to be lamer, but you get the idea. As the expiration date on President Bush's term starts getting closer and closer, he will have less and less leverage. If one of the houses goes to the Democrats, his leverage will plummet. And then you even might have the specter of congressional investigations hounding him.

So the whole focus of Washington is on navel-gazing and not on governing again. So insurance issues are not going to take high priority in this, so --

Mr. COFFIN: And especially, since -- we have been discussing since this entire briefing had begun -- is just regulation in the reinsurance industry. You had, in your briefing, mentioned some very interesting bills that came up. But they're just spinning their wheels and not really going anywhere. It's not really hard to see why.

And especially, I think that given how poorly some legislators even understand the fundamental principles of how insurance works, let alone reinsurance, let alone alternatives to reinsurance, you're not really going to get any kind of major spurt for any kind of serious (unintelligible) and regulation, I think, until something really bad happens.

And then it's going to be all very reactionary, and people are just going to hit the throttle and try to fix something. And by that point, it's too late. Or it's too late to get the best, to get the best regulation you could possibly get, I think. It's not going to be as thought-out as before, perhaps.

Mr. LONEY: I think the industry's biggest problem is that no one ever won an election by supporting insurance.

Mr. COFFIN: That's true.

Mr. LONEY: They only like going after insurers. You have to look at Garamendi or people like that who have scored points and easy points off insurers. Just look at -- was it Jim Hood in Mississippi -- who called them Nazis? And, yes, it's an easy target.

And certainly saying you've got to do this for these lovely insurance chaps is not going to make you particularly popular.

Mr. FRIEDMAN: Yes, these are not high-profile issues that are going to win them taking points or votes. And also especially when the industry's split, like on issues like national catastrophe funds.

'If you guys can't decide what you want, you know the group you, I'm not going to impose something, because I don't really understand this business anyway very well to begin with. And I'm very reluctant to take on any additional risk here. So that's really your business at risk.'

Mr. COFFIN: But regulation really is inevitable at some point, only, because the largest migration in U.S. history is going on right now. It's in this century, and it's people going to the coast, where the hurricanes are going to hit and hit them hard.

Mr. FRIEDMAN: And they're building nice, big houses.

Mr. COFFIN: They're building beautiful houses, and in this country insurance is looked at as a right more than something you actually have to buy. What's right, you hate to pay for it. That's why we have the insurance guy, you know?

But just the level of risk is increasing at a rate way faster than the industry's ability to pay for it all. That's not a slam against the industry. It's a matter that there's no sense of risk management among the general populace. I mean, people think, 'I'm an American, and it's my right to build a house right there on the tip of Cape Hatteras. And never mind that Cape Hatteras was built by God specifically to catch hurricanes.' 'I'm going to build a house there, and that's that.'

And you've got this incredible break from reality with a lot of people. And as a result, especially regarding catastrophe risk and natural disaster risk and storms in particular, the level of risk is skyrocketing to such a degree that I just have to feel that there's going to be a breaking point where, at some point, there's going to be a loss so big, it's going to jar the industry so bad that something is going to have to happen.

And that's when the regulators are going to have to step in, because the industry can only get jangled so hard before the industry really has to step in and step up hard.

But honestly, I don't like to think about it that much, because the whole thing is such an ugly situation, I can't possibly imagine how it will shake out. And I don't want to be anywhere near it, frankly.

Mr. FRIEDMAN: Well, talking about being anywhere near it, there's all the warnings going on about how New York is overdue for a major "cat" -- and we just got taste of this last weekend with the very mild tail end of Ernesto. What was it, about 50 miles an hour hitting Long Island? For this, Floridians wouldn't even board up the windows for this, right?

And you saw, ConEd said there were 70,000 people without power. A lot of people had roof damage, water damage, right? Beach erosion. I mean, it's --

Mr. COFFIN: We covered in our magazine -- the "Long Island Express," a hurricane that came in through the '30's and leveled Long Island. Thankfully, nobody was really living there, so most of the damage was trees. But now, that's all developed, and if you had a "Long Island Express" nowadays, you're talking about like a trillion-dollar loss. That's trillion with a T.

And that's a lot of insured loss as well. It's not like New Orleans. A lot of that's going to be insured. As far as the industry is concerned, that's akin to an asteroid landing on the planet.

Nobody believes me. That's such a huge thing, nobody wants to think about it. The thing is, those are the kinds of risks that are starting to emerge. And I mentioned before about super-terrorism -- 'Fly planes into a building? OK, maybe in James Bond film. You know, back to reality.'

Mr. FRIEDMAN: A Tom Clancy book. Had to find another insurance agent, by the way.

Mr. COFFIN: Right. But the thing is, just because the risk seemed fanciful didn't mean there wasn't a serious reason underpinning it and making it very plausible. And look at Long Island and storm risk. That's a great example. People look at that: 'Ah, it's never going to happen. It never happened in my lifetime; I can't remember it, so what's the risk? What am I going to do, move my house?'

Well, you have that kind of attitude. And yes, it's going to happen someday. And nobody is prepared for it. And we're all going to have to live with the after-effects of it once it happens.

And this is something -- you want to talk about the reinsurance industry getting involved. They're going to be right there on the front line. People don't know about reinsurance before Hurricane Omega slams Long Island? Well, they're sure going to know about it afterwards. And everybody's going to have to go to school and learn a lot about it, because they're going to be faced with a very, very complex financial industry that's in a very big stew.

It's in a lot of trouble, and everybody's going to have to step up and figure out how to fix it. And right now -- you were talking about there's not a big talent pool out there?

That talent pool is going to have to get a lot stronger and a lot deeper, and right now, it's a little shallow wading pool.

Ms. DAKIN-GRIMM: You guys have about five minutes left. Do you want to try to invite some questions or comments from your audience?

So would you advocate that the insurance-buying public should, therefore, take the risk of living where they live and the regulators should let insurers limit the coverage they're willing to offer for flood or storm damage on coastal properties?

Mr. COFFIN: Well, there's how Bill Coffin would like to answer, and there's how the publisher of Risk management magazine would like to answer.

Ms. DAKIN-GRIMM: You could answer as both. And the video is on.

Mr. COFFIN: Yes. Yes, I am very aware of it. Little red light, you know.

That's a real tough one. You know, in America, we like to talk about personal accountability.

Ms. DAKIN-GRIMM: Or lack thereof.

Mr. COFFIN: Or lack thereof. And this culture is of its (unintelligible). The reality is that I think if people are made to be more aware of the financial repercussions of living and building in high-risk areas and the fact that when their house gets knocked over everybody pays for it -- I think if you made them more aware of it and more appreciative of it, that might have an impact.

You know, the problem is that some community in Happy Valley on the coast of Florida gets knocked over by a storm and everybody from Happy Valley moves back there to rebuild their houses, and the rest of us have to pay for that; either because we had to pay into some sort of national guaranteed fund or because we're all paying slightly higher premiums, because the effect shook out through the entire industry.

The thing is, our economy is so vast and nobody really feels it. Or what little they feel, they can't attach it to anything. So it's like trying to get that awareness out there -- that's what you need, but how are you going to do it? Unless Hurricane Omega takes out Long Island. And you're going to have to have something that is so big, you're going to need a catastrophe of that size to really shake people up and realize, yes, we can't have it entirely both ways. I mean, this all has to be paid for somehow.

So, yes, I would advocate a little bit -- I think the insurance industry -- major insurance is discriminating risk. And in many ways, our government -- kind of helps them not -- it sort of makes it impossible for them to discriminate risk.

It's seen as some sort of sinister activity: 'Well, you're discriminating against me.' Hell, yes. That's what insurance does. It's a (unintelligible due to laughter) racket, you know.

But I think we give them that latitude sometimes. And if they're going to flee the market, then it's up to the government to decide, 'Well, are we going to become the insurer of last resort and make everybody else pay for it, or are we going to make everybody understand what it's like to go naked?'

I mean, the world's a dangerous place. Most parts of the world live without a lot of insurance coverage. Americans don't realize how good they have it. It's not like you have a God-given right to be insured for everything. You have to roll your dice and take your chances.

Mr. FRIEDMAN: I don't think the public appreciates, really, the fact that even when insurance is not available, how much they really do pay, because you see like in New Orleans or after Hurricane Andrew how much federal money was pouring in. There's been a lot allocated to New Orleans. I don't know how much has been spent. That's a good question now. There's a lot of promises.

But you're looking at another $20 to $30 billion at least, just up front. They're talking maybe $100 billion. I mean, that money is not made up. Or what it eventually is, it's borrowed. Right? We float more T-bills.

And essentially, it's our debt. I don't think people appreciate that either. They don't know what the national debt means. 'It's not my debt; it's the government's.'

No, the government by the people of the people. Right.

I'm so intrigued by the -- you know, Allstate has a big stake. Allstate is not promoting this altruistically. They took a huge hit. They're pulling back in "cat"-prone areas.

I'm not totally sold on the national "cat" plan yet, though. But I'd like to look at it a little more and see if it might be viable. If they allow insurers to price according to risk. I mean, that's a big factor, because that's another subsidation (sic), is when you artificially suppress rates. And that's been the case in a lot of these "cat"-prone areas.

Ms. DAKIN-GRIMM: So the answer is we make Mr. Friedman maybe the insurance czar. And then prices can be what they should be.

Mr. FRIEDMAN: Absolutely, as long as you don't charge more than -- (audience laughs)

Mr. COFFIN: 'As long as my rates don't go up.'

Mr. FRIEDMAN: It's very, very interesting stuff.

Ms. DAKIN-GRIMM: On that, I have to cut this off. But let's thank our panelists for an excellent presentation. (Applause)
And thank you all for joining us. We'll invite you again in about six months. Thank you.

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06.00
07.00
LONDON, ENGLAND 08.00
Deposing Lloyd's and London Market witnesses
09.00
10:00
LOS ANGELES 11:00
Arbitrating dispute between cedent and reinsurers over allocation of long-tail claims
12.00
13.00
NEW YORK, NEW YORK 14.00
Defending insurers in class action suits over vanishing premiums
15.00
16.00
BERMUDA 17.00
Meeting with reinsurers on issues of fraud in procurement of treaties
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