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BEFORE

THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

REGARDING

STABILIZING INSURANCE MARKETS FOR COASTAL CONSUMERS

September 13, 2006

Mr. Chairman, Mr. Kanjorski, Members of the Subcommittee, thank you for inviting me to testify today on behalf of Lloyd's of London, the world's leading specialist insurance market. Last year's record-breaking storm season presented significant challenges to the global insurance market. Although the first half of this year's Atlantic storm season has not proven as deadly or as costly as the early part of the 2005 season, it is nevertheless important to continue the dialogue on protecting the US economy from large-scale catastrophic losses. Lloyd's is very pleased to participate in today's hearing and commends the Subcommittee for recognizing the continuing need for stability in coastal markets.

Lloyd's is the world's best known -- but perhaps least understood -- insurance brand. This is because Lloyd's is not an insurance company, but an insurance market made up of underwriting members. Members of Lloyd's, or "capital providers" as they are often known, are companies, individuals, and limited partnerships that accept insurance business through syndicates on a separate basis for their own profit and loss. In other words, members of Lloyd's are not jointly responsible for each other's losses. Collectively, however, Lloyd's has established a Central Fund, which can be made available to meet any portion of any member's liabilities that the member is unable to meet in full. These assets are held on a mutual basis. Thus, policyholders at Lloyd's are protected by a chain of security that is unrivalled in the global insurance market.

Although Lloyd’s Underwriters write business on a non-admitted basis in all US markets, Lloyd’s is licensed only in Illinois, Kentucky and the US Virgin Islands. Therefore, in Florida and the Gulf States, Lloyd’s functions as an eligible surplus lines insurer and a reinsurer. In this region, Lloyd’s is a significant direct insurer of industrial and utility property, particularly in the offshore oil and gas sector. Lloyd’s also insures many other businesses and high-value residential properties.

Within hours after Hurricane Katrina hit the coast, Lloyd's established an emergency hurricane response team in London and the US. We also launched a toll-free helpline to deal with urgent policyholder concerns, which took thousands of calls and helped more than 99 percent of policyholders initiate contact with the right people in our marketplace. And Lloyd's syndicates were the first to pay claims to the offshore energy industry after Katrina decimated the Gulf.

More importantly, Lloyd's continued its 318 year record of paying claims on tough risks. We first made our reputation in the US a century ago when we paid out more than $50 million ($1 billion in today's dollars) to meet all claims in the wake of the 1906 San Francisco earthquake. This decade has been a challenging one for all insurers, Lloyd's included. But we have proven that we are up to the challenge. We paid more than $3 billion in claims after the 9/11 attacks, $2.7 billion relating to the 2004 Florida hurricanes, and almost $6 billion related to Hurricane Katrina and other US hurricanes last fall. But despite these record-making catastrophes, Lloyd's scored "A" grades from both Standard & Poor's and Fitch after the 2005 hurricane season, and these ratings were affirmed at the end of the year.

The US is the largest overseas market for Lloyd's underwriters, accounting for over one-third of all Lloyd's premium income in 2005. We insure 56 of the 65 businesses that comprise the Dow-Jones index. In addition, we maintain approximately

$13.7 billion in US trust funds to secure our liabilities to US policyholders. The US is a vitally important market for us.

We thank the members of this Subcommittee, as well as the other members of the House Financial Services Committee, for leading the way in promoting serious analyses and dialogue on the tough issues, such as catastrophe mitigation and regulatory efficiency and uniformity, which necessarily impact the stability of both the US economy and our global industry.

Addressing the Potential for Future Catastrophic Losses

Researchers have estimated the chance of a Category 3 or stronger hurricane making landfall on the East Coast this year at 64 percent. So far, this year's hurricane season has not yet proven as devastating as 2005—but the second half of the season has just begun. We are proud of our record, but our responsibility to our US policyholders going forward is to avoid complacency. We realize that we must ensure that we can continue to meet the future challenges that the marketplace and Mother Nature will present. We commend you, Mr. Chairman, Ranking Member Kanjorski, and the members of the Subcommittee for recognizing that, although markets have recently responded to large-scale disasters, the Federal government must also avoid complacency and anticipate future challenges.

Specifically, you have recognized that the Federal government's role is broader than simply providing immediate relief for losses and that policy initiatives and mitigation measures play a crucial role in stabilizing markets.   Regulatory and litigation reform for the underlying direct market can have a material beneficial impact on the availability of reinsurance capacity. Likewise, land-use planning and public policies which affect the changing concentration of exposed values in coastal states may be an important component of long-term stability.

While the insurance and reinsurance markets tend to adjust to dislocations on their own in time, public policy can and should play a role in improving that market response. For example, most of the natural disaster bills which have been introduced by members of the Financial Services Committee over the past year have included mitigation measures, such as encouraging the development of mitigation programs by States as well as standards for the construction and maintenance of buildings to protect against future disasters. Reinsurers and direct insurers alike are interested in the efficacy of these measures. As a major US income taxpayer, Lloyd’s also notes the dialogue initiated by this Subcommittee and in the tax-writing committees regarding the use of tax policy to encourage expansion of natural catastrophe risk capacity.

At Lloyds, we have our own initiatives to meet future challenges while continuing to protect our central assets and reputation. Part and parcel of that is to ensure that all underwriting syndicates perform to Lloyd's standards, which is the responsibility of the Lloyd's Franchise Performance Directorate. We will also continue to refine our Realistic Disaster Scenarios, which help us anticipate potential losses and ensure that both syndicate-level and market-level exposures will permit us to handle catastrophic losses.

Last year, one of our Realistic Disaster Scenarios asked underwriters to analyze their ability to handle a windstorm in the Gulf of Mexico resulting in losses of $60 billion. Hurricane Katrina proved that scenario to be realistic indeed. The severity and frequency of catastrophic events is increasing and we must make sure that we stay ahead of them. This year, Lloyd's will add two new scenarios with losses of up to $100 billion.

What role global climate change plays in recent or future losses may be subject to debate, but Lloyd’s has taken several steps to contribute to worldwide efforts to find some answers. We have joined a U.K. organization that aims to connect business with the latest science and which also participates in a range of specific climate change action groups. We have also agreed to sponsor two Ph.D. climate change research posts in leading universities. Finally, but importantly, we have set an example by working to reduce energy usage in our own building in London.

Positioning the Global Insurance Market to Respond to Potential Catastrophic Losses

As we consider our responsibilities to our policyholders and how to continue meeting them, US lawmakers and regulators might also consider their responsibilities to help ensure that the global insurance market is well-positioned to handle increasingly severe and costly natural disasters in the US. In this regard, we would like to raise two specific issues with you today.

First, we believe it to be important to create greater uniformity, simplicity and efficiency in State regulation of surplus lines insurance, to streamline placements for large commercial policyholders, and to modernize State regulation of reinsurance. We, therefore, commend your leadership, Chairman Baker, and that of Mrs. Brown-Waite, and all cosponsors and supporters of H.R. 5637, the Nonadmitted and Reinsurance Reform Act of 2006. We were gratified to see the Financial Services Committee take such a strong bipartisan stand in favor these goals, with invaluable leadership from you and Chairman Oxley. We pledge to continue to work with you and your colleagues on both sides of the aisle in Congress, state insurance regulators, and other interested stakeholders to continue to build consensus for creating greater uniformity in surplus lines and reinsurance regulation as well as in other aspects of insurance regulation.

We also recognize the efforts of Representatives Shaw and Foley and other members of the Ways and Means Committee to examine how tax policy might be used to address capacity issues.

Second, it is important to recognize that most of the reinsurance protection provided to the United States market comes from reinsurers based outside the United States. It is altogether appropriate to use global capacity as this provides a buffering effect to a blow that would otherwise have to be sustained entirely by the local economy. Such reinsurance provided substantial benefits to US insurers in the face of large-scale catastrophic losses resulting from September 11 and the 2004-2005 hurricane seasons. Global reinsurance protection continues to be a vital element in the US insurance industry's ability to meet the challenges of the future.

Data from the Insurance Information Institute demonstrates the significance of the foreign reinsurance market to economic recovery in the Gulf and Southeast coasts in particular. In 2005, some primary insurers with exposure in those regions had up to 60 percent of their gross losses covered by reinsurance. Approximately one-third of the insurance industry's $60 billion loss from last year's hurricanes was paid by reinsurers based outside the US, including Lloyd's.

One way to address the capacity issues before us today is to maximize the participation of the world's strongest and most stable reinsurers in the US catastrophic risk market. This can be accomplished by reorienting US credit-for-reinsurance rules to focus on soundness and security. Specifically, the rules should focus on the financial quality of reinsurers and the security that they provide rather than the geographic locations of the reinsurers' headquarters. Appropriate weight should be given to external valuators such as the financial ratings assigned to reinsurers by third party rating services and the actual claims paying records of reinsurers.

Conclusion

Once again we thank you for your leadership. We also urge you to continue your efforts to ensure that the global reinsurance market as a whole is in the best position to meet the insurance needs of US consumers, especially in high-risk coastal areas where specialist overseas insurers such as Lloyd's provide such a critical source of insurance and reinsurance capacity.

Thank you for the opportunity to testify today.