

THE TIME FOR TRANSPARENCY: RESTORING TRUST IN AMERICAN BUSINESS



Remarks to the EXECUTIVES' CLUB OF CHICAGO October 29, 2009

Thank you, Richard, and hello Executives' Club of Chicago and guests. Thank you for inviting me here today. I'm honored to be addressing one of our nation's most vibrant business forums in one of our nation's most vibrant cities.

When I came here three months ago for the naming of Willis Tower, one of the things that struck me about this great city was its ability to reinvent itself. You did it after the Great Fire of 1871 and, more recently, by turning this city into a global center for the financial sector and the service economy of the 21st century. When Chicago lost the Olympics bid, I was as disappointed as anyone, but I know that Chicago will bounce back. The Olympics last, what, two weeks? Chicago is forever.

Chicago is a city that understands that yesterday's solutions don't work in today's world and that today's operating models aren't going to keep you in business tomorrow. Harry Truman once said something about America that describes Chicago perfectly. He said that America "was built not on fear [but] on courage, on imagination and an unbeatable determination to do the job at hand." I'm someone who believes passionately in America and in the ability of businesses here in Chicago and everywhere else to do the job at hand and make the world a better place. I think big, as you've probably guessed from what we did at Willis Tower. And, for me, thinking big means believing in our ability to take a dream and turn it into a reality.

Let me give you an example. My first job after graduating from the College of William and Mary was teaching history and coaching at a high school in Langhorne, Pennsylvania. The football team was 0-11 the season before I took over. The first day of practice, a reporter asked me whether I was going to have a running team or a passing team. I said, "Ask me after practice."

First I told the quarterbacks to throw me some passes. One of them, the ball slipped out of his hands. Another kid threw the ball over my head. Then I threw a few passes to the receivers. The ball bounced off their helmets and shoulder pads. I decided we were going to be a running team.



More importantly, I told them to believe in themselves and start trusting each other. I told them they were so good, they could forget about a huddle, and just walk up to the line of scrimmage and point in the direction we were going to run. We actually did that – talk about transparency. We told the other teams what we were going to do, and guess what happened. They couldn't stop us. We went 11-0 that year and we won the state championship. It happened because we dreamed big – and we trusted each other to do what needed to be done.

Our economy is just coming off an 0-11 season.

By some estimates, as much as \$50 trillion of the world's wealth was destroyed in the financial crisis. This is something most of us have not known in our lifetimes – a decline as huge as the Great Depression, which started, incidentally, 80 years ago today – with the Wall Street Crash on October 29 – better known as Black Tuesday.

In 2008, household wealth plunged by \$11.2 trillion dollars in the U.S. alone, the most in a single year since recordkeeping began in 1952. And many question whether we will ever return to historical levels of prosperity.

But, as a nation, we have lost much more than money during this recession. As also happened eight decades ago on Black Tuesday, the financial crisis has cost us an ingredient that is essential for true recovery. You can't buy it. You can't borrow it. You have to build it. You have to earn it. It's that old thing called trust.

Consider this – in the respected Edelman Trust Barometer survey this year only 38% of respondents in the United States said they trust business to do the right thing – a 20% drop from 2008, and worse than after the Enron scandal and the dot-com bust. Worst of all, only 17% said they trust information from a company's CEO. *Seventeen percent.*

That's one out of six people. That means only one in six of you in this room believes what I'm saying! Would all the non-believers please stand up?

What happened? How was the trust destroyed? In my view, it comes down to a lack of transparency and, in turn, accountability. I'm speaking in particular about a lack of transparency with regard to risk and conflicts of interest.

The economy is now starting to emerge from one of the most difficult recessions in our nation's history. Green shoots of confidence appear to be sprouting. But I'm afraid that these shoots will be trampled by all the people running to stuff their money under their mattresses because they still don't trust the financial markets and the economy. Things

have to change. The old models just aren't going to work. Smart people on Main Street and Wall Street – and there's no difference in my book, by the way – won't accept them. We have to start by restoring trust and to do that, we need a new approach to transparency.

I'm a big believer in the notion that transparency and value are linked. If a company is really providing value, if their products and services are helping their clients, they're going to have no trouble selling those products and services. As a result, they'll be making lots of money and they'll have nothing to hide. The problem we had in the financial services sector was that they weren't delivering enough value to grow their top line. So financial institutions wrapped risk in derivative instruments so complicated that not even the experts could explain them. Derivatives aren't new, but the CDSs and CDOs went to levels no one had ever seen before. In the end what it amounted to was just financial engineering that offered no true value to people or businesses – all of it based on the assumption that property values would go up forever.

Mistrust is not new. Neither is greed nor the ability of some people to stretch the truth or delude themselves. Remember when cigarette makers came to Washington to testify that cigarettes didn't cause cancer? At the same time, a guy name Madoff was making unbelievable returns on his investments – by faking account statements. And Major League Baseball is still dealing with fallout from the steroid scandal, which forced baseball fans like me to question not only the players' achievements, but their honesty and the very integrity of the game itself. Like it or not, this kind of behavior is part of human nature. There may be no way to change it, but there is a way to fight it: transparency.

Let's look closer at transparency and what people mean when they talk about it. There are three transparency models, in my view.



The first is the “zero transparency” model. This is what you saw a lot of at the height of the credit boom. In an age of cheap money and public faith in ever-rising home values and stock prices, it worked. Business leaders were so focused on short-term profits that they threw out long-term planning, they turned their backs on risk and they hoped it would all work out. It was “dine and dash” on an unimaginable scale. Would transparency suffer under the rules of that game? You bet transparency would suffer. Accountability was obscured, transparency was eliminated, and, when the bubble burst – as of course it would, not being based on value – trust evaporated.

Then there is “lip-service transparency.” This was very popular for most of the last decade. There was maybe a veneer of integrity and honesty, but what it amounted to was people saying, “I told you I was going to rip you off so now you can’t complain if I did.” A lot of clever people spent a lot of time studying the rules so they could come up with ways to get around them. Let me give you a very simple example. I like to work out and I have a favorite energy drink. The manufacturer is required to include nutritional information, right? So, do they tell me how many calories I get if I drink a bottle? Of course they don’t. The bottle says it has 10 calories – but when you look more closely it has 10 per serving – and the bottle has *two and a half* servings. And the list of ingredients looks impressive – but I don’t really know if they’re doing me any good.

There’s another model of transparency that I believe we must embrace as business leaders – that we embrace at Willis: true transparency. It means being up-front with our various stakeholders – whether they’re shareholders, clients, partners, employees or the communities in which we do business – and explaining what’s in it for them and what’s in it for us. It means educating them in a clear and straightforward way about the risks and opportunities so they can make

informed decisions based on their best interests. For the makers of my sports drink, it’s telling me straight that there are 25 calories in this bottle.

True transparency is about creating businesses that value open communication, appreciate candor and celebrate clarity and courage. It’s about living by a set of principles that will make you proud, rather than hiding behind a set of rules you know are wrong. It’s about making better decisions and it’s about good behavior.

So I’d like to propose four steps we can take to establish true transparency and begin to restore the trust that is vital to a sustained economic recovery and real growth:

1. Create a Client Contract
2. Elevate Risk Awareness
3. Voluntarily Disclose your Risks
4. Tell Our Story

First, we need a real contract with our clients – let’s tell them straight out what they can expect from us – like the Client Bill of Rights we introduced at Willis a few years ago, where we lay it out in black and white.

And let’s address the conflicts of interest that affect the way we do business. We must manage them transparently and we should resolve them in the interests of our clients.

Some of those conflicts are all too familiar from the financial crisis – the conflict faced, for example, by the rating agencies, which were paid by the issuers of structured finance products to rate them.

In my own industry, contingent commissions remain a major source of conflict. These are the commissions brokers earn from insurance carriers for steering business their way. Not, please note, commissions the brokers earn on the value of the service that they provide to their clients.

Contingent commissions are based on the volume or profitability of coverage that a broker books with a specific insurance carrier. So the client is led to believe that the commission the broker is getting on the

business is less than it actually is. A client may think the broker is booking 6% commission. But that's up front. There could be more – say, 5% – on the back end that the broker only earns if the carrier's profits on the premium hit a certain level. To meet that hurdle, a broker may not push as hard to recover a claim on behalf of his client. It's like your interior designer recommending a certain bathroom tile from a certain supplier. They say it's a great tile, made in Italy, but maybe the designer is getting a cut from the supplier. It could be a lousy, overpriced tile, even if it is from Italy, and you won't know it till it looks just as lousy on your bathroom wall.

I am convinced the only way to resolve the conflicts inherent in contingent commissions is to stop taking them. We stopped taking them because we want to be paid for the value we provide our clients, not the insurance companies.

Many in our industry believe that simply telling clients that they are taking contingents makes it OK. I disagree. With contingents, telling your clients you take them does not resolve the conflict. That's just lip-service. It does not change the fact that your true incentive is to act in the interests of someone other than your client – and that when push comes to shove you're not going to fight for the best deal in the marketplace or advocate fiercely to recover a claim if you know your compensation from the insurer will suffer. It sounds like transparency but it can never be true transparency.

The second step is risk awareness. As business leaders, we need to embrace true risk assessment and risk management, something I firmly believe is to our strategic and financial advantage.

My industry lives and dies by its ability to identify and assess risks and then help our clients manage those risks. Only when those risks are fully known is it possible to make good business decisions that preserve and enhance long-term value.

I'm not the only one thinking in this direction. There are moves afoot in Congress to compel public companies to establish risk committees

reporting to their boards and hold directors personally liable for excessive risk-taking.

Senior executives and boards need to take a far broader and more comprehensive view of risk than they currently do and reflect this in their decision making and oversight. Companies should move to hire chief risk officers and establish risk committees on their boards. They should demand true enterprise risk management because they need it now more than ever before. The fact is that the risks of doing business are increasing – and they'll continue to increase.

One major new risk was underscored by the financial meltdown – the interconnected nature of business due to globalization. Many economists were surprised by what a house of cards the worldwide financial system had become. Take away one card and the house comes down. Interdependence is both a benefit – and a risk – of contemporary business.

And there's more – cyber security, the rise of terrorism, climate change, piracy – all of these issues raise risk for businesses – not to mention the increased liability risk that directors and executives of public companies may well face from new legislation and regulation in response to the financial crisis.

None of these risks existed when I was growing up. The only terrorist I knew was my brother. But the risks aren't going away.

The answer, however, is not just buying insurance. A lot of companies buy insurance instead of effectively analyzing risk. When that happens, insurance becomes a commodity, like soybeans or lumber – you look for the cheapest price. This is not the answer to risk.

The answer is to understand the broader concept of enterprise risk management – and to have well-tailored insurance that protects your business. You should be



measuring risk and the cost of risk and then tailoring your coverage – or improving your operations – accordingly. Otherwise, you risk not only money, but the trust of your customers, employees and the communities where you operate.

Step three. Businesses should put a stake in the ground and begin voluntary disclosure of the risks we face – and our corresponding insurance coverage.

If you're an investor in a publicly traded company, a lot of information is available to help you assess the risk of your investment. But it's still just lip-service transparency. Insurance coverage is fundamental to a company's risk profile – yet it's not a reporting requirement.

Why should the business community voluntarily disclose their insurance coverage? Well, for one thing, it might be a good idea to do it before someone else makes us do it.

For another, investors could see this as a plus. As things stand, investors put their money into companies and sometimes have no idea whether the balance sheet has effectively been protected or mitigated against risk.

Final step! As business leaders, we need to do a better job of telling our story - and explaining to Main Street the role business can and should play in society and the economic recovery.

We get so focused on balance sheets we sometimes forget that we provide most of the jobs and the health benefits in this world. We deliver value by providing services and products that help people live their lives. We help solve the world's problems. We've got to tell people this. Business has a PR problem right now.

That's certainly true for the insurance industry. Clearly, some areas of our industry, like the bond insurers and AIG, found themselves at the center of the financial meltdown because they were not as transparent as they should have been about the exotic products they were

offering. As I like to say, they should have stuck to their knitting. They should have stayed boring like the rest of us.

But the fact is that insurers are fundamentally sound. In the past two years, something like 125 banks have failed in the United States – compared to just nine property and casualty insurers. Policies continue to be issued and claims continue to be paid.

The insurance industry is also a provider of stable, affordable capital as well as a valued risk adviser in a time of scarce capital and huge risk. That capital advantage is often overlooked and it shouldn't be.

The transfer of risk from investors to the insurance market is built on contingent capital, and this will be essential to driving growth, recovery and prosperity. Always necessary, insurance becomes even more important during times of economic duress, because companies need to aggressively manage risk.

The cost of the contingent capital we provide is reasonable. Take, for example, a \$500 million construction project. If the premium rate is 3%, the cost for a half a billion dollars is \$15 million. That's a pretty good deal. The point is that the value of insurance – of the products, services and capital we provide – is greater than ever.

I tell everyone in our industry that we need to demonstrate to the world the fundamental role we play in the capitalist system and why that's a good thing. Without insurance, loans don't get made, goods don't get produced, buildings don't get built and injured workers don't get compensated. What portion of the \$62 trillion GWP, Gross World Product, does insurance account for? I would say the correct answer is 100%, because nothing happens without insurance.

More than that, we're the silent heroes of recovery and we shouldn't be so shy about saying it. Being boring doesn't mean being quiet. You can be loud and boring. We have to tell people that insurance makes investment possible and affordable. In the midst of this terrible credit crunch, we're the foundation of credit.

Kevin Landis, one of the nation's best known portfolio managers for high-tech funds, has an interesting perspective. He said that disasters, whether natural or man-made, are forms of economic stimulus. I quote: "Most of the replacement comes out of insurance instead of out of normal cash flows. That's the reason that any disaster gives you a silver lining of economic recovery."

Let me give you just one example – Hurricane Katrina. After the levees burst in New Orleans in 2005, it was the insurance industry that covered the lion's share of rebuilding the Big Easy – not FEMA or the state of Louisiana. Without that insurance, reconstruction would be nowhere near where it is now.

Our industry needs to stand up and contribute even more to solving the major issues facing our society – whether that's health care reform or environmental safety.

We have the expertise. We have the insight – sophisticated analytics and intellectual capital. Yes, we've made some mistakes. But we have an important role to play in the world economy, and we need to do a better job of explaining our value.

Ladies and gentlemen, I believe, as I imagine many of you do, that our economy is starting to heal. Let's not miss this opportunity to capitalize on the promise to rebuild. I know it's tempting to look away, forget the cause of the financial crisis and return to old ways.

Right now, life insurance settlement contracts are being sliced, diced and sold just as mortgage-backed securities were not long ago. These are big bets against people living longer, healthier lives. What a thing to bet against! And it could all blow up if someone finds the cure for cancer.

In my own business, a time could soon come when Willis and its big three competitors will be allowed to take contingent commissions again. One big insurance broker has already been given the green light by the insurance regulator here in Illinois to do just that. And New York-regulated brokers may be able to do so as well.

But we've already decided at Willis that we're not going to go back to the old ways – we're looking to the future and we will continue to put in place the measures that will enhance trust and transparency, not undermine it. It may mean that Willis will be the only company not taking contingent commissions – but that's OK with me.

Of course, some will cling to the familiar, and keep shooting for quick, short-term gains. That's a lot easier than pursuing big ideas. But the businesses that will lead the way to recovery are the ones that will deliver true value to our society in ways that create jobs, contribute economic security to our communities and reward their stakeholders over the long term. The successful companies will be the ones that recognize and embrace the need for change and deliver the products and services that our customers need for today's world. New companies will rise to fill the gaps left by old companies that failed to evolve and adapt. The companies that will win are the ones with



ideas that meet today's needs and have the ability to bring those ideas to fruition because they think big and dream. And the ones that thrive will, as always, be transparent because they have a great story to tell.

Let me conclude with a brief story about someone who preferred to look back. In 1829, Martin Van Buren, then Governor of New York, is said to have written to Andrew Jackson, President of the United States, warning of the great evils of a new technology: the railroad. He wrote:

Dear Mr. President:

The canal system of this country is being threatened by the spread of a new form of transportation known as 'railroads.' The federal government must preserve the canals for the following reasons:

One. If canal boats are supplanted by 'railroads,' serious unemployment will result. Captains, cooks, drivers, hostlers, repairmen and lock tenders will be left without means of livelihood, not to mention the numerous farmers now employed in growing hay for the horses.

Two. Boat builders would suffer, and towline, whip and harness makers would be left destitute.

Three. Canal boats are absolutely essential to the defense of the United States. In the event of the expected trouble with England, the Erie Canal would be the only means by which we could ever move the supplies so vital to waging modern war.

As you may well know, Mr. President, 'railroad' carriages are pulled at an enormous speed of 15 miles per hour by 'engines' which, in addition to endangering life and limb of passengers, roar and snort their way through the countryside, setting fire to crops, scaring the livestock and frightening women and children. The Almighty certainly never intended that people should travel at such breakneck speed.

I can assure you that if Mr. Van Buren were here today, he'd be one of the disbelievers in the audience – and he'd be one of the people holding us back. Where would the great crossroads city of Chicago be without the railroads? I prefer to take my lead from Harry Truman. Let's proceed as Chicago has always done – with imagination, determination and trust in the future.

Thank you.

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