Fatal Flaws in Global Risk:
What You Don't Know Might Kill You!

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Thank you very much for that warm introduction. I want to thank Dean Brown, Professor Gimeno and my friends at INSEAD for doing me the honor of inviting me to participate in this very prestigious event.

I very much appreciate the privilege of being here today and addressing this group of future business leaders. I'm especially honored when I look at the previous speakers who have been behind this podium this year and over past years, leaders of the industry from all around the world. INSEAD is known the world over for its ability to attract people and ideas with the goal of helping to transform organizations. And this is important, as in today's world firms like Aon need leaders with the knowledge and sensitivity to operate anywhere in the world.

I have been with Aon nearly five years, and I have to say that it has been an incredible pleasure over that time to work with my colleagues from around the world. I have a great perspective about France from colleagues such as Vincent Redier, who as Chairman of Aon France and through his many years of service to our clients has contributed so much to the growth of our firm, and from our CEO of Aon France, Damien Guermonprez, who recently joined Aon and who already is making a strong impact.

However, the reason in large part as to why I am here today is due to my good friend Dick Verbeek. It was Dick who created the momentum for what has become a strong partnership between INSEAD and Aon, and which resulted last December in the creation of the Aon Dick Verbeek Chair in International Risk and Strategic Management.

We decided to endow this chair because we truly believe that risk affects all areas of business strategy, and the interaction of these two forces is an area that we believe merits further research. And we could not think of any finer way to honor Dick's many achievements in our industry. We have already established a very solid working relationship with Dean Howard and Professor Gimeno, and we look forward to bringing the results of this research to benefit our clients around the world.

As you may know, I joined Aon from McKinsey, where I led the financial services practice. Having watched the risk management industry for over twenty years and Aon in particular for over a decade, I came to the firm with incredibly high expectations. Having traveled the world over and meeting with many of my Aon colleagues and our clients, I find now that my high expectations have been significantly exceeded.

I have been asked to share a few words on a topic that is often discussed, but I would suggest to all of you more often misunderstood, and that is the topic of global risk.

For today, I want you to think about risk in a slightly different way. I want you to think about and consider that the desire to take risk, the ability to understand risk, is one of the fundamental drivers behind our global economy. Without it, we cannot make the investments, we cannot take the initiatives required to succeed. And if we do not understand it or manage risk correctly, it could be damaging to the future of an enterprise.

Everybody talks about risk from a downside perspective. We see that every day. Whether you are watching CNBC, reading the International Herald Tribune or Le Monde, you see the downside of risk. But I believe that risk is much more about opportunity. It is, in fact, a requisite. Risk is a building block for opportunity like almost nothing else.

In some respects risk is very much married to innovation. It is married to exploration and it is married to expansion.

So what are the risks out there? What are the issues that companies face today? What are the upsides, what are the downsides? What are the opportunities that they face? What are the issues that are going to impact their income statements? What are the things that are going to impact their balance sheets? More importantly, what is the risk of inaction? What is the risk for firms if they do not go after opportunities? What is the risk of standing still?

How do companies calibrate risk? What do they think about in terms of risk? As you see, risk, and the opportunity to think about it, is everywhere.

Insurance is not seen as the most glamorous of industries, so let’s look to some that are for our examples. From filmmaking to diamond production, from outer space and space tourism to cyberspace and some of the world’s busiest websites, Aon serves global firms that must make critical risk decisions at every stage of their growth and development.

Aon is a global firm – you will find our brand in over 120 countries around the world and over 38,000 colleagues focusing on one idea – how can we help a client or how can we help a colleague help a client.

Many of our major clients are global – and they have to decide whether they want to grow or not. Clients have to ask questions such as, “Do we want to grow in Iceland or Greece, where there is a rise in exchange transfer and sovereign non-payment risk as well as an increase in widespread protests and street disturbances? Do we want to invest in countries such as Iraq or Venezuela, where volatility in global commodity prices is contributing to political and economic instability?” Each and every company has a strategic decision to make: “Do we grow or not grow?” And at the crux of that decision is risk management.

Since joining Aon I have focused on two key constituents: One is my Aon colleagues - I’ve spent time in Asia, Europe, and the Americas meeting with hundreds of colleagues. The other is our clients - I talk to about 100 clients a month, over 4,000 clients in my time to date.

And in a nutshell, they tell me and my colleagues who visit them that they are concerned about financial risks in the marketplace, whether they are related to the economic slowdown, commodity price risk, or cash flow and liquidity risk. They also are concerned about whatever regulatory or legislative changes that will take place to address the concerns surrounding the global credit crunch. And they continue to pay close attention to concerns associated with reputation risk.

So what I would like to do today is to draw directly from that experience and give you six perspectives or observations that come directly from those conversations with CEOs, CFOs, risk managers and treasurers, from Asia, Europe and the Americas; six observations that I think they would want you to know about how they see risk, and talk about the fatal flaws if you do not address it.

Misunderstanding Risk

Observation number one: Misunderstanding risk can be a fatal mistake. I have talked to many CEOs whose companies have gone through tremendous turmoil because they misunderstood risk. What is it, how big is it, what is the priority? Consider the fact that over $32 billion was spent last year in the U.S. alone on governance risk management and compliance, an increase in excess of seven percent from 2007.

According to a recent survey of over 300 financial services executives conducted by AF Feldman, more than 70 percent of the respondents believed that the losses stemming from credit issues were largely due to failures to address risk management issues.

Last September, a survey by CFO Magazine revealed that 62 percent of finance executives blamed the current global crisis on risk management’s inability to understand complex financial instruments; nearly three quarters of the respondents said risk management now outranks in importance such issues as long-term and short-term debt financing, relationships with financial institutions, pension plan asset allocation, and the ability to secure equity financing.

There also was a study conducted a few years ago by my old firm, McKinsey that said that when you look at the economics of risk, when an event happens, the impact within the first six months is almost twelve times the actual event. So if a $100 million event happens, the impact is over a billion dollars within the first six months in terms of market cap. That is a huge penalty when you think about how your firm can be impacted if you are not managing risk in an appropriate way.

So misunderstanding risk could be a fatal mistake.

The magnitude is rising

The second observation is that everywhere around the world – the magnitude of risk is increasing. Think about the biggest set of events that ever happened over the course of the last decade. The tragedy of 9/11 in the United States, and Hurricane Andrew in Florida in particular were two of the biggest single events in history up to a couple summers ago. They were $20 billion events. Hurricanes Katrina, Wilma and Rita in the U.S. combined were a $60 billion event; three times the difference. The magnitude is absolutely staggering. Between 1970 and 1990, over a twenty-year period, the average insured catastrophe loss was around $9.3 billion. From 1990 to 2008, the average loss was in excess of $33 billion. Catastrophes cost insurers more than $50 billion in 2008, making it the second costliest year in insurance history.

So, observation number two is, get ready. The magnitude of risk continues to go up. Whether you think it is terrorism-related or pandemic or global warming, the magnitude of risk is definitely increasing.

The complexity is rising
Third lesson: complexity. This was an interesting one for me. Not only is the magnitude of risk increasing; the level of how people understand risk is also going up. As I said before, there were $20 billion in insured losses from 9/11; probably more than that. But according to the U.S. Congress and the White House, last year the U.S. government spent nearly $200 billion fighting terrorism, when you include the wars in Afghanistan and Iraq, the global war on terrorism, and the enhanced security for all of America's global military bases. It's an incredible domino effect which happens.

Think about the threat of pandemic risk. It is an issue of tremendous importance. We have talked with thousands of our clients over the course of the last year on pandemic and have done a lot of work analyzing it. The projected potential impact of a pandemic over a six-month period could be as much as $200 billion around the world, not to mention the personal tragedy that comes with that.

The conversations we have had with clients are about how to prepare for that. But it's incredibly complex. What if you are fully prepared for a pandemic? You and all of your colleagues at INSEAD and around Paris are at home with your PCs. You do perfect work and know exactly what's going on. But nobody else is or does. You are done. You stop. What if as a businessman you have a supplier in China or India? You aren't touched at all. Yet, your suppliers are directly impacted. Bottom line; you are in trouble. I am sure many of you remember all of the activity surrounding Y2K? We talk to clients every day about, what if you spend a few million dollars and nothing happens? What do you say at that point? So risk is an incredibly complex game.

Behind Hurricane Katrina is a set of complexity which is still unbelievable today. Our top 25 or 30 clients had almost $4 billion worth of claims to resolve, and the complexity on how that worked was absolutely stunning. We had a $500 million building that got hit by wind. A $50 million claim. It got hit by a storm surge. A $50 million claim. It got flooded in a city that was hot; the water stayed there for a month and developed mold. That's a $500 million loss. But is it covered? The difference between yes and no is literally the survival of the company. So the stakes and the complexity here are absolutely stunning.

Scrutiny is rising
So, the first point is, you cannot get this wrong. Second, the magnitude of risk is going up. Third, the complexity of risk is going up. The fourth thing I would say is that the level of

scrutiny is going up at an unbelievable rate. I heard this in so many places and always from the risk managers. The CEOs did not say it; the risk managers did. So, basically, CEOs are increasingly asking what is going on with risk management now.

It used to be that the risk manager could do his or her job in the corner without much fanfare. The insurance would be perfectly good. The reinsurance could be arranged. Today, that entire dynamic has changed. Over 40 percent of organizations currently have an appointed Chief Risk Officer, and over 20 percent intend on appointing one in the next three years.

CEOs want to know what is going on, the board of directors wants to know, CFOs want to know, treasurers want to know. Risk management is a big deal. The stakes are huge. In the U.S. Sarbanes-Oxley is out there for firms to deal with. So not only has the stage gotten bigger and the complexity of risk has gotten bigger, the level of scrutiny has gone up in a way that is quite incredible. Suddenly everybody wants to know what the risk manager is thinking about.

When asked, “What’s your risk management strategy?” a risk manager no longer can say, “We don’t have one.” But, to really think about what it means to have a risk management strategy that’s fundamentally actionable, that’s going to change behavior in the organization, that will change performance and protect it from downside, and more important, give it upside, is a very difficult thing. And that’s all about scrutiny.

Opportunity 3: 1 Downside Protection

Observation number five and this is the one I like the most. Risk ideas and solutions are three parts opportunity and one part downside protection. For example, while some of you may have heard of Allstate or State Farm Insurance, two very well-known U.S. brands, how many of you have heard of a U.S. company called Progressive?

Progressive is an insurance company which a few decades ago took a different approach to thinking about risk. This is a U. S. insurance example; but there are thousands of examples like this in every industry and every country. Progressive looked at a body of risk called auto insurance and said, if we put credit scores into auto insurance it turns out that the biggest predictor of whether we are all going to have an accident is our credit score. They put that into insurance scoring.

Right now they understand risk better than anybody else on the planet. They looked at the risk that Allstate and State Farm saw and said, “There isn’t risk there; there’s opportunity”. Before the economic slowdown, Progressive had grown over a period of time from 1986 to 2008, in share price, by roughly 3000%. They’ve done an unbelievable job of tearing through the auto world and gaining market share on two icons – State Farm and Allstate. And it is because in large part they took a different view of risk. And I am suggesting to you behind every great idea is a view on how to think about risk and how to move around risk in ways that other people don’t.

Attack and embrace risk
And the final point; and this came through loud and clear from our discussions with clients, is that risk, how a company views risk, how it thinks about risk, has to be attacked. It has to be managed, it has to be embraced. If a company waits to react, it's too late. It has to think ahead in ways that other people and other companies do not. In terms of the lessons that I have learned from CEOs around the world is, you have to have a strategic view. How do risk managers think about risk in their firms? Is it a big deal or not? Is there more upside or downside? How is it managed? What's the game plan? If they don't have a view, they are losing tremendous opportunity.

How do we respond?
As risk changes, as the business landscape on which we operate and our clients operate changes, so we must change. Many of the clients we deal with at Aon, because of industry, international presence, complexity or sheer size, deal with the most complex and challenging of risk issues and they need truly global partners to help them address those risks.

Pressures from regulatory bodies and governing authorities, global economic slowdown, softening rates and the ever-increasing expectations from clients have exposed the truth of the broking sector today – the traditional business model is just not able to cope. It is out of date and is not designed to survive, let alone thrive in today's world of risk.

As clients face increasing risk exposures and pressures, they demand more from us as brokers and insurers. They want and expect better services, more sophisticated solutions and higher standards of service. If the insurance sector is to respond, then we need to reassess our own expectations. We have to reassess our own business strategies and structures. Are we in a position to respond to those client demands? In every decision we make as a business, I encourage our people to ask the very simple question I outlined for you earlier in my remarks: Does this help our clients or does it help those who help our clients?

It requires a change in thinking, a change in mindset and it requires a great deal of courage to make the necessary changes in our businesses.

It's about understanding the impact the risk manager can have on upside and opportunity, and of course, about downside protection; and risk has to be both attacked and embraced.

I thought Professor Gimeno captured it well with the statement he made when we announced the endowment of the Dick Verbeek Chair. Professor Gimeno said, and I quote:

"There is today a unique opportunity to integrate the insights of strategic management and risk management. Strategy involves making decisions under uncertainty and competitive pressures, and risk management techniques can help us to develop more robust and flexible strategies, and to avoid failures."

Let me make one thing clear: our business is not about failures. It is all about providing solutions for our clients. The exciting challenge for our industry, and which really drives me day to day, is the fact that our firm is part of a great industry in a great position to make a difference at perhaps the time of greatest client need ever. For Aon, this represents both an incredible opportunity and an equally incredible obligation. We have a saying at our firm that “momentum never sleeps.” It either goes up or it goes down, but it never stays the same.

In many ways this crossroad for Aon is the crossroad for the risk management industry. We are in the fortunate position of being able to both lead and manage the outcome. As a CEO, I cannot ask for anything more than this. I truly believe that my colleagues at Aon, and the collective leadership within our industry, are in a unique position to shape the impact of our industry for the next half-century. Our industry can be, should be, and will be, an integral part of the solution to get our global economy out of the current economic crisis. It is an exciting time to be in our business, and it is an equally exciting time to be at Aon.

In conclusion…

As the world changes, so does the global face of risk, as shown by the six observations I outlined for you today. Misunderstanding risk can be fatal to a business; the magnitude of risk is going up in a significant way; the complexity is going up in a significant way; scrutiny is going up in a significant way; and most importantly, risk is about opportunity.

Thank you again for giving me the chance to speak with you today. I am very honored to be here, and I will now put myself at risk and take a few questions.