

# THE ReBrief

THE REVIEW REPORTS FROM THE WORLD INSURANCE FORUM, DUBAI 2008

INSIDE

## Climate change rethink

ENVIRONMENTAL EXPOSURES NEED TO BE RECOGNISED WARNS LEADING SCIENTIST

Reinsurers and insurers must radically rethink their exposures in the face of the increasing threat posed by climate change, delegates at this year's World Insurance Forum (WIF) in Dubai heard.

Dr Anthony Knap, president and director of the Bermuda Institute of the Ocean Sciences (BIOS) said during a panel discussion on the subject: "Trying to go forward by looking in the rear view mirror is not going to work any more."

Dr Knap pointed to changing ocean temperatures and sea levels and said that although the actual changes might seem small, 'the mean changes extremes'.

"Most of you are in the business of reinsuring extremes," he told delegates, singling out the experience of Fremantle where

what had been a one-in-five-year flooding event has now become a one-in-two-year event.

Meanwhile, Charles Kennel, professor of atmospheric science at the University of California, San Diego's Scripps Institution of Oceanography, emphasised that adaptation to climate change impact should be considered alongside mitigation of further changes. Professor Kennel pointed to findings by the Inter-Governmental Panel on Climate Change which suggested even if greenhouse gas emissions had been pinned back at 2000 levels, the globe would still be looking at warming of 0.6C.



by Anthony Knap

"That shows that whatever we do and whatever efficiencies we make, there's still a minimum amount of climate change we've got to adapt to," he said.

The next day Lloyd's chairman Lord Levene said that insurers should use the most potent weapon at their disposal – pricing – in the battle to save the environment.

The industry has attempted to discourage people and businesses from developing in high-risk coastal areas by cutting cover and pushing up prices.

"But then we get criticised by certain legislatures – especially in the US – who then circumvent us by subsidising the risk," Lord Levene said.

"Recognising what these risks truly are is something we have to stand up to." ®

## China is not a threat...

...HOWEVER REGIONAL ECONOMIC SLUMP SHOULD BE FEARED, CLAIMS PATTEN

One of the major risks that global industry faces today is the prospect of the Chinese economy experiencing a downturn, Lord Chris Patten of Barnes told delegates.

During his keynote address on the conference's main themes of globalisation and understanding terrorism, Lord Patten, the last governor of Hong Kong,

who oversaw the handing over of the British crown colony to the Chinese in 1997, said that in the 21st century China would become the largest economy in the world – not in GDP but in overall terms.

"We must not be worried about China being a threat," he said. "We must be worried about



Lord Chris Patten of Barnes

the Chinese economy going wrong," he cautioned.

Keeping things stable between now and this summer's Olympics in Beijing, managing inflation and environmental hazards and further development of the country's private sector were the greatest challenges facing the Chinese leadership, he concluded. ®



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# The view from Dubai

BANKING CRISIS CAN NOT BE ALLOWED TO STUNT INSURERS' PROGRESS ON ENTERPRISE RISK MANAGEMENT

Globalisation, climate change and terrorism were the issues on the agenda at this year's WIF. But as **Ian Dilks** told **Greg Dobie**, ERM and the threats posed by the current financial crisis also dominated discussions

This year represented pastures new for the World Insurance Forum (WIF) Advisory Board as it took its biannual conference outside of its traditional home of Bermuda for the first time.

Although the location was different, one thing remained consistent and that was the extent to which the issues on the agenda were regarded by senior management. The participation of such notable re/insurance executives as Jacques Aigrain (Swiss Re), Greg Case (Aon), Lord Levene (Lloyd's), and Martin Sullivan (AIG) in the leadership panel discussion on the second morning of the WIF (*see page 4*) highlighted how seriously they regarded the opportunities and threats posed by the overriding themes of the conference: globalisation, terrorism and climate change.

The first theme – globalisation – is particularly relevant to this year's host city Dubai and its financial centre, the DIFC. Just over three years ago the DIFC was launched as a global financial centre with the aim of bridging the time gap between the financial centres of London and Hong Kong. What the three hundred plus delegates who attended this year's conference witnessed were the steps it has taken since then towards establishing a commercial insurance and reinsurance market.

Bermuda has played a major role in its initial successes with the 'Class of 2005' members Lancashire and Flagstone having already commenced operations in the DIFC. During WIF they were joined by Gulf Re, which is a joint venture between a longer established Bermudian carrier Arch and the Gulf Investment Corporation (*see page 3*). Dubai is certainly benefiting from the success of Bermuda as a reinsurance domicile and with the increasing development of Sharia-compliant products such as takaful and increasing wealth across the Mid-



The Dubai International Financial Centre

dle East the prospects for further success look good.

However, the WIF conference was not just all about Dubai and the Middle East. In his keynote speech on the opening morning of the event, the honourable Lord Chris Patten of Barnes, the last governor of Hong Kong under British rule, also followed the globalisation theme and offered a timely reminder, given the current volatility in the financial markets, of the increasing importance of the Chinese and Indian economies. Lord Patten also outlined what he considered to be the key challenges facing the globe today: the absence of 'reasonable sufficiency' in the US; resolution of the Palestine/Israel situation and; how Turkey's accession to the EU is handled; the renewal of the nuclear non-proliferation treaty; and the threats posed by 'failing states'. Interestingly he considered climate change to represent much more of an important issue than the threat of terrorism.

One issue that was a particularly popular point of discussion during WIF was the extent to which the perceived weak-

nesses in the banking community's enterprise risk management (ERM) systems had appeared to have failed them during the financial crisis.

Obviously this could have major implications for the insurance industry and it is understandable that recent events may have caused consternation and debate about just how effective ERM can be. There may be real lessons to learn and even some of the criticisms are unfair – the potential impact on key shareholders cannot be ignored.

The industry certainly needs to assess what it can learn from the banking crisis, however with regulators and rating agencies currently leading the drive towards more risk-based capital regimes this should not detract from the progress that has already been made to date and what is likely to still be required. ®

*Ian Dilks is the global insurance leader at PricewaterhouseCoopers.*

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# Gulf Re is ready for rating

JOINT VENTURE PROVIDES GIC AND BERMUDA'S ARCH CAPITAL WITH REINSURANCE PLATFORM IN THE MIDDLE EAST

**G**CC reinsurer Gulf Re is hopeful of obtaining at least an A- insurer financial strength rating, following its launch at WIF, according to its CEO Gail Norstrom.

Gulf Re, which is capitalised at \$400m, was awaiting a licence from the Dubai International Financial Centre (DIFC), where it expects to be based, at the time of writing. The new reinsurer represents a joint venture between Bermuda's Arch Capital Group and the Gulf Investment Corporation (GIC). A holding company has already been established in Jersey and GIC chief executive, Hisham Al-Razuqi said the new venture reflected the rapidly growing economic and risk management opportunities in the region.

He explained Gulf Re would focus initially on "high value oil and gas, industrial, utility and transportation assets", mainly in the six Gulf Co-operation Council states: Bahrain, Kuwait, Oman,

Qatar, Saudi Arabia and the UAE.

Mr Norstrom, former managing director of Aon Risk Services property practice group in the US, said that Gulf Re would be "writing aviation, energy, commercial transportation, marine, engineered risk and property business".

Echoing the earlier comments of Arch Capital Group president and CEO Dinos Jordanou at a WIF press conference he added: "Our aim is to become the leading Gulf-based reinsurer.

"Although we will initially focus on countries in the GCC region, if business opportunities and quality staff emerged in the wider Asian market we may consider these in time." He added that Gulf



Re currently had no plans to introduce re/takaful operations.

Caroline Foulger, partner at PricewaterhouseCoopers said the Arch/GIC joint venture provided further proof of how Middle East financial centres such as the DIFC could benefit from Bermuda's success as a reinsurance domicile. "Some people talk about Dubai becoming an alternative reinsurance domicile to Bermuda but I don't think this will be a possibility for a long time yet," she said. "However, ties between the two will continue to strengthen."

During WIF it was also announced that Willis had become one of the first brokers to be officially licensed in Saudi Arabia by the Saudi Arabian Monetary Agency. The global insurance broker's operations in the country, which have previously operated through the Arabian International Management Company (AIMCO), will now be known as Willis Saudi Arabia. ®

# Regulatory controls welcomed

BERMUDIAN MARKET PARTICIPANTS OFFER LARGELY POSITIVE RESPONSE TO INTERNATIONAL SUPERVISORY MOVES

**B**ermuda's re/insurance market has been broadly welcoming of tighter regulatory control imposed by the island's authorities, according to PricewaterhouseCoopers.

Speaking in Dubai, Colm Homan, a partner in PwC's commercial insurance practice in Bermuda described the market's reaction to the more intense regulatory scrutiny as "surprisingly supportive".

More recent moves have seen the island's regulator, the Bermuda Monetary Authority (BMA) take the supervision of insurance away from government – it is now firmly under its independent wing – and beef up its staff. Insurance companies are subject now to tighter scrutiny, including on-site spot checks and 12 month reviews for new companies.

And although the island has long claimed that it had 'risk-based principles' in place well before the likes of the Solvency II initiative currently being implemented across Europe, Mr Homan said that international regulatory developments had meant that Bermuda could not afford to be perceived as being left behind. Its new regulatory framework brings in a risk-based capital model similar to the individual capital assessments (ICAs) in the UK. The novel part for Bermuda is that the model includes a specific charge for catastrophe exposures.

"From a practical standpoint this will not be a burden for the Class 4 re/insurers who mainly write this type of business," Mr Homan told *The ReBrief*.



"The regulatory environment is growing up and becoming a modern-day regulator. Any time additional regulation is brought to bear, people are going to be nervous because of the extra work but the industry felt the extra regulation would strengthen Bermuda's credibility."

David Ezekiel, chairman of the Association of Bermuda International Companies and a member of the WIF Advisory Board agreed that Bermuda was experiencing a renewed focus on regulation.

"We are successful because we have had a regulatory regime which we think makes sense. One thing I hope we are all mindful of however is that if we strive to look like everyone else, it could damage the model we have created here," he cautioned. ®

# Global concerns addressed

TIPS FROM THE TOP ON MANAGING EMERGING AND EXISTING THREATS TO THIS AND OTHER INDUSTRIES

WIF delegates got the chance to grill senior insurance executives on the state of the market during the conference's Industry Micro-Issues Day. WIF chairman **Michael Butt** moderated.

**T**he themes of this year's conference are globalisation, terrorism and climate change. No doubt the current volatility in the markets will also feature, but since we now appear to be at the point of the cycle where there has been a downturn in underwriting, I would like to concentrate on that first.

**GC:** Is the cycle going to continue? Yes and it is due to how capital is measured and provided. Our shareholders only really care about their return.

In some of the work we've done we have tried to deconstruct what drives insurer profitability. We estimate that 35% to 40% of decisions to increase price are not based on frequency or severity.

Severity and frequency are key issues. While severity is painful, frequency kills and our industry reacts almost a year and a half after changes in frequency. For example, look at D&O. The rate of class actions is at its height right now yet rates in the last quarter were down 19%. The notion of exactly how we react to frequency will contribute to the continuation of the cycle.

**MB:** Our ROE has been relatively low compared to banking.

**MS:** We have poorly performed as underwriters. I think 2004 saw the first combined ratio under 100% for 20 years. The frequency point is a valid one. However, what I am seeing in this cycle is that terms and conditions are holding as rates come down.

**JA:** The industry has been mediocre and the frequency issue is really the most delicate part. Yet for the first time over the past few years the industry has

become more strict in managing capital via share buybacks and sidecars etc. This has been led by the Bermudian markets and for once it is history we are delighted to imitate.

**MS:** The reinsurance market has normally led the retail market. This cycle the reinsurance market is holding firm.

**LL:** We have been criticised a lot recently for letting in new capital but as a market if we stop people from coming in we will fall foul of the competition authorities. We then started to take a look at the people who are criticising us, and they are not reducing their own capacity but increasing it.

**BH:** 2008 will be a difficult year in terms of higher competition. One thing I have seen that is different, is that actuaries are much more involved with loss ratios. I see much more honest dynamics in the market. There may be a change in the cycle due to technical adjustment. The real telling point will be the end of 2008. Will the market really respond to what the actuaries say?

**One theory surrounding the cycle is it is driven by the fact that senior management doesn't know what its underwriters are doing. Do we have confidence that we know what is happening in our companies?**

**MS:** Actuaries are identifying loss trends but technology is also playing a role. The real thing from a management perspective is to get the message through to underwriters. If they realise they are being judged on underwriting profits that will incentivise them.

**JA:** Do too many people talk the talk and not walk the walk? There is more control than there was five or six years ago. It is an extremely varied landscape. Our observation of the primary market is that it is the 20% to 25% of the business that is being churned that seems to be the subject of wild competition.

Insurance demand continues to grow but that churn is where it can be worrying. So-called new business is difficult to judge.

**BH:** The 70% of the business that doesn't churn – buyers and customers have learned there is a value to consistency.

**LL:** Everybody talks, few walk. What can we do? Following the relaunch of our graduate programme, we have been overwhelmed by applications. These problems have been solved in other industries. Better training has got to be one of the answers.

**Is successfully managing investment risk becoming more important than underwriting in our industry?**

**BH:** Insurers that are focused on pure property cat and have an asset liability on a short to medium duration are not as impacted by what is going on in the markets as those in life.

**MS:** They are both very important but they are independent. AIG's underwriters are not being judged on investment income. We manage them very independently and they are appraised on a separate basis.

**LL:** The truth is you can't have one without the other. The ideal strategy is two separate models with two different performing levels.

**What more should the industry be doing to combat global warming?**

**LL:** The industry's response so far has been too little too late. There has been a lot of talk about housing and development around the world in coastal areas but this is the worst place for it. Recognising what these risks truly are is something we have to stand up to. We have to use the one weapon we have and that's pricing. If we don't discourage people from the type of development and investment that's going to cause us to be badly hit, then we're not helping the problem.

**JA:** Where the industry has not done a good job is translating the awareness into actions. How do we contribute to finding solutions which can mitigate the problem, mitigate the symptoms, as well as taking the commercial benefit of the circumstances?

This industry can have a fairly significant impact by associating the talk with the walk.

**MS:** What is your company policy on climate change? Graduates are very interested in this. It is an issue that we can make an impact on. AIG is looking to reduce its footprint, purchase offsets, we are the leading environmental insurer in the world.

**MB:** Our industry has not had a way of globally responding to this, at the

moment we have to do it company by company or market by market.

**LL:** My view is we don't have time for some great international get-together to get these things as it will take years [responding to Crispin Tickell's call for a World Environmental Organisation, see page 6]. It is a wonderful concept but it is not going to deliver for some time.

**MS:** Continued improvement in building codes would be useful.

**Should we consider the withdrawal of cover for polluters?**

**JA:** Do you establish an enforceable standard where no one is going to offer the coverage? When it comes to underwriting in general, other players may think it is a nice place to play. The banking industry has a considerably more cohesive approach. I am not sure this is the case in the insurance industry.

**LL:** It is the indiscipline of the industry. 'That is good – all my competitors have gone out of the industry – I can make a load of money'.

**MS:** Unless you get unanimity someone else would step in. For example, brokers – would they stop advising people? Their competitors would step in.

**Looking at the recent financial volatility, the ERM systems of banks failed significantly. Can we as an industry including brokers, do better than the banking system has done in recent times?**

**MS:** 9/11 proved that risks that weren't previously thought to be correlated actually were. Risk in its broadest sense is now going to be in the boardroom, we have made great progress on managing aggregate risk. The real question is asking how we are managing operational risk, asset liability risk and credit risk.

**JA:** There is probably a benefit to being second in line for regulatory development. Solvency II is one step ahead when it comes to correlation of asset and liability.

It will be essential to see some developments in the US, see more convergence. It is likely that China and India will have ascended to the Solvency II framework faster than America.

**GC:** Banks have spent an enormous amount of energy on ERM. But what are they doing? It means what are the top five issues facing your bank? The banks are really grappling with an issue of what is ERM and we should deal with this as well.

*This is an edited version of the WIF leadership panel discussion.*

THE PANEL



**MB: Michael Butt**  
Chairman, Axis Capital



**JA: Jacques Aigrain**  
CEO, Swiss Re



**GC: Greg Case**  
CEO, Aon Corporation



**LL: Lord Peter Levene**  
Chairman, Lloyd's



**BH: Brian O'Hara**  
Acting Chairman, President and CEO, XL Capital



**MS: Martin Sullivan,**  
President and CEO, AIG

# Europe set for takaful growth

PASSPORTING SCHEME AND ETHICAL CONSIDERATIONS SET TO PROMPT WIDER DEVELOPMENT ACROSS THE CONTINENT

With the announcement of the imminent launch of the first standalone sharia-compliant insurer in the UK [BIIH], Mohammed Khan, director of insurance, actuarial and takaful services at PricewaterhouseCoopers, said in Dubai that he anticipated similar incorporations across continental Europe occurring in the future.

“The big market for takaful is not just across the Middle East or in the UK but in Europe as well,” he told *The ReBrief*.

“It is estimated that there are around 20 million Muslims in Europe [France alone has an estimated five million] and that is not including the potential 70 million Muslims in Turkey. There is significant potential there and within the passporting scheme the hub and spoke model for takaful could be easily applied.”

Mr Khan also said that development of takaful across Europe could be spurred by it being marketed as an ethi-

cal investment. “People are becoming increasingly interested in ethical products,” he added. “It is a way for Islamic finance to move into the mainstream.”

Rating agency Moody’s recently reported that premiums for takaful insurance products are expected to treble by 2015 to approximately \$7.4bn in the Gulf Cooperation Council region alone but some market commentators believe that takaful has not been as successful as it should have been in tapping new markets.

“The key aim in developing takaful was to access previously uninsured individuals with a product that was compliant with their religious belief,” said Andreas Molck-Ude, Munich Re’s chief executive for Middle East and Africa.

“But that is exactly what we are not seeing. We are seeing

new takaful companies coming up but offering existing products to existing policyholders.”

“Takaful companies also need to think about the positioning of the product they are offering,” added Chris Singleton, head of client management for the Middle East at Swiss Re. “There is still this feeling that consumers in the GCC are reluctant to buy anything called insurance and some people are dealing better with that than others.”

However, Mr Khan said it was still early days for takaful. “Twenty years ago in Malaysia no-one would have predicted that takaful and sharia-compliant banking products would have been part of the mainstream finance industry there.

“With the growing incomes of Muslims in the UK and the EU, and the increasing demand for ethical products generally in the EU, takaful products have the potential to be successful,” he concluded. ®



Mohammed Khan

# CEOs can change environment

CALLS FOR INSURERS TO PARTICIPATE IN A WORLD ENVIRONMENTAL ORGANISATION BUT INDUSTRY SAYS IT'S TOO LATE

Re/insurance management will need to think differently in the future if it is to more effectively combat risks to the environment, delegates in Dubai heard.

On the opening day of the conference, James Martin, from the Institute of Science and Civilisation at the University of Oxford warned re/insurers that if the world did not take action within the next 20 years, the cost of solving such problems would become very high.

“This cannot be managed with the management techniques or policies of today,” he warned. “No matter what technology we have, we need to invent

new mechanisms of management to deal with these problems and we need to do it quickly.”

Dr Martin added that the power to instigate change is “not with governments but with chief executives” and later during the conference, the former British ambassador to the United Nations, Sir Crispin Tickell, now director of the policy foresight programme at the James Martin Institute, called for re/insurers to play a major role in the creation of a World Environmental Organisation.



Sir Crispin Tickell

“We need something equivalent to the WTO called the WEO to act as some kind of umbrella for all the environmental agreements in existence,” he said. “The world insurance industry could play a massive part in this in terms of common standards and arbitrage.”

However, Lloyd’s chairman Lord Levene said more immediate action was required. “My view is that we don’t have time for some great international get together to get these things as it will take years. We have left it too late already. It is a wonderful concept but it is not going to deliver for some time,” he concluded. ®

# Insurers' practices blasted

TOO MANY COMPANIES LOOKING TO UNDERWRITE WAR AND TERRORISM BUSINESS, SAYS AXIS CEO CHARMAN

Underwriting in the terrorism insurance market needs to be significantly improved, according to Axis Capital CEO John Charman.

Speaking during a panel discussion at the WIF Mr Charman said the industry was currently suffering from a "huge under-supply of intellectual capital" and due diligence, which he said had "inevitable consequences".

"There are too many companies looking to underwrite war and terrorism business at present," he noted.

A consequence of this, according to Mr Charman, was that pricing in the terrorism insurance market had therefore gone in the opposite direction from the threat of terrorism activity.

Mr Charman had the following warning for those underwriters entering the terrorism insurance market without what he considered to be a proper understanding of the risks and due diligence.

"You are playing with fire," he said.

"From a management standpoint this is one of the most volatile lines of business but it is so critical to the global economy because it underpins asset values around the world."

"What I fail to understand is that companies that wish to involve themselves in this business allow unmonitored and largely uncontrolled activity to take place," he added.

"This is catastrophic business and the impact on balance sheets is enormous."

As an example Mr Charman reminded delegates that the 9/11 attacks had caused \$50bn of unmodelled losses. He also estimated that the foiled aircraft hijacking plot of two years ago could have produced an insurance loss of \$10bn. ®



John Charman, CEO Axis Capital

## OPENING SPEECH

### UAE MARKET PROFILE

The UAE is the largest insurance market in the Middle East, growing by 27% in nominal terms in 2006, with total premium volumes reaching \$2.7bn, delegates heard during the opening presentation of this year's WIF conference.

Dr Omar Bin Sulaiman, Governor of the Dubai International Financial Centre (DIFC) said: "The WIF's choice of the DIFC as its first host location acknowledges the rapid progress we have made in creating an ultra-modern, highly efficient and well-regulated financial centre to serve both our region and the world."

In addition, Dr Sulaiman said that takaful products had experienced unprecedented growth in recent times and looked set to continue this growth in line with global demand. He said the global takaful market is expected to grow by some 15% to 20% per annum to reach \$7.4bn in annual contributions by 2015.

# Terrorism threat assessment

CENTRAL CHALLENGE FOR UNDERWRITERS IS UNDERSTANDING THE FULL BREADTH OF THE EXPOSURES THEY FACE

Insurers need to encourage more cultural empathy between their clients and the environment in which they work, according to anti-terrorist experts at the WIF.

Dominic Armstrong, a director at Aegis Defence Services (ADS), acknowledged that the situation was tricky for insurers keen to understand the exposures to terrorism they face.

"However, a proper threat assessment can take place if the intelligence is right," he said. "Managing a physical threat is much easier than rebuilding a reputation once it has been destroyed. If a proper assessment is right, solutions can

be put in place."

In the insurance industry Mr Armstrong stressed it was something that leaders needed to insist on. "We have seen economic globalisation but not cultural globalisation," he said.

According to Mr Armstrong's colleague, Tim Spicer, chief executive of ADS, the most significant threat from global terrorists today comes from a radiological 'dirty bomb'.

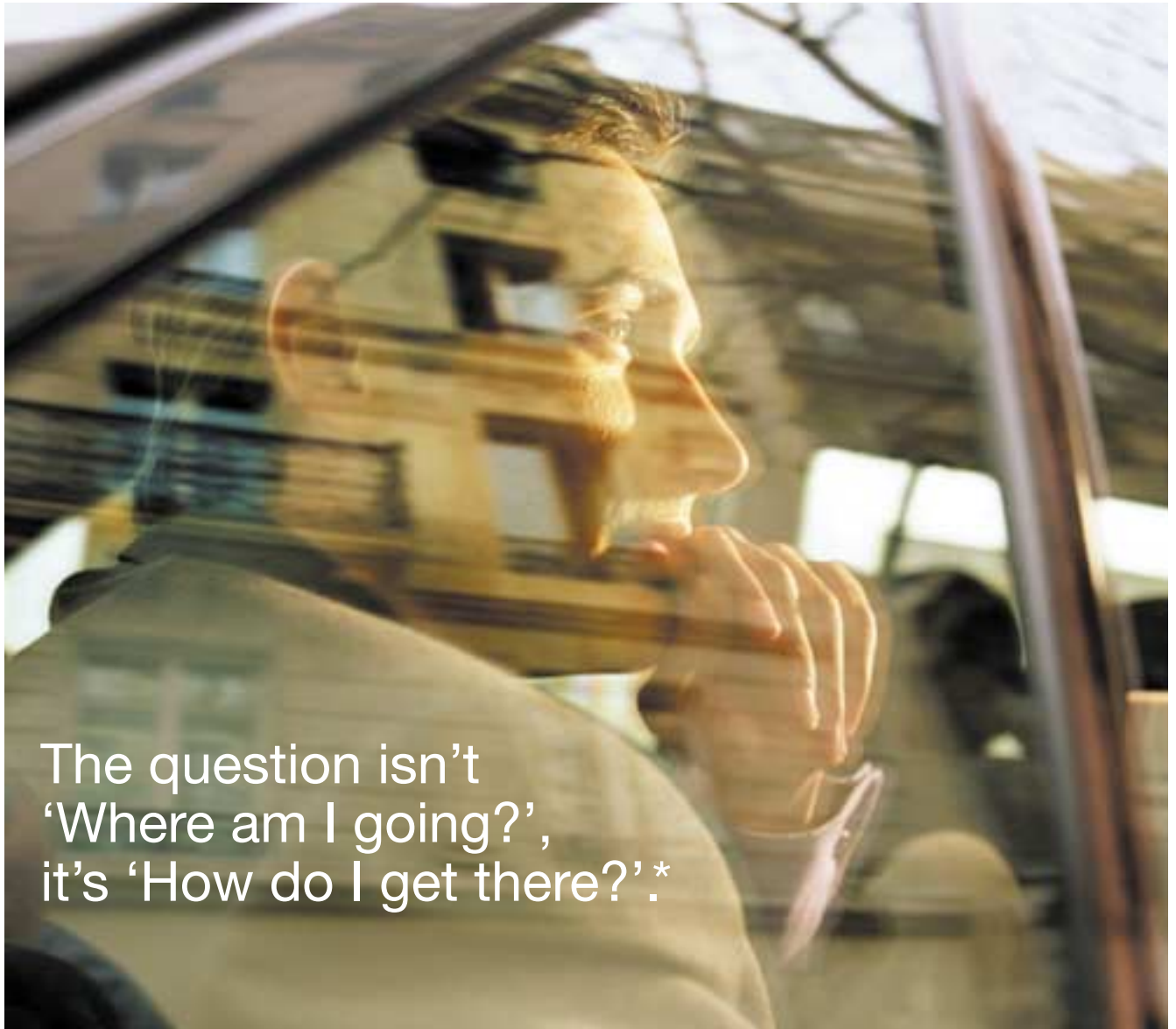
The repercussions would come more



Fallout warning: Civilians take part in a terror attack simulation

from the psychological impact of contamination by radioactive material than from the physical damage.

"It is dangerous not because of the physical blast but because of the fact that it is going to be radioactive for 200 years," Mr Spicer said. ®



The question isn't  
'Where am I going?',  
it's 'How do I get there?'.\*

In an insurance industry of increasing complexity and fundamental change, choosing the right strategy is important. But it's only the start. Implementation linked to constant innovation will be the true key to success. At PricewaterhouseCoopers we offer thought leadership to companies through our multidisciplinary, global approach, helping them to identify the drivers of change and to leverage the opportunities that these present. To find out more about how we can help you maximise shareholder value visit [www.pwc.com/insurance](http://www.pwc.com/insurance)

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