U.S. insurance reels from worst year

by John Hoefle

Shortly after Hurricane Andrew devastated southern Florida and then hit Louisiana late in August, the insurance companies estimated their payouts to policyholders at $7.8 billion, of which $7.3 billion was in Florida, and the remaining $500 million in Louisiana.

Three of the 10 worst insurance disasters in U.S. history have occurred this year: Hurricane Andrew; Hurricane Iniki in Hawaii, which will cost the insurance companies an estimated $1.6 billion; and the Los Angeles riots of April and May, which will cost the insurance companies an estimated $775 million. Losses through the first eight months of the year totaled $11.2 billion, according to the American Insurance Services Group, easily surpassing the previous record of $7.6 billion for all of 1989—the year of Hurricane Hugo and the San Francisco earthquake.

Faced with mounting losses from the hurricanes, record levels of bad real estate loans, and a wave of asset sales and bailouts, the U.S. insurance sector is reeling. With the economy rapidly deteriorating, the situation will only get worse. The insurance companies are foolishly planning to solve this crisis by raising their rates. The very day that Andrew struck Florida, the highest management levels of American International Group were circulating a memo calling the hurricane "an opportunity to get price increases now."

An expensive disaster

The $7.8 billion damage estimate made Andrew easily the most expensive disaster in U.S. insurance history, surpassing the $4.2 billion in insured damages done by Hurricane Hugo in September 1989, and the $1.2 billion in insured damages from the Oakland, California fire in October 1991. But that preliminary figure, which was derived before the companies had a chance to begin the physical survey of the damage, has already begun to escalate.

Several major insurers have dramatically raised their estimates of how much Andrew will cost. Prudential Insurance Co. announced on Sept. 23 that it had more than quadrupled its initial estimate, to $1.2 billion from $250 million. "The major reason for the higher figures is that while hurricanes to date have resulted in maximum damage of 30-40% of insured properties, Andrew's destruction is averaging above 50%," explained E. Michael Caulfield, president of Prudential's Prudential Property and Casualty Insurance Co. subsidiary. Prudential announced it would infuse $900 million in additional capital into the subsidiary, to help cover the losses. The next day, insurance rating agency A.M. Best placed Prudential on its watch list.

Geico Corp. raised its estimate 60%, to $80 million from $50 million.

State Farm, the largest insurer of homes in south Florida, doubled its estimate, to $1.5 billion from $775 million. The company has already received more than 100,000 claims. By late September, its 2,500 adjusters and employees in the region had visited only one-third of the company's 82,000 insured homes. State Farm said it hopes to have visited them all by Oct. 15, the deadline set by state insurance commissioner Tom Gallagher for adjusting most claims. "People talk about Hugo, the Oakland fire, and the San Francisco earthquake," said State Farm spokesman Alan Miller. "Well, throw those all together and they still aren't as bad as this."

Travelers Corp. more than doubled its loss estimate, to between $175 million and $225 million, from $75 million. The loss might well have sunk Travelers, which is struggling with more than $5 billion in bad real estate loans, but it was bailed out by financial services conglomerate Primerica, which bought 27% of the insurer for $723 million.

Shock waves

Two smaller Florida insurance companies have already failed due to Andrew. Florida Fire and Casualty Insurance Co. of Fort Lauderdale was seized by the state Department of Insurance on Sept. 21. The small company, which had 11,000 policyholders and provided mostly homeowners' and flood insurance, did not have the money to pay its claims.

"We had some examiners that determined [that] by the time they paid out their claims from the hurricane that they'd be under," said state insurance department spokesman Karen Chandler.

Two days later, the state seized the Great Republic Insurance Co. of Tallahassee. "This is an Andrew victim," said state insurance department spokesman Jill Chamberlain. "There is no question that we are feeling the shock waves or the ripples, depending on how you look at it."

The claims of both defunct insurers will be covered, up to $300,000 per claim, by the Florida Insurance Guaranty Association.

The insurers will also take a big loss on Hurricane Iniki, which hit the Hawaiian islands of Kauai and Niihau on Sept. 11. The initial insurance company loss estimate for Iniki is $1.6 billion, making it the third most expensive catastrophe in U.S. insurance history.

Continental Corp., a major property and casualty insurer, has announced a $55 million loss due to Iniki, on top of $55 million in losses due to Andrew. As a result, the company will cease writing policies on some lines of insurance, and cut its stockholders' dividend 40%. Company president William Thiele will step down at the end of the year.