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Insurers' Outlook (Unexpectedly) — Good, Despite Big Claims

By JOSEPH B. TREASTER

This has been a terrible year for the commercial insurance business. Yet the insurers say it is hard to remember a time when prospects looked better.

Prices for coverage are soaring and are likely to keep rising in 2002. After that, many insurance executives say, prices may stay on a high plateau for several years with what the industry regards as healthy annual increases of 10 to 15 percent.

The terrorist attacks on Sept. 11 were the crowning blow for the insurers — and the major impetus for higher prices. Earlier, a string of small, but costly storms had cut earnings for the first half of 2001 by 75 percent from a year earlier, and the drops in the stock and bond markets had chopped $18 billion out of the insurers' investment portfolios. The terrorist attacks were the single largest disaster they had ever endured, with costs estimated at $50 billion and climbing.

Already, two small insurers — one in Japan, the other in Denmark — have failed under the financial burden of the attacks. More bankruptcies are expected.

Despite the heavy losses, the insurers say they can pay the claims stemming from Sept. 11, and most expect earnings to rise sharply. As in previous insurance disasters, this one, by all indications, is going to have a silver, if not golden, lining.

"The opportunity out there is tremendous," Henry C. V. Keeling, the chief executive of XL Re, an insurer based in Bermuda and a subsidiary of **XL Capital**, said at a recent industry conference.

The economics go like this: The industry loses a chunk of capital, reducing its ability to provide coverage just when customers are more worried than ever and want more insurance. Demand far exceeds supply, resulting in a roaring seller's market.

"A simple way of saying it is that adversity breeds opportunity," said Rod Fox, the chief executive of Benfield Blanch, an insurance brokerage firm in Dallas that is part of the **Benfield Group** of Britain. "That's probably a little too crass. But that's the way capital looks at it."

Individual investors can share the wealth through stocks. Analysts say the best bets are powerhouses like the **American International Group** and **Berkshire Hathaway**, Warren E. Buffett's investment vehicle.

Nothing, of course, is certain. More terrorism or a natural catastrophe could hammer the insurers again, though they have appealed to Washington for help in reducing losses if there are new attacks.

The insurers are nearing the end of their heaviest policy-renewal season. Prices are running five or six times the level of a year earlier for some lines of coverage, like worker's compensation, liability or protection against lawsuits and property coverage for skyscrapers in New York, Chicago and Los Angeles that are considered prime terrorist targets. Renewals through the next year are expected to come at the same, if not higher costs. Eventually, prices on insurance for cars and homes — which were already rising — are expected to reflect the impact of the terrorist attacks.

Insurers say that customers seem to be accepting the higher premiums.

"You get a big incident, and it increases people's fear; it increases the value of insurance," said Stephen J. O. Catlin, the chairman of the Catlin Underwriting Agencies Ltd., which is part of the **Western International Financial Group** and manages two insurance businesses, or syndicates, at Lloyd's of London. "People want to buy insurance now, and they are prepared to pay for it. A corporation goes 10 years without a loss, and they start asking, 'Why do we need to buy insurance?' "

That question, the insurers say, is not coming up now.

The last big surge in insurance prices came after Hurricane Andrew tore through

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southern Florida in 1992 in the previously worst insurance disaster, with losses of nearly $20 billion in today's dollars. Then the companies that profited were mainly home insurers, not commercial insurers.

Customers may be tolerant of an industry recouping losses from a tragedy. But if prices stay high, as they did after Hurricane Andrew and as insurers hope they do now, big profits can begin to look like gravy.

J. Robert Hunter, the director of insurance for the Consumer Federation of America, has protested to state insurance regulators that many of the latest price increases are unjustified. Both he and Senator Bill Nelson, a former insurance regulator in Florida, have urged the regulators to monitor commercial insurance prices closely. But a committee of regulators responded by voting in early December to relax controls.

The insurers' response to the criticism is that they need to make up for a lot of lost profits. After more than a decade of cutthroat pricing, they say, commercial insurance coverage now costs 60 percent less than it did in 1990. During the price war, which began fading away a little more than a year ago, the insurers' annual return on equity averaged 8.1 percent, or nearly five percentage points less than the rest of corporate America, said Robert P. Hartwig, the chief economist at the Insurance Information Institute, a trade group in New York.

Since the attacks, the insurers have not only raised prices, but they have also been rewriting policies to take back some of the features they dispensed to woo customers in the lenient years.

For example, it became commonplace for insurers to write what Mr. Catlin in London referred to as "holy cow" coverage, broadly encompassing "whatever might happen."

A corporation with perhaps 20 plants around the country, would buy, say, $50 million worth of coverage that could be applied to losses at any of the plants from a fire, an explosion with heavy casualties or a big lawsuit. The insurers simply closed their eyes to the likelihood that the plants represented vastly different levels of risk. Now, Mr. Catlin said, the coverage for each of the plants and for each of the kinds of coverage is being priced separately and at considerably higher cost.

The industry looks so attractive these days that new money is pouring in, both to start new insurance companies and to expand existing operations. Analysts expect $25 billion to be raised by the end of the year. The industry's fear is that this new money will shift supply and demand back in favor of the customer, creating, once again, a buyer's market, driving down prices.

But Ronald W. Frank, an analyst at Salomon Smith Barney, said he did not expect that to happen soon. The money raised so far, he said, is not nearly enough to offset the losses from Sept. 11 and the increased demand. Moreover, he said, he expects the new investors to insist on a high return and not be willing to accept bargain prices.

Those founding the new companies agree. "Return on equity for the first couple of years is going to be astounding," said Andrew J. Barile, an insurance consultant from Rancho Santa Fe, Calif., who helped start one of the companies.

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