

## MOVING THE MARKET

Tracking the Numbers / Outside Audit

# Insurance Buyers Seek To Sidestep Rate Boost

As Premiums Look Likely To Rise Following Storms, Firms Explore Alternatives

By CHARLES FLEMING

WITH THE GLOBAL insurance industry still trying to calculate the extent of losses from hurricanes Katrina and Rita, some corporate insurance buyers already are looking at how to avoid the likely rate increases that insurers will demand to restore profitability.

The full extent of the price increases will only be apparent at the beginning of next year, when most insurers renew their largest corporate contracts. In a study of the bellweather Lloyd's of London insurance market issued last week, Moody's Investors Service Inc. said it expected corporate insurance rates to climb back to, or above, 2003 levels, after two years of declines.

Already, some insurers have told energy companies as far from the two storms' Gulf Coast strike zone as the U.K. that their annual premiums could increase 20% to 50%, as the insurance industry tries to recoup losses estimated at as much as \$80 billion for Katrina alone.

How aggressively the insurance industry will push prices higher is an open question. Price rises after major disasters are common. Insurance rates for many corporate insurance policies doubled, for instance, in 2002 following the Sept. 11, 2001, terrorist attacks. This time around, the rise may not be quite so marked because many insurance companies are in better financial shape than four years ago, thanks primarily to those price increases of 2002.

Another reason insurers may temper their increases this time around is that corporate buyers—still smarting from the sharp rise in insurance costs three years ago—are likely to aggressively explore alternatives to conventional insurance.

"What you'll find...is more shopping around, looking at each and every alternative," says Ernst Csiszar, president of the Property Casualty Insurers Association of America, a trade group.

Among the alternatives: greater use of self-insurance vehicles; sector-specific risk-sharing arrangements, such as ones already used by the oil industry and parts of the drug industry; more use of sophisticated financial instruments; and more spending on security and loss-prevention systems, and less on insurance coverage.

"If the insurers overreact in pushing up prices, there's a real threat that some insurance buyers will look for other options," says Charlie Cantlay, deputy chairman of the U.K. reinsurance unit of insurance brokerage Aon Corp.

"We're looking at a wide range of tools and structures to reduce the impact of the insurers' demands," says Andrew Turpin, a spokesman for the U.K.'s largest household gas and electricity supplier, Centrica PLC, declining to give details. He says the company is concerned about the "arbitrary way" insurers are seeking to push up prices given that risk exposure in the U.K. hasn't changed.

It isn't just the energy industry. Scott Malkin, chairman of Value Retail PLC, which operates nine outlet-shopping villages across seven European countries, says his business was hard hit by the post-Sept. 11 increases in property-insur-

ance rates and that he will seek alternatives to avoid further increases.

"The insurance market is inherently inefficient," Mr. Malkin says. "Surges in price and capacity come from its herd mentality, which results in risk being priced too aggressively when there is ample capital available, or all pulling back and rejecting even the good risks when there is a shortage."

Other insurance buyers think governments should help. "If you have no alternatives, you have to accept what the insurer is proposing, and that's a weak position to be in," says Marie-Gemma Dequae, a Belgian risk manager who takes over as head of the Federation of European Risk Managers Associations next month. Ms. Dequae says that one of her first tasks will be to lobby for tax breaks for companies that set aside their own disaster reserves, rather than pay insurance premiums.

If companies do pursue such alternatives to insurance more aggressively, it could add to uncertainty over the outlook for insurance stocks. Since Katrina's Aug. 29 landing, shares of many of the world's biggest insurance and reinsurance companies have held up well, buoyed by expectations that the likely rise in premium rates would quickly feed through to insurers' earnings.

It won't be the first time corporate insurance buyers sought to sidestep the

Pursuit of alternatives might fuel uncertainty about the outlook for insurance stocks.

industry. After the 2001 terrorist attacks, for instance, there was a surge in demand for self-insurance vehicles, known as "captive insurers." Stephen Cross, who heads Aon's Captive Services Group, estimates that the captives market has doubled in size since 2001 to a range of \$50 billion to \$60 billion, measured in the equivalent of annual insurance premiums. The new hurricane-related losses "will be a catalyst to growing our business," he predicts.

Since the early 1970s, the oil and energy industry has pooled many of its large risks in an insurance vehicle called Oil Insurance Ltd., or OIL, domiciled in Bermuda. It has more than 80 corporate members today, including industry giants Royal Dutch Shell PLC and ChevronTexaco Corp. OIL, which says it still is too early to estimate the most-recent storm damages, covers its losses by charging its members a premium based on its previous five years' losses and by buying reinsurance.

Some companies also are shifting the risk of such disasters as earthquakes and hurricanes onto world financial markets. To date, most of the world's "catastrophe bonds" have been issued by insurers themselves to provide additional coverage in the case of a major disaster. However, a handful of noninsurance companies also have issued them.

One of the first, in 1993, was Japan's Oriental Land Co., which operates Tokyo Disneyland. Since then, three European groups have followed—France's Vivendi SA, Electricité de France and the International Soccer Federation FIFA. Under the bonds, investors foot the bill for losses provoked by certain defined disasters.

## Risk From Hurricanes Becomes Too Great For Insurance Firms

Continued From Page C1

concentrating on Katrina and Rita, a spokesman said Friday.

With the cost of rebuilding the Gulf Coast mounting and its hands full with next year's budget and two Supreme Court vacancies, Congress has no interest in rushing through legislation that could be viewed as an insurance-industry bailout, Capitol Hill staffers say. Insurers also face an uphill battle with some state officials; Mississippi's attorney general has sued to force insurers to pay flood claims.

Still, federal lawmakers could consider commissioning a study of the issue, and insurance regulators from New York, California and Florida last week announced a November summit to try to unify officials and executives behind a single proposal.

Thanks in part to Katrina and Rita, Congress is likely to give the industry a break by extending the Terrorism Risk Insurance Act of 2002, due to expire Dec. 31. Passed in response to the attacks of Sept. 11, 2001, the law requires insurers to offer terrorism insurance to busi-

nesses. In return, it limits the industry's losses in the event of attacks by foreign terrorists in the U.S. Insurers have devoted most of their lobbying firepower this year to extending the measure.

The current push fits in with the industry's history of seeking to avoid big risks in favor of smaller, more profitable ones, like house fires, said Robert Hunter, insurance director for the Consumer Federation of America and a former Texas insurance commissioner. "When risk got high, the industry said, 'We're not going to do it,'" he said.

Among the first federal disaster-insurance programs, the 1968 National Flood Insurance Program has roots in President Harry Truman's realization that insurers wouldn't cover damage from a devastating flood in Independence, Mo., said Mr. Hunter, who oversaw the program in the 1970s. Only about one flood-prone homeowner in four owns the coverage, but flooding was so extensive in the Gulf Coast that Congress is expected to have to pump \$10 billion to \$30 billion into the program to pay Katrina claims.

Also in 1968, in the wake of urban riots, the federal government created a riot reinsurance program—essentially agreeing to reimburse insurers for some claims—after many homeowners and businesses had trouble finding coverage. The program ended in the early 1980s.

In response to Andrew's damage in Florida and a punishing earthquake Northridge, Calif., in 1994, lawmakers in states prone to such disasters unsuccessfully pushed for a Natural Disaster Protection Act. Midwest and P states stymied the measure, calling bailout of insurers and coastal h

Hurricane Rita is expected to cost insurers \$2.5 billion to \$6 billion.

owners that would come at the expense of taxpayers far from danger zones under current law, homeowners' insurance prices are regulated by individual states.

But, by some measures, half the population now lives within 50 miles of the Gulf Coast. And this year's huge dislocation of Gulf State residents, and the socio-economic repercussions, mate with many lawmakers.

Some key free-market Republican committee leaders from hurricane-affected states—Alabama Sen. Ric Shelby, banking committee chair; and Louisiana Rep. Richard Baker,

Are you missing out on some of the biggest news in mutual funds?

## U.S. Probes Fairfax Financial Over 'Finite-Risk' Reinsurance

By IAN McDONALD AND THEO FRANCIS

Federal investigators are seeking to determine if Fairfax Financial Holdings Ltd. improperly furnished its financial statements with nontraditional insurance pacts, including contracts with affil-

broader market and moved in line with or better than some peers.

Fairfax has canceled some finite-risk policies in recent years and has disclosed at least some of their accounting effects. "Crum & Forster's underwriting results are significantly affected by reinsurance," it said in that unit's annual

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