NEWS

Gettleman gives firms green light to file AIG claims

AIG (*pictured*) may yet face further claims from several hundred insurers which have accused the company of deliberately understating premiums paid into workers' compensation pools.

AIG was handed something of a boost by Chicago district judge Robert Gettleman, who threw out a federal lawsuit that accused the insurer of deliberately understating premiums paid into workers' compensation pools.

However, Gettleman warned the financial services group, which was considered the world's largest insurer until its spectacular near-collapse last September, the case was only thrown out because the National Council on Compensation Insurance, which had brought the case, lacked the necessary standing to sue.

Instead, Gettleman said: "There is no dispute the pool's members – the participating companies – have standing to bring claims separately against AIG."

Gettleman acknowledged AIG had for decades understated workers' compensation premiums to evade payments.

Reports have indicated many of the insurers in the National Workers' Compensation Reinsurance Pool, which AIG is alleged to have cheated by understating premiums, will now attempt to pursue individual class actions under Gettleman's jurisdiction.

BLOOMBERG NEWS/ANDREW HARRER

No assessment for Louisiana Citizens

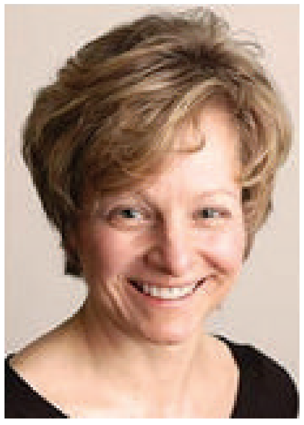
LOUISIANA Citizens Property Insurance, the state's last-resort property insurer, will not have to impose an emergency assessment on other carriers and policyholders in the state to help cover the cost of a $95m bond it needs to file an appeal of a recent court ruling.

Louisiana insurance commissioner, Jim Donelan, made the announcement after the recent decision by a local parish court ordered Citizens to pay $92.8m to certain policyholders for failing to handle 2005 hurricane-related claims in a timely fashion.

Donelon said Berkshire Hathaway and Travelers had offered "reasonable conditions" for writing the bond to guarantee the court judgment.

Had Citizens posted the bond itself, its corporate chequing account would have been left with a $5m balance at the peak of storm season, thereby requiring the 5% assessment on all property insurance policies in the state.

As a back-up plan, Citizens also offered to pay $6m to plaintiffs' attorneys in the lawsuit in exchange for them dropping their demand that the company post the bond. Citizens has until the end of business on Monday to post the bond.



Insurance's message will be better received in post-downturn world

As the countdown to the Monte Carlo Rendez-Vous continues, **ROSANNE BACHMAN** examines challenges facing insurance

"IS THE insurance industry the next shoe to drop?" New York University economist Nouriel Roubini asked in his daily *RGE Monitor* newsletter in February.

Fortunately, it has not dropped so far, but market dynamics, the potential for multiple catastrophes, the lack of capital available to reload balance sheets (should they become impaired), the low level of investment income and the fact some commercial insureds are on a financial knife-edge, mean his question was, and continues to be, a relevant one.

While the industry may celebrate that the shoe is still on, it might be fair to say the laces have come undone: the industry ended 2008 with a total of £52.5bn ($86.6bn) in insured losses and started 2009 somewhat on the wrong foot. Early estimates for European windstorm Klaus turned out to be rather thin and have increased to €1.5bn ($2.1bn); in the US, Mother Nature kicked off 2009 by continuing her tantrums with storms, tornadoes and flooding; and revisions of the losses from September 2008's hurricane Ike seem to be lasting longer than the storm.

While 2008 had the distinction of being the third-largest insured loss year on record, it was also interesting in that the high loss stemmed from the combination of events: death, one might say, by a thousand cats. Insured losses for 2008 represent, however, only 24% of total losses – there was also $217bn of uninsured losses.

I have pointed out a number of times in presentations over recent years that past economic loss events, particularly in uninsured parts of the world, are indicators of future industry insured losses. At a British Insurance Brokers' Association meeting in Manchester in 2003, I said the 1998 and 1999 catastrophes, including hurricane Mitch, in uninsured parts of the world had resulted in high economic losses but low insured losses. It did not need much imagination to realise there could be a similar event in an area where insurance take-up was high – and, of course, there was, in 2004 and 2005. Somehow, the industry had failed to relate the personal and economic havoc caused by those uninsured events to an area in which there was a high number of insured properties. Using each year's valuation at that time, insured losses in 2004 ($49bn) and 2005 ($83bn) were fairly close to the total economic loss levels of 1998 ($65bn) and 1999 ($100bn).

Previous economic losses and events should send clear warning signals to the insurance industry. Total global economic loss numbers of $123bn for 2004, $230bn for 2005 and $269bn for 2008 simply cannot be ignored. We need only to remember the 1995 Kobe earthquake, the total economic loss of which was $100bn in 1995 values, to understand how severe a single event can be.

A consistent increase in weather-related disasters and other severe natural peril events over the past 20 years seems to indicate Mother Nature holds most, if not all, of the cards and, since she does not always play by the rules, she usually has a few surprises in store. This raises the stakes somewhat when trillions of dollars of values are at risk. An example of Mother Nature dealing from the bottom of the deck was highlighted in a recent paper on the 2004 Indonesian earthquake, published in *Nature*. The paper's authors included Kerry Sieh, formerly Sharp Professor of Geology at Caltech and now director of the Earth Observatory of Singapore, who has been studying the region's geological faults for years. He pointed out the earthquake not only broke records with a 1,600 km rupture, but also broke some of "the rules" – two of which were old plates do not produce big earthquakes and their rate of movement must be high.

AP PHOTO/ITSUO INOUYE

A pedestrian makes his way carefully over the earthquake-damaged pier at the Kobe port following the magnitude 7.2 quake in 1995, Japan's deadliest in more than 70 years: the earthquake caused damage with an economic cost of $100bn in 1995 values, showing how serious a single catastrophe can be

The fault that produced what was the world's third-largest earthquake in the past 100 years was old and relatively slow. As a result, views of subduction zone behaviour have begun to change and it is now suggested those zones thought to be benign should be reassessed. Sieh specifically mentions the Caribbean, saying: "It could well be an error to assume the entire subduction zone from Trinidad to Barbados and Puerto Rico is aseismic." One more potential risk to add to the list.

According to a January 2005 report in UK newspaper *The Times*, Sieh was so concerned about the potential for a large earthquake in the Indonesian region he flew to Indonesia in the summer of 2004 to alert the appropriate authorities. Unfortunately, his message fell on deaf ears. Still determined to make a difference, he travelled to some of the areas likely to be at risk from an earthquake and tsunami and tried to alert local people by hanging posters and speaking at meetings. He did, indeed, make a difference to those people who saw or heard his warning, but how much better the outcome could have been if the whole region had been able to hear his message.

After a recent revision of the potential for an event in the area, the Cascadia subduction zone off the north-west coast of the US should be raising a few concerns. In 1700, an earthquake of 9.1 magnitude in this zone created a tsunami that killed 30,000 people in Japan; and the prediction this zone would produce a magnitude 8.0 or stronger earthquake every 500 years or so, has now been revised to every 300 to 350 years. In addition, according to *The Seattle Times*, experts are perplexed by recent mysterious interplate earthquake swarms. The Cascadia zone has the potential to produce an earthquake similar in size to that in Indonesia in 2004, as well as to unleash a tsunami. Sieh said this is an area where another earthquake "may occur before long".

The west coast does not, of course, have a monopoly on earthquake zones in the US. The New Madrid and related Wabash zones, which have produced sizeable earthquakes in the past, reminded us of their potential in April 2008 with a magnitude 5.2 tremor on the Wabash fault in southern Illinois. While it was not particularly strong, the shock was felt from Green Bay to Atlanta. Opinions vary as to whether the New Madrid fault could repeat the magnitude 8.0 earthquakes experienced in the 1800s, but the United States Geological Survey has suggested there is a 25% to 40% probability of one of a 6.0 or greater magnitude in the next 50 years. The Federal Emergency Management Agency funded a study of the two faults, which resulted in a 926-page report released in September 2008. It identified, in extensive detail, the effect an earthquake of 7.7 magnitude would have on the seven states surrounding the faults. The statistics for Tennessee alone are disturbing.

There has always been a reluctance to scare people by publicising the likely effects of an extreme event over which we have no control. The recent economic meltdown has, however, created an opportunity for the insurance industry to communicate its assessment of future losses and of how it and its clients can work together to mitigate potential losses. While we are unable to prevent events, we undoubtedly have the ability to help people and businesses survive them. The question insurers should be asking is: "If a serious event happens, how well have we prepared our clients – and how well prepared are we?"

A market-changing event can happen at any time, but the first hard market to follow the banking crisis may be very different from those which preceded it. I question whether the industry will be able to catapult premiums as we have in the past. The level of capital to even allow that may simply not be available. If we fail to anticipate the risks, the inquiring minds that have recently had a great deal of practice elsewhere in the financial markets will certainly be asking questions about the way we judged/measured our risk levels.

I believe clients are ready to listen to reason. They now understand the way the financial markets under-priced risk and miscalculated probability, even if not using those terms. We need to help them understand why the world economy cannot afford our industry to make the same mistake – that it cannot afford to let another shoe drop.

We need to take Sieh's example and make an extra effort to reach out to people – to tell our clients about potential risks and to show them how we can help to manage them.

Rosanne Bachman is the founder of Pinwheel Consulting