Insurer Losses From Subprime Approach Katrina Claims

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March 14 Bloomberg) – The collapse of the subprime mortgage market will lead to record losses for insurance companies, overtaking Hurricane Katrina, the worst natural disaster in U.S. history.
The amount of asset writedowns and credit losses reported by the industry has reached at least $38 billion, just short of the $41.1 billion in claims from Katrina, which killed more than 1,500 people and left more than half of New Orleans homeless in 2005, data compiled by Bloomberg show.
American International Group Inc., the world's biggest insurer, reported the largest quarterly loss in its 89-year history because of the decline in investments linked to mortgages. Chief Executive Officer Martin Sullivan told shareholders last month that more losses are possible amid the most depressed U.S. housing market in a quarter century. The KBW Insurance Index ended 2007 with its worst quarter in five years and fell another 17 percent this year.
"This is a bigger event than Katrina," said Robert Haines, an insurance analyst at New York-based CreditSights Inc. "This is a much more unprecedented event."
After Katrina, companies including Northbrook, Illinois- based Allstate Corp., the largest publicly traded U.S. home insurer, raised rates in disaster-prone areas, bolstering their balance sheets and stock prices. Now, insurers are stuck holding mortgage-related investments in a market where there are so few buyers that it's hard to know what those assets are worth.
Unquantifiable Losses
AIG, Ambac Financial Group Inc. and MBIA Inc. have reported the biggest markdowns tied to the mortgage markets.
AIG topped the list with $6.7 billion of losses from residential mortgage-backed securities and more than $11 billion from so-called credit-default swaps, which protect fixed-income investors. The New York-based company's stock fell the most in 20 years on Feb. 11 after auditors found AIG originally used the wrong formula to value its holdings and understated losses.
New York-based Ambac, the second-largest bond insurer, had about $6 billion of writedowns as credit

markets deteriorated. Armonk, New York-based MBIA, the biggest bond insurer, suffered losses of more than $3 billion.

The industry tally of $38 billion includes 15 publicly traded companies based in the U.S. and Bermuda, and excludes policyholder-owned insurers and European companies.

Last year marked the first time since at least 1999 that the combined book value — assets minus liabilities — of the 24 companies in the KBW Insurance Index declined, according to Bloomberg data. The drop was 0.9 percent, compared with a gain of 7 percent in 2005 after the record hurricane season.

Book Value Slump

AIG’s book value, including minority interest, slipped 3 percent in 2007 to $106.3 billion, compared with a gain of about 8.2 percent the year Katrina hit, according to Bloomberg data.

The company reported adjusted net income of more than $9 billion in 2007, said AIG spokesman Chris Winans. “That outcome illustrates the virtues of having a diverse portfolio of businesses,” he said.

MetLife Inc. and Prudential Financial Inc., the largest U.S. life insurers, added asset-backed holdings before the housing slowdown as they reached for higher returns than those from government or corporate debt.

Prudential, based in Newark, New Jersey, had gross unrealized losses of $2.86 billion on fixed-maturity investments as of Dec. 31, a threefold increase from a year earlier. About $1.1 billion of the total is related to subprime mortgages, said spokesman Bob DeFillippo. MetLife, based in New York, reported gross unrealized losses of $4.45 billion, a 95 percent increase, including $219 million from subprime.

Credit Quality

Prudential dropped 23 percent in the past year in New York Stock Exchange composite trading, and MetLife fell 8.3 percent. Both companies posted annual gains of at least 17 percent every year from 2003 to 2006.

AIG, Prudential, MBIA, Ambac and CNA Financial Corp. say damage from the credit markets may decrease over time. That’s because markdowns are pegged to the price insurers could get if they chose to sell securities today in depressed markets — which the companies say they won’t do. They’re planning to hold on and collect the full value.

“I say to our portfolio managers, when you buy something, make sure the credit quality is sufficient that we can hold it to maturity,” said Jim Tisch, the CEO of CNA parent Loews Corp., in a March 6 interview.

CNA’s unrealized losses totaled $367 million. The Chicago-based insurer, which also posted realized losses of about $480 million in 2007, declined about 40 percent in the past 12 months.

Regulators Approached

AIG has spoken with regulators about changing the accounting rules that forced the company to record an $11.1 billion fourth- quarter writedown on the swaps, Winans said. A projection of the "maximum possible loss" on investments the company continues to hold is a more useful number to investors, Winans said.

The company's share-price estimate was cut 32 percent to $47 by Citigroup Inc. yesterday on possible investment losses.

Prudential estimates that at most $300 million in markdowns will turn into realized losses over five years. That assumes home prices drop 40 percent from their peak and that bond insurers fail.

MetLife Chief Investment Officer Steven Kandarian has said the company is comfortable with its subprime holdings.

S&P Downgrades

Standard & Poor's has downgraded or placed under review more than $350 billion of collateralized debt obligations, casting doubt on whether some mortgage-backed debt will reach maturity intact. CDOs package bonds, credit-default swaps and other assets to provide income for investors.

"Perhaps holding out is the right strategy, but some of the losses will be real," said Cliff Gallant, a New York-based insurance analyst at KBW Inc., adding that equity investors aren't waiting to see how bad the damage will be. "The way the markets have been, it's shoot first and find out later."