NATIONAL INSURANCE
CONSUMER ORGANIZATION

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INSURER CLAIMS OF GREATEST LOSSES EVER IN 1985 A FRAUD, NICO CHARGES

The property/casualty insurance industry has used misleading statistics in claiming a $5.5 Billion loss in 1985 when, in fact, it earned $6.6 Billion, the National Insurance Consumer Organization (NICO) charged today.

At a Washington, DC press conference, NICO president J. Robert Hunter, former Federal Insurance Administrator in the Carter and Ford Administrations, made the following points:

* The insurance industry's claim to have lost money in 1985 is false, because the industry defines "losses" to include expenditures that aren't losses -- such as dividends declared by profitable companies -- and defines "income" to exclude certain income, such as realized capital gains.

* The stock index of property/casualty insurers rose by 50% during 1985, almost double the rise of the general stock market.

* Insurers' net worth rose by $7.6 Billion in 1985, from $62.4 Billion at year end 1984 to $71.0 Billion at year end 1985.

* The total insurance bill in the U.S. will rise from 11.1% to more than 12% of disposable income in 1985 -- more than $300 billion -- displacing personal federal income taxes as the third largest expense in the nation's budget. Only food and housing cost Americans more than insurance.

* Property/casualty premiums written rose by $24.6 Billion, from $117.7 to $142.3 Billion, while coverage decreased substantially. This works out to an increase of $105 per person, or $397 per family, for substantially less coverage.

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* Property/casualty insurers' profit rose from 2% of net worth in 1984 to an estimated 7% in 1985. If the effects of dividends to policyholders and unusually high hurricane losses in 1985 were removed, the industry's return on net worth in 1985 would have been about 13%, about the average for all American industries.

According to Hunter, dramatic increases in insurance premiums were possible only because "state regulation of insurance is so weak as to be almost non-existent." The former Federal Insurance Administrator emphasized that only half the states have actuaries on their staffs. Hunter, an actuary himself, disparaged the insurance industry's claim that the legal system is to blame for skyrocketing insurance costs. The insurance industry made the same argument in 1975-76, the last time it raised premiums substantially, Hunter said.

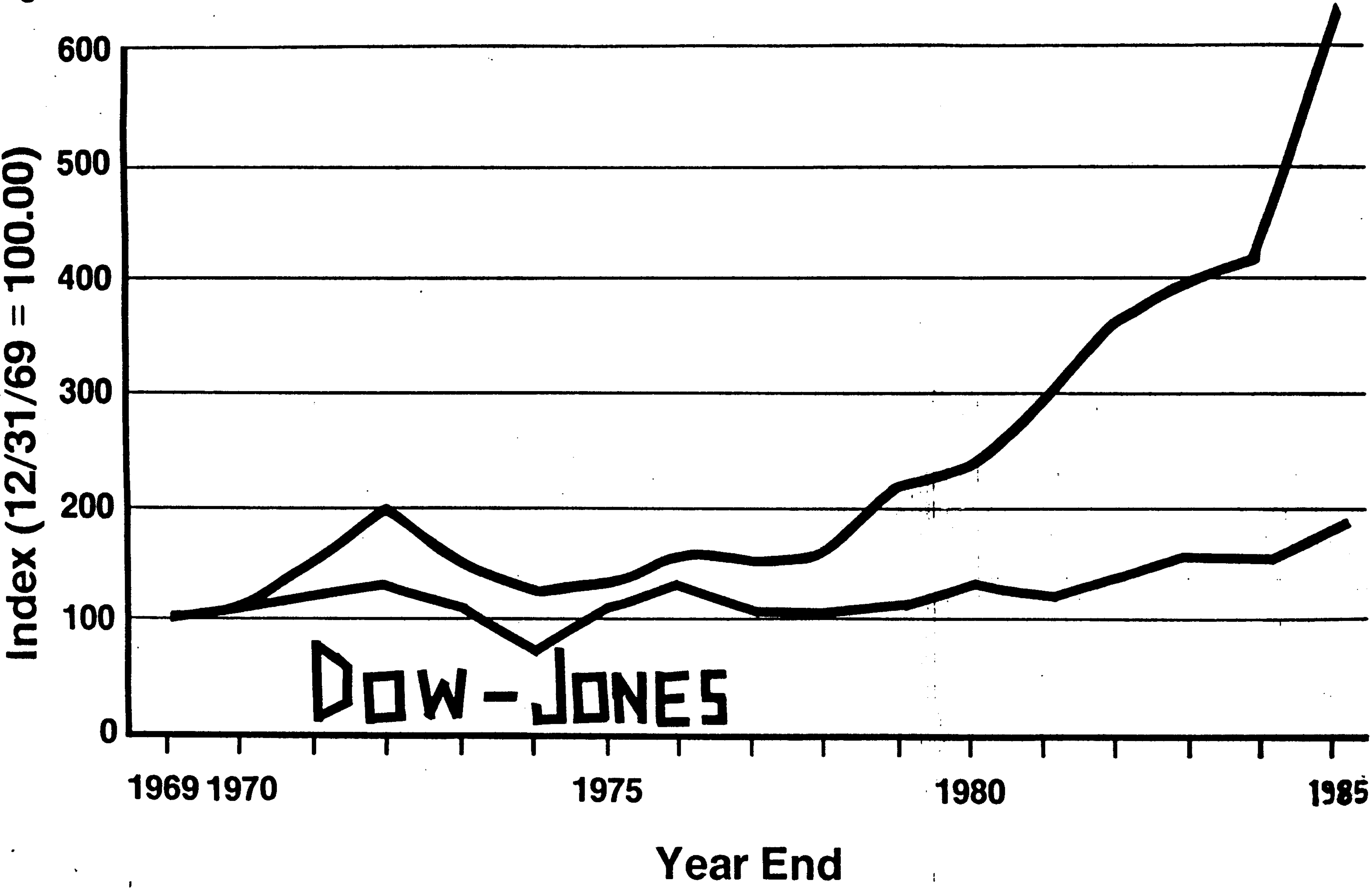
NICO released a review of the economic cycle (Chart 1) which shows the similarity between the behavior of the insurance industry in 1975 and 1985. "In 1975 they blamed the courts, boycotted insureds and gouged the public. It was a great dry run for 1985," Hunter claimed.

NICO also released data comparing the property/casualty insurance stock index with the Dow-Jones Industrial Average (see Chart 2). Insurer stock prices have exploded over the last five years, almost tripling during the 1980s and rising by 50% in 1985 alone.

NICO called for sunsetting the insurance industry's anti-trust exemption, creating federal standards for state regulation and subjecting state regulatory performance to continuing federal oversight in order to prevent further insurance crises in the future.

CHART 2

BEST'S PROPERTY/CASUALTY STOCK INDEX



"LOSS" CLAIMED BY INSURERS	$5.5 Billion
IGNORED INCOME:	
Capital Gains	$6.5 Billion
Federal Tax Credits	$3.5 Billion *
IMPROPERLY DECLARED LOSS	
Voluntary Dividends to Policyholders	$2.1 Billion
ACTUAL INSURER PROFIT	$6.6 Billion
RATE OF RETURN ON EQUITY	7% *

Source: <u>Review and Preview</u>, A. M. Best and Company, 12/30/85

* Estimated by NICO

THE INSURANCE INDUSTRY:

<u>WHAT THEY SAY IN PUBLIC</u>

QUESTION:

<u>Who's to Blame for the Insurance Crisis?</u>

ANSWER:

"The liability insurance availability/affordability problem is primarily caused by the structure and operation of the tort liability system rather than by temporary market dislocations."

Statement of the American Insurance Association before the Senate Subcommittee on Business, Trade and Tourism, December 3, 1985

<u>WHAT THEY SAY IN PRIVATE</u>

"The property/casualty industry must accept the major responsibility for its current financial condition."

<u>1985: A Critical Year</u> Insurance Services Office, Inc. May, 1985

"Financial schemes of various shapes came into vogue during the recent cash flow cycle, and the result was an almost total disregard for pricing adequacy."

Atlantic Companies President Edward K. Trowbridge in <u>Best's Review</u>, July, 1985

"The property/casualty industry as a whole continues to overreact to the competitive pressures of the marketplace, in turn causing periods of solid profitability, severe financial strain such as we are still experiencing and many transition periods."

CNA Chairman Edward J. Noha in <u>Best's Review</u>, July, 1985

". . . the property/casualty industry will always be cyclical. . . ."

US Fidelity and Guaranty President Paul J. Scheel in <u>Best's Review</u>, July, 1985

THE INSURANCE INDUSTRY:

<u>WHAT THEY SAY IN PUBLIC</u>

QUESTION:

<u>How Much Did the Industry Earn (or Lose) in 1986?</u>

ANSWER:

"The industry is expected to complete 1985 as another record year for losses."

Statement of the Alliance of American Insurers before the Senate Subcommittee on Business, Trade and Tourism, December 3, 1985

<u>WHAT THEY SAY IN PRIVATE</u>

". . . the estimated year-end surplus shows a $7.6 billion gain, thanks to investment income of $19.7 billion, capital gains of $6.5 billion (much of which has been realized) and all other changes (which include federal income tax refunds and new capital) totalling $6.6 billion."

"Review and Preview"
<u>Best's Insurance Management Reports</u>
December 30, 1985

STOCK MARKET PERFORMANCE

	PROPERTY/CASUALTY STOCKS		GENERAL STOCKS	
Year	Index	% Change	Index	% Change
1969	100.00	---	800.36	---
1970	112.20	+12%	838.92	+ 5%
1971	154.89	+38	890.20	+ 6
1972	198.60	+28	1020.02	+15
1973	158.64	-20	850.86	-17
1974	114.66	-28	616.24	-28
1975	129.59	+13	852.41	+38
1976	162.70	+25	1004.65	+18
1977	156.10	- 4	831.17	-17
1978	164.03	+ 5	805.01	- 3
1979	212.06	+29	838.74	+ 4
1980	235.50	+11	963.99	+15
1981	284.90	+21	875.00	- 9
1982	360.61	+27	1046.54	+20
1983	397.20	+10	1258.64	+20
1984	416.30	+ 5	1211.57	- 4
1985	624.33	+50	1546.67	+28

Percent change in 5 year increments:

Increment	Property/casualty	General
1/1/70 to 12/31/74	+14.7%	-23.0%
1/1/75 to 12/31/79	+85.0	+36.1
1/1/80 to 12/31/85	+194.4	+84.4

Percent change over entire period:

	Property/casualty	General
	+524.3%	+93.3%

Source: Property/casualty stock index from A. M. Best and Company (1969 is the earliest data available from Best"s) General stock price is measured by the Dow-Jones Industrial Average.

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QUESTION: The property/casualty insurers say 1985 was their worst year ever and that they lost $5.5 Billion. Is that true?

ANSWER: No. In fact the property/casualty insurers earned $6.6 Billion, before dividends to policyhoders.

QUESTION: How did the insurers get their $5.5 Billion figure?

ANSWER: First, they calculated how much they paid out in claims and expenses in 1985 and how much they are likely to pay out in claims and expenses in the future. This is called their "incurred losses". They subtract this amount from the premiums they earned in 1985. The result is called their "underwriting gain" (or loss). In 1985, the industry's earned premiums were $131.6 billion, but their incurred losses were $156.8 billion, so they had an underwriting loss of 131.6-156.8, or $25.2 billion.

Balanced against this $25.2 billion is the industry's investment income -- dividends and interest the industry earned in 1985 by investing the premiums it has collected. In 1985 this was $19.7 billion.

To arrive at its $5.5 billion loss figure, the industry merely subtracted its underwriting loss from its investment income.

QUESTION: What's wrong with that?

ANSWER: It includes all of their losses--and some expenditures that were not losses--but it doesn't include all their gains.

QUESTION: Let's take the losses first. What's wrong with the industry's definition of losses?

ANSWER: It includes all their claims and expenses--such as lawyer's fees--that they paid out in 1985, plus all the claims and expenses they estimate they will pay out in the future. Their estimates of future payments are often overstated, but we do not challenge them today. (We do note, however, that the amount the insurance industry estimates it

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will pay out in the future is money the industry has in the bank and earns interest on. This is largely responsible for the industry earning profits of more than $70 billion over the past decade yet paying no federal income tax. Further, we note that, at the last "crisis", the industry seriously overreserved, particularly in medical malpractice.)

The property/casualty industry's profits also include, however, declared dividends to policyholders of 1.6%, or $2.1 billion. This is not a business expense, but a voluntary choice of managers of profitable companies to distribute some of these profits to policyholders. It is hardly a loss.

QUESTION: Even with that $2.1 billion added back in, however, the insurance industry still lost $3.4 billion. How do you come up with a $6.6 billion gain?

ANSWER: As investment income, the industry included only the interest and dividends it earned. It did not include the $6.5 billion increase in the value of its stock--its capital gain--most of which it realized, i.e., it sold the stock and has already reinvested the cash.

QUESTION: But even adding that $6.5 billion back in gives the industry a profit of only $3.1 billion. Where does the other $3.5 billion come from?

ANSWER: According to Best's, the insurance industry "Bible", industry surplus increased $6.6 billion because of "all other changes." "All other changes" includes federal tax refunds, which are income. It also includes new capital contributed, which is not income. The new capital portion of this total we estimate at between $2.5 billion and $3.5 Billion, leaving between $3.1 billion and $4.1 billion as federal tax refunds. Using an estimate of $3.5 billion for tax refunds leaves a total profit of $6.6 billion.

QUESTION: Did the industry profit level rise or fall in 1985?

ANSWER: Insurer profits rose in 1985. In 1984, the industry earned about 2% on total equity; in 1985, it earned about 7%, after dividends to policyholders. The 7% is also after record catastrophic losses from hurricanes of about $3 billion, 25% more than ever before, making the recovery seem less sharp than it really is.

QUESTION: Isn't a 7% return still too low?

ANSWER: Yes. Insurers needed to raise rates in 1985 to make up for their price-cutting of the last few years. To earn an average rate of return (13-15%) in 1986, they needed to raise their rates by 12 to 15% in 1985 while providing the same coverage. In fact, however, the industry both raised its premiums an average of 21% -- and in general commercial lines by an average of 71% -- and at the same time reduced coverage dramatically. The result is that businesses, doctors, municipalities and others are paying much more for much less coverage.

QUESTION: Why did the insurance industry increase its rates so dramatically in 1985?

ANSWER: The insurance industry increased its rates dramatically in 1985, just as it did in 1975-76, because of the insurance industry cycle. The industry cuts its rates when interest rates, and thus its income from investing the premiums it has collected, are high; it raises rates when interest rates and thus its investment income are low. It overreacts at both the top and bottom of the cycle.

QUESTION: With a 7% return, aren't more rate increases needed?

ANSWER: No. Rates are already excessive and state regulators should be moving to challenge them. Unfortunately, most states have neither the will nor the competence to do so. Half the states don't even employ an actuary. We are particularly shocked to hear that the industry itself predicts that 1986 will see prices rise by about as much as 1985. This will lead to grossly excessive profits. That's why the stock market for these insurers has skyrocketed.

QUESTION: The insurance industry maintains that the rate increases are necessary due to an "explosion" of litigation. Do you see that?

ANSWER: Certainly not in the aggregate. The insurance industry has been challenged by NICO for months to come up with the statistical proof of their claims that this is a crisis caused by litigation. We have asked them to show us paid claims data for the last several years split between those involving lawyers and those not, to show us payouts by size of claim for the last several years to see how much impact large verdicts and settlements have on prices and profits, and we have asked for information on how victims fare under this system of law as regards payouts compared with economic damages. A comprehensive closed claim study by the insurers is fundamental if we are to fully understand the exact causes of this crisis--and it must be done by line and by state so that policymakers can move appropriately to ease the crisis.

The insurers, after all, are the ones seeking reduction in victim rights; the insurers control the claims data--it is in their files. It seems to us that the burden of proof is on them to show that there is, in fact, a tort law crisis.