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Insurance giant bites the dust

The failure of Monarch Life marks a new phase of the collapse of the U.S. real estate markets.

The relentless collapse of the Reagan-Bush real estate bubble, which has left the corpses of hundreds of banks and savings and loan institutions in its wake, has now claimed a major insurance company.

Unlike the recent failures of First Executive and First Capital, which were brought down by their huge portfolios of junk bonds, the May 30 seizure of Monarch Life Insurance Co. was directly caused by real estate losses.

The Massachusetts-based Monarch, until recently one of the nation's largest life insurance companies, got into trouble last fall, when its parent, Monarch Capital Corp., defaulted on a $235 million loan from a syndicate headed by Chase Manhattan Bank. Monarch Capital had pledged the stock of Monarch Life as collateral.

To head off an involuntary bankruptcy filing by the bank syndicate, the Massachusetts Division of Insurance put Monarch Life into temporary receivership. The company will continue to meet its obligations to its 250,000 policyholders, the state said.

The problems at Monarch Capital began in 1987, when the stock market crash and tax-law changes diminished the market for variable life insurance, Monarch Life's primary product. To compensate, the parent company increased its investments in real estate projects. That decision left Monarch Capital floundering in a sea of red ink, with losses of over $570 million since late 1989.

The devastating decline in the value of real estate was underscored by a report from the Mortgage Bankers Association of America, showing that the equity which Americans have in their homes had dropped $363.4 billion during 1990, a staggering 16% drop. Of the decline, $288.9 billion was due to increases in mortgage debt and $74.5 billion was due to declining property values. The amount of money borrowed against the average U.S. home rose to 57.5% of its value, nearly half again as much as the 36-40% range which prevailed over most of the last two decades.

A great percentage of this new mortgage debt represents second mortgages, mortgage refinancing, and home equity loans. One of the fastest-growing components of this new debt is home equity lines of credit, a sort of revolving credit line commonly used to pay for consumer purchases. Home equity lines of credit outstanding totaled more than $100 billion at year's end.

At the same time that millons of desperate homeowners are hocking their homes to pay their bills, the default rate on residential mortgages is zooming. According to the Mortgage Bankers Association, delinquencies on residential mortgages rose to 4.95% in the first quarter of 1991, compared to 4.71% at the end of 1990—more than 2.3 million homeowners.

Thanks to skyrocketing bankruptcies and defaults, U.S. banks have inherited massive inventories of seized properties, known in banking jargon as Other Real Estate Owned, or OREO. OREOs held by U.S. banks have grown to more than $22 billion, from $11.2 billion two years ago, according to Sheshunoff Information Services.

The banks have only two choices when dealing with OREO: They can either sell the properties at cut-rate prices and take massive losses—and often immediate insolvency—now, or they can hold on to them and go broke later. Either way, most of the nation's bigger banks are already bankrupt.

Take Citicorp, for example. The bank's non-performing real estate loans rose 120% in 1990, to nearly $2.6 billion, and its portfolio of foreclosed properties rose 79% to $1.3 billion, according to Salomon Brothers. The giant bank has reported losses of nearly $5 billion in the last two years, and added another $3 billion to its Third World loan loss reserves, but that is merely the tip of the iceberg.

Citicorp is not alone. During 1990, non-performing real estate loans jumped 462% at Republic New York, 268% at Manufacturers Hanover, 245% at Bankers Trust, and 125% at Chase Manhattan. Reflecting this rapid deterioration, the Federal Deposit Insurance Corp. has increased its projections on the number of banks to fail in 1991 and 1992. The agency had previously forecast between 340 and 440 failures, while insisting that the lower figure was the more likely. However, FDIC official John Bovenzi told the House Ways and Means Committee May 29, "Our present expectations place us somewhere between the two scenarios."

Two days later, the FDIC seized the $10 billion Goldome, of Buffalo, New York, in the largest savings bank failure ever. The insolvent bank—its capital stood at negative $452 million at the end of 1990—had been on the FDIC's zombie list for months. The FDIC projects a net cost of $930 million to close Goldome, making it the sixth most costly failure in the agency's history.

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