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U.S. bankruptcy sparks the 'great insurance war'

by David Goldman

Ralph Nader turned up on the doorstep of Lloyd's, the British insurance syndicate, in London on Jan. 15, denouncing it for using its muscle to win huge premium increases in the United States. That was all Lloyd's needed, after a series of widely publicized fraudulent bankruptcies among syndicate members, and the announcement of an investigation of Lloyd's practices by the Thatcher government.

Mr. Nader is a bit player in a global battle for control of the American insurance market, incited by a crisis among American property-casualty insurers. That crisis, in turn, is a by-product of the threatened bankruptcy of the federal government, which has put on the chopping block the tax breaks the insurers lived on for the past 10 years.

Nader and associate Robert Hunter have launched a consumer advocacy organization for premium-payers, the National Insurance Consumer Organization, and made Lloyd's a principal target. They argue (accurately) that Lloyd's controls the American property and casualty insurance market through the $5 billion in reinsurance it buys in the United States each year. American insurers will not cover risks that they cannot re-sell in the secondary, or reinsurance market, and "Lloyd's of London is often the source of decisions to abandon lines of insurance," as Hunter charged at a press conference with Nader.

Nader's London press conference intersects an authentic consumer revolt against premium increases for many categories of insurance that have ranged, during the past year, from 300% to 1,000%. Doctors and other professionals, transportation companies, and various manufacturers, especially in the pharmaceutical and other litigation-prone industries, have suffered most.

Most of the vitriol has been exchanged between various insurance consumers, with the medical profession in the forefront, and the greatest of all "consumer advocates," the Trial Lawyers Association. The doctors and other victims of impossibly large premium increases want a legal limit to awards by juries, which have risen to heights of absurdity in the past 10 years; the lawyers insist that manipulation by insurance companies is responsible for the increases, and that the big jury awards cannot possibly justify the present level of increases.

Nader has staked out an extraordinary position: He is defending *both* the individual's right to sue the manufacturer of a defective toothpick for a billion dollars, and the victims of enormous premium increases, by dumping the blame upon Lloyd's doorstep. Mr. Nader is to be congratulated for a piece of demagogery far more sophisticated than his usual inventory: Lloyd's, in the narrow sense, is the agent of the crisis, if not its source.

The Canadian weekly *Financial Post* explained on Jan. 11, "When insurance companies take on huge commercial risks—say $100 million or more—they reinsure it in layers with other companies. That spreads the risk, which is what insurance is all about.

"But in Europe, where the bulk of the world's reinsurance is transacted, reinsurance companies are taking much smaller portions of North American business. In some cases, they're taking none at all, especially in liability insurance. They are refusing it because they don't know what the awards will be or how the courts will interpret contracts . . . as much as three-quarters of the reinsurance available in 1985 is not available in 1986, and is unlikely to be for the next year or two."

Since Lloyd's dominates the American reinsurance market, Lloyd's triggered the crisis. Nader would be perfectly right to go after the London syndicate, one of the world's dirtiest financial operations in any event, except for one error of omission: The effect of knocking Lloyd's out of the Amer-

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ican picture would be, all things equal, to bring in Lloyd's major competitor: the Swiss-Venetian insurance cartel centered upon the merger of the Munich-based Allianz Versicherung, and the Venice-headquartered Riunione Adriatica di Sicurtà. Certain American insurance-industry sources suspect that Mr. Nader, who can't be bought, but will talk short-term leasing, is acting as an agent of the Swiss-Venetian reinsurance group.

At stake is control of the world's largest financial flow: insurance premiums.

Half a trillion in premiums

In 1982, the world's 78 largest insurance companies were paid $466 billion in premiums, according to the Swiss Reinsurance Company, the only source of worldwide data for the sector. Although more recent data are not yet available, that total has increased substantially, putting insurance premiums in the same league as the United States federal government's tax revenues.

For reasons noted above, $50 billion of reinsurance controlled nearly 10 times that amount of primary insurance, particularly in the property and casualty market; even the largest insurers are not big enough to handle the liability arising from pilot error on a jumbo jet, or suits arising from side-effects discovered years after a pharmaceutical product was in widespread use.

To an insurance company, a policy is no different than a stock, bond, or mortgage; it is an income-bearing security. Just as the insurance companies will not buy stocks and bonds which have no re-sale market, they will write no insurance that cannot be brought to the reinsurance market. The market-makers for reinsurance dictate conditions, therefore, in the entire market, just as Nader charges.

In 1982, $30 billion of the $50 billion in reinsurance volume was controlled by the handful of large companies known as the "professional reinsurers," in the definition of one of the largest, Swiss Re, which also is the only source of global data for reinsurance. That broke down as follows:

United Kingdom (Lloyd's)	$7 billion
Germany	$7 billion
U.S.	$5.5
Switzerland	$3.5
France	$1.6
Others	$5.4

Lloyd's, powerful as it is, is only one-sixth of the total. The giant Munich-based companies, Allianz and Munich Reinsurance, own 30% of each other; Allianz owns half of the Venetian Riunione Adriatica di Sicurtà; the RAS is linked by family and historical ties to the other Venetian giant, the Assicurazioni Generali; and all work closely with the Swiss Re, Winterthur, and the other Swiss insurance giants. The so-called continental European group has almost two-thirds of the action in reinsurance; by extension, it is, without question, the world's greatest financial power.

The more-than-half-trillion-dollar income of the insurance industry overshadows the pathetic position of the commercial banks, broken as they are by borrowers' inability to pay. The insurance companies have no such worries; they know, by actuarial calculation, what level of claims to expect against any level of policies outstanding.

While the British and continental wings of the reinsurance cartel are indistinguishable in action, they have had some disagreements in the course of the last century. One such disagreement was World War II, as a top official of a British insurance company put it. Not, of course, that the fortunes of the insurance cartel were solely responsible for the war, but that the respective financial powers supported Churchill on the British side, and Hitler and Mussolini on the continental side.

The continental faction's public face, the "International Association for the Study of Insurance Economics," also known as "The Geneva Association," is currently a major promoter of European decoupling from the United States in favor of a "New Yalta" agreement with the Soviets. Its chairman, Orio Giarini, and its president, Fabio Padoa of the Assicurazioni Generali, sponsored a 1984 conference on "Central Europe" at Duino Castle in Italy, which produced the most explicit statement of the "New Yalta" perspective in recent history.

All that is in keeping with the Swiss-Venetian cartel's Nazi past. Although the lines of division are not so simple as the national origin of participants, the old political distinction is still in place. The world saw, indirectly, how bitter the underlying division is, during 1983, when Allianz of Munich attempted to buy out Britain's Eagle Star Insurance. Allianz failed because the Thatcher government pushed British-American Tobacco into making a better offer for Eagle Star, to keep the company in British hands. Allianz responded to the rebuff by strengthening its continental ties, through the purchase of the RAS in 1984.

An unregulated industry

Now the American insurance industry, particularly the troubled property-casualty sector, is up for grabs, and both sides have seized the opportunity: the British reinsurers, who have turned the screws on their American clients, and the Swiss-Venetian gang, who hope that Lloyd's greed will backfire, and permit them to replace the British in control of the American market.

The American property-casualty insurance business can be characterized, most charitably, as a gigantic tax ripoff. If there were any governmental scrutiny of the industry (apart from the soft-boiled state regulators), we would probably learn that the insurance companies make the worst of the confessed money-launderers among commercial banks look like a Girl Scout troop.

Since no federal government agency regulates the insurance industry, no investigations have been conducted com-

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parable even to the stunted efforts of the Justice Department against bank money-laundering. For the moment, therefore, we will concentrate on tax fraud.

Supposedly because of operating losses during the past five years, and supposedly because of insane jury awards, insurers have been forced to raise premiums by intolerable margins, or abandon risk coverage altogether.

The jury awards have, indeed, been insane, as formerly sensible ordinary people who serve on juries are whipped into fits of vengeance against supposed symbols of corporate authorities. As FMC Chairman Robert Malott warned in a speech on Oct. 10 at Northwestern University, excessive liability costs have all but shut down production of the DPT vaccine, which is used to prevent diphtheria, tetanus, and whooping cough among children. Horror stories Malott cites include the following:

"In the past decade, 10 of the 13 U.S. firms making football helmets have had to stop production, due to runaway jury awards.

"In 1983, Merrell Dow was forced to discontinue production of the drug Bendectin, although the Food and Drug Administration approved the drug for treating women who suffered nausea during pregnancy. The reason? The cost of liability insurance for making Bendectin had reached $10 million a year, or over 80% of the company's annual sales from the drug.

"And today, the continued production of small aircraft in this country is being seriously threatened by burgeoning liability costs. This year, those costs to general aviation airframe manufacturers will amount to $100 million, requiring an average increase of $50,000—or 50%—to the cost of the average plane. Such cost increases have already led one manufacturer, Beech Aircraft Corporation, to shut down its plant in Wichita, Kansas, and eliminate up to 12,000 jobs."

All this is true. But excessive jury awards still accounted for only a fraction of the $19.4 billion operating loss of the property and casualty insurance industry during 1984.

Since 1980, when Federal Reserve chairman Paul Volcker drove interest rates to the highest level in U.S. history, the property and casualty insurers have used federal tax breaks to run a loss on operating income (the difference between premiums received and claims paid), in order to boost their *investment* income.

Federal tax law permitted the companies to earn, net, a total of $75 billion between 1975 and 1984, without paying a penny of income tax. Not only did they fail to pay a nickel of taxes; the 29 largest property and casualty insurers chalked up an additional $6 billion of "tax loss carry forwards," i.e., tax losses to apply against income earned in the future.

This incredible fact is documented exhaustively in a March 25, 1985 study by the General Accounting Office of Congress, which was never reported in the major news media.

Six of the top insurers are owned by corporations not in the insurance industry, which use the tax losses racked up by their insurance subsidiaries to write off other income.

Between 1975 and 1984, the GAO study reports, the insurers lost about $46 billion in insurance operations, but made $121 billion on their investments—for a net gain of $75 billion. Federal tax breaks written for their benefit allowed them to exempt an incredible 60% of their investment income from Federal taxes!

It was a great deal, while it lasted. Starting in 1980, the insurers cut their premium rates, in order to sign up as many new accounts as possible. It didn't matter that they lost money on underwriting; they could write that off, and earn tax-free income at Volcker's stupendous interest rates by putting their premium income into the money market. For example, the insurance companies gleefully paid out 60% more in malpractice insurance claims than they received in premiums, during the early 1980s.

By 1984, operating losses exceeded investment income, at least on paper. But even then, the GAO study points out, the insurers had a positive cash flow of over $11 billion. How is that possible? The insurers are permitted, under law, to write off (for tax purposes) their total claims liability, even if it is to be paid out over years, while premium income continues to roll in.

Small wonder that property and casualty insurance company stocks are selling at 50% above their 1980 level, and at 150% of book value (nominal worth). Despite the paper losses, they were a gold mine of cash flow and tax breaks.

With the near-bankruptcy of the federal government, the handwriting is on the wall for the insurers' special tax deal. Rep. Dan Rostenkowski (D-Ill.), head of the Ways and Means Committee, wants to slap limits on their tax write-offs. So the insurers have turned around and put the screws on doctors, farmers, truckers, homeowners, and whatever other victims they can find.

The whole, Venice-based insurance cartel must be broken up. The United States should have as much sense as the Brazilians, and replace these vultures with national liability insurance. It won't be necessary to nationalize them. Opening their books would be sufficient to put the management of most of the big insurance companies in jail.