

## Longtime L.A. Insurer Facing Pressures

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Staff Reporter

It's been a tough time all around for the **insurance** industry, but perhaps nowhere more than at **Farmers Insurance**, Los Angeles' venerable 75-year-old financial-services giant.



The company has seen its ratings downgraded in the face of continuing underwriting losses. It has pulled out of the huge Texas homeowners' market, where it's being sued by the state and mold claims are sky high. And it's had to fend off rumors that its financially ailing Swiss-based parent, Zurich Financial Services Group, wants to put it on the block.

"It's definitely been an organization under stress," said Grace Osborne, an analyst with Standard & Poor's, which cut **Farmers'** ratings in February from AA- to A.

**Farmers** isn't the only insurer that has suffered in the face of higher-than-expected claim payouts after years of underpricing its auto and homeowner policies – pricing helped by huge investment returns that have now dried up. Industry giant State Farm Mutual Automobile **Insurance** Co. reported this year losing a record \$5.5 billion in 2001 after earning \$200 million in 2000. And that doesn't include the billions of dollars in claims related to the terrorist attacks.

But **Farmers**, actually a group of associated **insurance** exchanges, finds itself under extra scrutiny by customers, regulators and even its parent, although there are indications that a turnaround might be in sight.

"If you go back to **Farmers'** 75-year history the thing you will see is a strong, consistent performer and strong consistent growth in earnings," said Jeff Buyer, the company's spokesman. "This is our track record."

**Martin Feinstein**, the company's chairman and chief executive, was not made available for an interview.

### Widening losses

Underwriting performance has been a core problem at **Farmers**.

The 18 exchanges, which operate similarly to mutual **insurance** companies that are owned by policyholders, lost \$77.7 million in 1999, \$591.7 million in 2000 and \$787.2 million in 2001.

Analysts attribute these losses not so much to a dip in investment income but to underwriting losses, especially in its core businesses of writing automobile and

homeowners coverage – two market segments where it's No. 3 nationally and No. 2 in California.

The losses have resulted in the company paying out as much as \$1.17 for every dollar of premium earned in 2001. As a result, the company has been tightening its underwriting standards and raising prices.

Just two weeks ago in California, **Farmers Insurance** Exchange, the biggest of its companies, had a 13 percent homeowners' rate hike approved by regulators.

“**Farmers** and their affiliates have been fostering their problems on consumers,” said Doug Heller, a representative of the Foundation for Taxpayer & Consumer Rights.

The losses have cut into the exchanges' surplus, or capitalization, which is the amount that **insurance** companies set aside for unexpected losses, as well as growth. Last year, surplus fell to \$3.4 billion from \$3.7 billion in 2000 and \$4.7 billion in 1999, prompting the ratings downgrades. (Reserves are the amount set aside to pay expected claims.)

But price hikes and tighter underwriting seem to be making a difference. **Farmers** cut its losses for the first six months of the year to \$136 million, from \$454 million for the like period a year ago.

Texas-sized troubles

Still, the company is far from out of the water. In Texas, where it's the second-biggest carrier of homeowner **insurance**, **Farmers** has suffered \$1.3 billion in underwriting losses over the past two-and-a-half years.

These losses have resulted from huge claims for mold damage; in June 2001, a jury ordered **Farmers** to pay a homeowner \$32 million for improperly handling her claim.

Unlike other states, policies written in Texas allowed homeowners to claim mold damage for problems like a slowly leaking pipe, as opposed to a “sudden or accidental” event, like a burst pipe or storm.

As a result, State Farm stopped writing new homeowner coverage in the state in January 2001, while **Farmers** switched to a new policy that excluded mold coverage unless homeowners paid extra for it.

Then, based on complaints that homeowners were being hit with 200 percent rate hikes, the state **insurance** commissioner initiated an investigation into the premiums being charged by all the major carriers. In August, the commissioner filed a cease and desist order against **Farmers**, accusing it of unfair pricing practices. This included placing surcharges on Texas customers for catastrophic losses the company experienced elsewhere.

Also that month, the state attorney general filed a lawsuit seeking damages for these practices, up to \$25,000 for every injured customer, of which **Farmers** has 700,000 in the state.

Last month, **Farmers** fired back, announcing it was leaving the state's homeowners market, a core market for the company. It also claims that the mold issue has become political fodder for Republican Gov. Rick Perry, who is running for re-election.

"It's a state we are interested in remaining in, but right now we are unfortunately caught in an election-year dispute," Buyer said. "We find no merit to the charges."

The hardball move by **Farmers** has not gone over well in the state, leading to charges that the company is trying to coerce regulators into dropping the lawsuit by disrupting coverage for nearly a million residents.

"They have given themselves a big black eye. Their problems just snowballed," said Rob Schneider, an attorney for the Austin branch of Consumers Union. "I don't think they are the reason for the **insurance** crisis in the state, but now they are getting painted as the reason."

Analysts pleased

While the move has angered Texans and would represent a big loss in premium volume for the company, analysts are praising the company's decision.

"They are effectively shedding a very bad business," said Stefan Holzberger, an analyst with A.M. Best Co., which also downgraded both **Farmers** and its parent, Zurich, last month.

Meanwhile, the company is getting pressured by its ailing parent, which took control of **Farmers** in 1997. Zurich reported \$2 billion in losses for the first half of the year, largely as a result of poor underwriting performance that required it to use \$1.9 billion of its capital to beef up its reserves. It also took goodwill impairment charges of \$900 million.

Seeking a turnaround, the company's new management announced in September a series of "strategic initiatives," including a \$2.5 billion offering of rights, which is similar to a stock sale, to raise capital.

Company officials also plan to assess their subsidiaries, especially ones that are not meeting a benchmark of 12 percent return on equity, or are not in core markets or core services. That prompted rumors that perhaps **Farmers**, its biggest subsidiary, would be on the block. Holzberger dismisses the idea.

"**Farmers** is a main source of revenue for Zurich," he said.

Zurich Financial Services does not own the exchanges, but does own **Farmers** Group

Inc., the corporate entity that has its own life **insurance** business and manages the exchanges for a substantial fee based on premium volume.

This arrangement has insured that the management company remains consistently profitable and is able to consistently contribute to Zurich's own revenue.

Zurich officials deny any possibility of a sale but acknowledge its problems have not gone unnoticed.

"It's a pretty good business that generates a very good business for us," said Daniel Hofmann, chief spokesman for Zurich financial. " (But) it's in our interest that the exchanges get their act together."

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