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Japan Disaster Shows Coverage Gaps, But Quake Still Costly For Insurers

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NEW YORK (Dow Jones)--Despite the massive destruction caused by Friday's earthquake and tsunami, the global insurance market won't bear the heaviest burden when rebuilding begins because Japanese homeowners and businesses have been reluctant to buy insurance to cover all of their potential losses.

The cost will be borne more by the government and citizens of Japan, making the recovery process more arduous than it would be on other developed nations. Still, the massive scope of the disaster will mean the portion covered by international insurers will be well into the billions of dollars--and will likely be one of the most expensive earthquakes in history.

Fewer than half of Japanese homes have earthquake protection, and the policy limits are often well below the cost of rebuilding a dwelling, experts on the Japanese insurance market said. Much of the coverage is backed by a government-supported pool, called Jisai, instead of being passed off to the global reinsurance market, which protects insurers from large losses.

Still, some home insurance in Japan is sold through cooperatives called kyosai, where agricultural groups, unions or other organizations arrange the coverage for their members. Kyosai buy backup protection from companies based outside Japan, unlike the rest of the home-insurance market.

Businesses in Japan don't buy government-backed insurance, relying instead on private insurance. But the coverage isn't included in standard property policies, and the companies that buy the added protection often don't purchase an amount that would cover a total loss. Risk Management Solutions Inc., a disaster-modeling company, said many small- to medium-size businesses are "completely uninsured."

The earthquake that killed more than 6,000 people in Kobe in 1995 caused about $100 billion in economic damage. Only about $3 billion of it was insured, and much of the cost was borne by domestic companies. The devastation--which struck a part of the country that wasn't thought to be overly susceptible to earthquakes--prompted more businesses to buy quake protection, said James Few, president of the reinsurance operation at Aspen Insurance Holdings Ltd. (AHL). But the increase in insurance buyers has been less than expected. Both businesses and homeowners perceived the coverage to be expensive, he said.

"It's not that this won't be a big loss" to the insurance industry, said Few. "But the gap between economic loss and the insured loss will still be far greater in Japan than you would expect to see for a similar event in the U.S. or Europe."

RMS and its rivals haven't published estimates of insured losses yet, but analysts who track insurance companies said insurance claims could be $10 billion to $25 billion. One analyst said it could be as high as $50 billion. Even at the low end of the range, the losses would mark Friday's event as the second or third most-expensive quake for the insurance industry in history. The only quakes that rival it are the $15.3 billion earthquake in Northridge, Calif., in 1995 and last month's temblor in Christchurch, New Zealand, where costs are still being tallied.

Investors on Friday were busy trying to sort out which insurers and reinsurers would be hardest hit, though the companies themselves declined to comment or said it was too soon to say. Flagstone Reinsurance Holdings SA (FSR) plunged 12% in afternoon trading to $9.65. The company said in a filing with securities regulators last week that it sold a "significant amount of catastrophe" coverage in Japan, though it wasn't its largest market. Lloyd's of London underwriter Chaucer Holdings Plc (CHU.LN) fell 6.5% to 54 pence. Other decliners included the world's largest reinsurers, Swiss Reinsurance Co. (RUKN.VX) and Munich Re; and smaller firms, including Platinum Underwriters Holdings Ltd. (PTP), Montpelier Re Holdings Ltd. (MRH) and TransAltantic Holdings Inc. (TRH). All fell 4% or more.

Still, industry executives said international insurers and reinsurers will be able to meet their obligations tied to the quake. But what happens to the industry next is a difficult question to answer. Insurers are already on the hook for substantial claims tied to storms and flooding in Australia and the Christchurch quake, and analysts said many reinsurance companies will report first-quarter losses and may end up losing money for all of 2011.

This year's spate of disasters comes after costly earthquakes in Chile and New Zealand last year, and some insurers and reinsurers are also paying out claims tied to last year's oil spill in the Gulf of Mexico.

After all the catastrophes, the Japanese quake could be cause for a worldwide increase in the cost of disaster coverage, which would be felt by buyers of insurance around the world.

Reinsurers have been flush with capital and have been cutting prices as they compete for clients. But payouts on catastrophe claims will deplete some of their excess capital and force a re-evaluation of the areas where disaster costs can, theoretically, be even higher, such as in hurricane-prone parts of the U.S. and earthquake-prone California.

In addition, RMS recently released a new hurricane model that drastically increased its estimates for potential storm costs in parts of the U.S.

"Everybody is already talking about the impact on the U.S. marketplace," said Rod Fox, chief executive of reinsurance broker TigerRisk. The Japan earthquake, "when you combine it with the model changes, will stop the slide in U.S. pricing and could have even stronger effects going forward depending on the size of the loss.

"Fifteen billion will stop the decrease in prices," he said. "To the extent Japan starts getting larger than that, the impact becomes even more significant."

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