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Analysts: why do they hate the insurance industry? A round table discussion of the troubled relationship between the insurance industry and its analysts – what can be done to fix it? With Bob Yates (Fox-Pitt Kelton), Ralph Hebgen (KBW), Harish Gohil (Fitch Ratings) and Georg Grodzki (LGIM) held on Monday, September 15, 2008, at the City Marketing Suite, Basinghall Street, London, EC2P 2EJ, from 12:30-2:15pm.

CSFI/Generali Programme in Insurance

If a $100 were invested in insurance stocks in 1975, with dividends reinvested it would now be worth $100. For the general index the answer would be $2,000. Either something is fundamentally awry with the business model or they are bad at communication. Of course the day of the roundtable saw AIG struggling to raise a $40bn of emergency funding, so the timing could not be better. The first speaker said there has been little reward for shareholders and an alphabet soup of disasters – AIG, RSA, ZFS and CU. He questioned the general business model and saw attempts by the industry to show economic value creation as akin to medieval religion.

Insurers do a bad job of their core job of event risk. Nor have they managed capacity given 85% of their costs are variable and cash can be returned to shareholders easily. The rolling three-year system of accounting means it is hard to see value creation. He was also critical of losses by insurers, particularly on the non-life side, on equity investments. Yes, equities can be a hedge against inflation but with low inflation and high volatility that argument didn't work. Analysts felt insurers should stick to their knitting.

There were reasons to be cheerful. Banks were about to become the new hate figure. Those insurers that suffered most were those that had tried to become banks – AIG, Swiss Re; the others are in pretty good shape. Insurers have learned a lot from their near-death experience in 2002 in terms of liquidity management. There are signs of structural change and hints that shareholders are starting to see that.

The second speaker said analysts were forced to make assessments based on misleading data and misleading assumptions. Just for amusement he had constructed a hate/love ratio for insurance and banking based on analysis of the results of Google searches on "love insurance" and "hate insurance". The result was 3.7 for insurers and 1.0 for banks. On a more serious note he gave examples of the way insurers issued financial updates that were hard to compare with other companies or even with their own past figures.

Combine unclear reporting with obscure accounting and analysts struggle to grasp the picture and investors are left in the dark. Granted, banks too have turned out hard to understand, but at least they focus on earnings growth rather than value as insurers do. Headline figures are distorted by a host of adjustments that are impossible to explain. Analysis of analysts' forecasts and actual results show an error spread of 50% in both directions – "in other words we are just guessing". If anything, the next steps in accounting will make things worse, as IFRS will make earnings look like embedded value. In conclusion his Google analysis of Gobbledegook and registered 5.2 for insurers versus 2.0 for banks!

The third speaker said insurers were up against a lot of hurdles. Generalists don't have time to study the intricacies of the business. The industry should do more to address that but doesn't. There is a strong feeling among analysts that insurance cannot be compared with other sectors. Indeed different companies and auditors use different accounting assumptions. The rolling accounts also make it hard to compare annual performance.

The fourth speaker said it was clearly popular to short insurers and issues of fair value and lack of transparency were top of peoples' minds. He admitted that as a credit analyst he did not like insurers and did not believe they should issue debt as cash-rich companies. On top of that list of defaults was overlong. So, yes, on the one hand insurers are undeservedly punished for not being self-explanatory. On the other hand the sector has a chequered history and has to be treated with reservation.

He raised a big issue: given equity analysts can't understand them and, post-AIG, they won't be able to raise debt, then maybe they should return to mutuality. One member said mutuals would not be able to raise cash in a hurry while another pointed to the lamentable example of Equitable Life. One member highlighted the Bermuda insurers who had made decent returns. The first speaker said they exploited legacy problems of the industry and then tended to sell up once that game was played out; or focused on specific areas such as catastrophe insurance. One member described the latter as "picking up nickels in front of a train" – eventually one will get wiped out.

If the panel was granted one wish for a change in the way insurers presented accounts, what would it be? The second speaker wanted to see investment margins, fee income, associated expense for life and P&C, pre-tax profit and then analysts can deal with the adjustments. The third speaker urged them to improve disclosure on cash values. The fourth said they should abandon numbers that only apply on a certain date and give as much detail about what they are doing and were they're investing. If they hand over a wealth of material analysts can do the rest. The first speaker wanted a ladder of maturity of liabilities and their likely repricing levels and details of maximum losses for anyone reinsuring layers of liability so analysts can see what the implications are.

The chair couldn't let the roundtable end without seeking views on AIG. The fourth speaker said it would hurt insurers' shares and spreads for a period of weeks but as people realised AIG was sui generis then conditions would improve. The others broadly agreed while the first speaker added that the "dirty linen" of AIG's activities would be washed in public.