Insurance Bonds Fall as Hurricane Katrina Strikes New Orleans
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(For a special report on Katrina, see {EXTRA <GO>}).

By Caroline Salas and Walden Siew

Aug. 29 (Bloomberg) -- Bonds of insurance companies including Allstate Corp., the biggest publicly traded auto and home insurer, fell on speculation that Hurricane Katrina will be the most expensive storm ever for the industry.

Katrina came ashore 55 miles southeast of New Orleans this morning packing 140-mph winds, according to the National Hurricane Center. Storm modeler Eqecat Inc. estimates the storm may cost the insurance industry as much as $25 billion.

``Those insurance issuers with large Gulf (of Mexico) exposure should widen,'' said Mirko Mikelic, who manages $14 billion of bonds at Fifth Third Asset Management in Grand Rapids, Michigan. Fifth Third holds insurer bonds, including Allstate and American International Group, but reduced its holdings during last year's hurricane season, he said.

Allstate's 5.55 percent note maturing in 2035 fell more than 0.5 cent on the dollar this morning to 101 cents and yielding 5.5 percent, according to Trace, the bond-price reporting engine of the NASD. The extra yield, or spread, investors demand to own Northbrook, Illinois-based Allstate's bond over comparable U.S. Treasury notes increased around 8 basis points to 113 basis points. A basis point is 0.01 percentage point.

Catastrophe

Prices for so-called catastrophe bonds, whose returns may be eroded in the event of damages from severe weather, also fell. The securities, used as an alternative to reinsurance for large claims, were created in the 1990s by Goldman Sachs Group Inc. bankers after Hurricane Andrew and a California earthquake caused a combined $35 billion of claims.

One trader estimated the lowest bid on hurricane bonds is 84 cents on the dollar and the median bid price is around 90 cents. The bonds are offered at a lowest price of 90 cents on the dollar and a median price of 95. Prices are usually around par, according to the trader.

``It's certainly not unlikely it could be like Hurricane Andrew, which was a big event and what got this market started,'' said Greg Hagood, principal at Nephila Capital Ltd., a Bermuda-based hedge fund that has traded catastrophe bonds since 1998.

No catastrophe bond has ever not returned its entire principal, Hagood said.

``A lot of players in the market have actually shorted some of the catastrophe exposure in insurance companies going into the season, so now that we actually have a major catastrophe on our hands, the market impact is not as dramatic,'' said David Havens, fixed-income research analyst at UBS AG and third-team ranked insurance analyst on Institutional Investor's 2004 All America Fixed-Income Research Team.

Four Storms

Spreads on property casualty insurance companies in the credit default swap market have widened only 2 or 3 basis points, said Havens, adding that flooding in New Orleans may add an additional 5 to 10 basis points.

``We went through four storms last year that generated more than $20 billion in insured losses and very few credit downgrades resulted,'' Havens said. ``The insurance companies are prepared to weather the storm with their ratings intact.''

--Editor: Pittman.

Story illustration: For a description of Allstate Corp.'s 5.55 percent coupon note maturing in 2035, click:
{020002AS0 <Corp> DES <GO>}
To see today's trading in the bonds that make up Goldman Sachs's iShares InvesTop corporate bond index, click on {BLRV <GO>}.
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