

# Update on Current Status of Insurance Market

November 25, 2008



*Recent events in the US and Global Financial markets have left insurance industry regulators, analysts and policy-holders concerned about the current state of the global insurance markets. In addition, during the third quarter, the industry has experienced \$11.5 billion in catastrophe losses due in part to Hurricanes Ike and Gustav. Some of the largest and seemingly best positioned insurance carriers have found themselves struggling to meet liquidity needs, with some seeking new capital infusions. To further complicate this negative environment, turmoil in the investment markets has negatively impacted investment income for insurance carriers.*

*Hylant Group is committed to providing our clients with the information they need to manage their risks during these challenging times. Our Market Security Committee, which is comprised of senior Hylant leadership, is keeping abreast of developments as they occur. The committee has developed a watch list including several carriers that we are closely monitoring. The following summary provides an update on several Insurance carriers that have recently announced capital concerns.*

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## **AIG**

In September, American International Group Inc. (AIG) found itself in a liquidity crisis resulting from significant investments in credit default swaps which resulted in a \$14.5 billion capital call. In order to prevent the company from filing bankruptcy, the federal government provided AIG with a two year \$85 billion loan in exchange for warrants representing 79.9% of the company. Edward Liddy replaced Robert Willumstad as the company's CEO. AIG intends to pay off the Federal loan through the sale of virtually all of AIG's non-insurance assets, however, as of this writing, none of the assets have been sold. In October, the Federal Reserve announced an additional \$38.7 billion facility for domestic life collateral operations. AIG repaid a portion of the loans but only by borrowing from a different government lending program. On October 31<sup>st</sup>, AIG was allowed access to another \$20.9 billion through the Fed's commercial paper program.

On November 10<sup>th</sup>, the U.S. government signed a new \$150 billion deal with the company replacing the prior agreement. Under the terms of the restructured loan, AIG's original \$85 billion bridge loan was reduced to \$60 billion, the borrowing period for the loan has been extended to five years and the interest rate cut by 5.5 percent. In addition, the Treasury will purchase \$40 billion of the company's preferred stock. The goal of the new plan is to establish a durable capital structure for AIG, and to help ease the impact of four straight quarterly deficits, including a \$24.5 billion third-quarter loss.

In September, S&P lowered its financial strength ratings for AIG's insurance operation to A+ with a negative outlook. The company's long-term and short-term counterparty ratings were also lowered. After the announcement of the Federal loan, the counterparty ratings rebounded somewhat. The company's A.M. Best financial strength rating is currently at A/Excellent for most AIG units with negative implications. Moody's also lowered AIG's debt rating to A2 from Aa3 in September.

In spite of the challenges being faced by its parent company, AIG Commercial Insurance's management has continued to stress its commitment to policyholders and to reaffirm its ability to pay claims. The situation remains fluid and is being closely watched by the rating agencies and analysts. After the announcement of the new bailout plan, Mr. Liddy stated that the new measures would, "put AIG on track to emerge as a nimble competitor with good long-term growth prospects."

## **The Hartford**

On October 6<sup>th</sup> Hartford reported that it was estimating investment losses for the third quarter including net realized investment losses of \$2.1 billion to \$2.2 billion as well as unrealized net losses at \$3.4 billion to \$4.2 billion. The company also announced that Allianz would be investing \$2.5 billion in the insurer potentially giving it a 23% stake in Hartford. On October 29<sup>th</sup>, the company's stock dropped 51.6% and on October 31<sup>st</sup> it reported a net loss of over \$2.6 billion. However, on Monday, November 3, 2008, Hartford's stock regained some

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momentum and closed at \$16.28 per share or 57.8% over the previous trading. On November 14<sup>th</sup>, the company announced that it had applied to participate in the U.S. Treasury's Capital Purchase Program (CPP). In order to participate in the program, insurers must also be a savings and loan or thrift company. In order to meet these requirements, Hartford announced two additional actions: 1) Hartford applied to the Office of Thrift Supervision to become a savings and loan holding company, 2) Hartford entered an agreement to purchase Federal Trust Corporation, a Florida savings and loan holding company. Hartford's share price continues to fluctuate. On November 19<sup>th</sup>, the share price dropped again to \$9.64. On November 25<sup>th</sup> the share price was at \$7.16.

As a result of the above events, rating analysts are reevaluating the company. A.M. Best has placed the A+/superior financial strength ratings of Hartford's operating units under review with negative implications. Standard & Poor has affirmed Hartford's financial strength rating of AA-/very strong but has adopted a negative outlook. Moody's has also affirmed their Aa3/excellent rating though it placed the holding company's debt rating under review for a possible downgrade. Analysts anticipate that Hartford will look at all alternatives for raising capital which could include selling portions of its property-casualty insurance business or selling the entire business. In addition, on November 4, 2008, Hartford announced that approximately 2% of its workforce would be laid off in response to Hartford's continuing challenges. The Hartford is reassuring customers that they are appropriately capitalized to meet their current and future commitments. The company feels that the capital made available through federal programs will strengthen it further.

### **XL Capital Ltd.**

On October 20<sup>th</sup>, XL Capital Ltd. announced an estimated third-quarter net loss to ordinary shareholders of between \$1.65 billion to \$1.67 billion. XL also advised that its chairman had involuntarily sold about 80% of his XL shares due to a margin call. XL indicated that the loss was due in part to a \$1.40 billion charge related to Syncora Holdings Ltd. (previously Security Capital Assurance Ltd.), a prior subsidiary that was divested in 2006. The company also said it had net losses of \$222.8 million from Hurricanes Gustav and Ike, as well as charges of \$41.7 million and \$22.5 million related to streamlining corporate functions and from the redemption of XL American Inc.'s \$255 million guaranteed senior notes respectively.

Moody's announced on October 23<sup>rd</sup> that it would be reviewing the company's ratings. Currently the company has a Baa1 rating for its senior unsecured debt and an A1 financial strength rating. A.M. Best's financial strength rating for XL is currently A with a stable outlook. Standard & Poor's credit rating for the company is currently A- with a negative outlook.

### **Everest Re**

Everest Re's 3<sup>rd</sup> Quarter earnings were reported at \$.21 per share as compared to \$3.68 per share for the same quarter last year. The loss was due to several factors including, previously unannounced hurricane losses, write-downs associated with its financial sector bond holdings & equity securities, and net realized capital losses on the sales of securities.

Despite the loss, A. M. Best has maintained Everest Re's financial rating at A+/superior with a stable outlook. Standard & Poor also affirmed the company's AA-/very strong financial strength rating. Moody's has rated the company at Aa3/excellent with a stable outlook.

### **CNA**

CNA Financial Corp. reported a \$331 million net loss for the third quarter. The loss was primarily due to catastrophic claims and investment losses. CNA's parent, Loews Corp. agreed to purchase \$1.25 billion of non-voting cumulative senior preferred stock to help strengthen the company. CNA indicates it will use \$1 billion of the proceeds to increase the surplus of its principal insurance subsidiary, Continental Casualty Co. CNA's current chairman and CEO, Stephen Lilienthal, stated, "We believe by taking this proactive step, we further augment our

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solid capital base and are well positioned to both meet the challenges and act on the opportunities likely to emerge in the marketplace". CNA also announced that former Chubb executive Thomas Motamed will take over as chairman and CEO effective January 1, 2009 succeeding Lilienthal, who will retire on that date.

A.M. Best has affirmed CNA's Property & Casualty A rating with a stable outlook. Moody rating of A3 with a stable outlook has also been affirmed and the Property and Casualty company's Standard & Poor rating is A-/strong,

### **MetLife**

MetLife reported that its 3<sup>rd</sup> quarter profit is down 39% from last year. The loss was attributed to paying out \$1.2 billion more in benefits and claims as well as higher operating costs. Total revenue was up 14.5% over last year. The results for the quarter also included costs from MetLife's spinoff from Reinsurance Group of America Inc. MetLife's Chairman, President and CEO, C. Robert Henrikson, has reassured customers that the company is financially strong with a diversified business model and fully able to meet obligations. The company also sought to improve its position by raising \$2 billion in new capital through a stock offering in early October.

MetLife currently has an A. M. Best financial strength rating of A/excellent with a stable outlook and a Standard & Poor's rating of AA/very strong. Moody's has rated the company at Aa2/excellent.

### **Prudential**

Prudential Financial, Inc. reported a 3<sup>rd</sup> quarter net loss for its Financial Services Businesses of \$108 million, compared to net income of \$860 million for the 3<sup>rd</sup> quarter last year. The company also indicated that it was changing its accounting practices immediately to follow SEC guidelines more closely and that \$500 million in fixed-income securities that would have been reported as an impairment other than temporary will now be reported as an unrealized loss. If the company had handled the accounting of the securities based on its previous accounting methodology, this amount would have increased the loss reported significantly. The company decided to withdraw its earnings guidance for 2008 in light of current market volatility and developments affecting financial markets. Chairman and Chief Executive Officer John Strangfeld stated that he felt the company's strong balance sheet, financial flexibility, and balanced mix of businesses and risks would help position Prudential well to achieve long-term results consistent with the its goals.

On November 3<sup>rd</sup>, Moody's cut Prudential's debt rating to A3 with a stable outlook. The company's financial strength rating of Aa3 was reaffirmed. The company's A. M. Best rating is still at A+/Superior and its Standard and Poor's rating is still at AA/very strong.

### **Progressive**

Progressive Corp. reported a 3<sup>rd</sup> quarter loss of \$684.2 million compared to a net profit of \$299.2 million reported for the same quarter last year. This is the company's first quarterly loss since 2000. The loss is due to it writing down the value of investments including holdings of mortgage lenders Fannie Mae and Freddie Mac.

After the announcement of the loss, Standard & Poor's indicated that it might lower the company's A+/strong credit rating, however, it later reaffirmed the rating but with a negative outlook. The company's financial strength rating is at AA+/strong. A. M. Best currently has Progressive's financial strength rating at A+/superior with a stable outlook. Moody's also affirmed Progressive ratings of Aa2/excellent for financial strength and A+/good for debt, however the outlook on debt was changed to negative.

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*Hylant continues to support these above referenced companies. Hylant Group will continue to monitor this fluid situation and will rely on multiple resources including several rating agencies, in assessing the financial strength*

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of our carrier partners. Ongoing updates will be available at Hylant's website: [www.hylant.com](http://www.hylant.com) under **Insurance Company News Update**. You may also call your Hylant Client Executive to discuss any concerns you may have.

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