

## Company Article

## American International Group Inc.

FSR: -/--/--

FSR Last Reviewed: -

United States

CCR: A-/Watch Neg/A-1

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Sector: Insurance Holding Company

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## Contact(s):

Mark Puccia, New York (1) 212-438-7233;

mark\_puccia@standardandpoors.com

Rob Jones, London (44) 20-7176-7041; rob\_jones@standardandpoors.com

## Contact(s):

Robert Swanton, New York (1) 212-438-7404;

robert\_swanton@standardandpoors.com

Thomas Upton, New York (1) 212-438-7249;

thomas\_upton@standardandpoors.com

While global insurance companies are not immune from September's turmoil in the U.S. financial markets, Standard & Poor's Ratings Services believes the repercussions will be less severe for them than for the headline victims, Wall Street investment houses, mortgage lenders, American International Group's (AIG's) financial products unit, and government-sponsored enterprises (GSEs). We foresee few immediate negative rating actions beyond the handful already taken for the biggest players in the reinsurance, property and casualty (P/C), and life sectors. Overall, only a few insurers have lost enough capital, liquidity, or earnings to require ratings actions (see table 1).

In general, these companies, whether in the U.S., Europe, or Asia, seem well-positioned to withstand the turbulence America's mortgage meltdown is generating. Many insurers already made efforts to maintain capital levels in the face of weakness in most product lines and geographic markets, reducing or eliminating common stock buybacks, or cutting dividends. In May, we projected that North American insurers, across all sectors, would lose less than 3% of statutory capital this year from their exposure to subprime mortgage securities. In addition, many insurers are not significantly exposed to the mortgage-related securities that have hurt other financial institutions. In Europe and Asia, we believe the aggregate impact of mortgage-related securities losses will be relatively modest.

## Insurance Rating Actions, April 1 Through Oct. 6, 2008

Parent companies	Insurance type	Date	To	From
AEGON N.V.	Life	April 29, 2008	A+/Negative/A-1	A+/Stable/A-1
American International Group Inc.	Life, P/C	May 8, 2008	AA-/Watch Neg/A-1+	AA/Negative/A-1+
American International Group Inc.	Life, P/C	May 21, 2008	AA-/Negative/A-1+	AA-/Watch Neg/A-1+
American International Group Inc.	Life, P/C	September 12, 2008	AA-/Watch Neg/A-1+	AA-/Negative/A-1+
American International Group Inc.	Life, P/C	September 15, 2008	A-/Watch Neg/A-2	AA-/Watch Neg/A-1+
American International Group Inc.	Life, P/C	September 17, 2008	A-/Watch Dev/A-1	A-/Watch Neg/A-2
American International Group Inc.	Life, P/C	October 3, 2008	A-/Watch Neg/A-1	A-/Watch Dev/A-1
Arrowhead General Insurance Agency Inc.	P/C	May 6, 2008	B-/Negative/--	B/Negative/--
Aveta Inc.	Health	June 6, 2008	CCC+/Positive/--	CCC/Watch Pos/--
Aveta Inc.	Health	September 17, 2008	B/Stable/--	CCC+/Positive/--
C.G. JCF Corp.	P/C	August 26, 2008	B/Negative/--	B+/Stable/--
Centene Corp.	Health	April 22, 2008	BB-/Stable/--	BB/Watch Neg/--
Fidelity National Financial Inc.	Title	August 6, 2008	BBB/Negative/--	BBB/Stable/--
Fortis ASR Levensverzekering N.V.	Life	June 26, 2008	AA-/Watch Neg/--	AA-/Negative/--
Fortis ASR Levensverzekering N.V.	Life	July 17, 2008	A+/Stable/--	AA-/Watch Neg/--
Fortis ASR Levensverzekering N.V.	Life	September 29, 2008	A/Developing/--	A+/Stable/--
Fortis ASR Levensverzekering N.V.	Life	October 6, 2008	A/Watch Dev/--	A/Developing/--
Fortis ASR Schadeverzekering N.V.	P/C	June 26, 2008	AA-/Watch Neg/--	AA-/Negative/--
Fortis ASR Schadeverzekering N.V.	P/C	July 17, 2008	A+/Stable/--	AA-/Watch Neg/--
Fortis ASR Schadeverzekering N.V.	P/C	September 29, 2008	A/Developing/--	A+/Stable/--
Fortis ASR Schadeverzekering N.V.	P/C	October 6, 2008	A/Watch Dev/--	A/Developing/--

Fortis Corporate Insurance N.V.	P/C	September 29, 2008	A-/Developing/--	A/Stable/--
Fortis Corporate Insurance N.V.	P/C	October 6, 2008	A-/Watch Dev/--	A-/Developing/--
Fortis Insurance Belgium	P/C	June 26, 2008	AA-/Watch Neg/--	AA-/Negative/--
Fortis Insurance Belgium	P/C	July 17, 2008	A+/Stable/--	AA-/Watch Neg/--
Fortis Insurance Belgium	P/C	September 29, 2008	A-/Developing/--	A+/Stable/--
Fortis Insurance Belgium	P/C	October 6, 2008	A/Watch Pos/--	A-/Developing/--
Health Net Inc.	Health	April 30, 2008	BB+/Negative/--	BB+/Stable/--
HealthMarkets Inc.	Health	June 9, 2008	BB/Stable/--	BB+/Negative/--
HealthMarkets Inc.	Health	August 25, 2008	BB/Negative/--	BB/Stable/--
Kingsway Financial Services Inc.	Life	May 9, 2008	BB/Negative/--	BB+/Negative/--
LandAmerica Financial Group Inc.	Title	July 25, 2008	BBB-/Watch Neg/--	BBB-/Negative/--
LandAmerica Financial Group Inc.	Title	August 8, 2008	BB+/Watch Neg/--	BBB-/Watch Neg/--
Liberty Mutual Group Inc.	P/C	April 23, 2008	BBB/Watch Neg/--	BBB/Stable/--
Liberty Mutual Group Inc.	P/C	September 25, 2008	BBB-/Stable/--	BBB/Watch Neg/--
Magellan Health Services Inc.	Health	May 2, 2008	BB/Positive/--	BB/Stable/--
MGIC Investment Corp.	Mortgage	April 8, 2008	BBB/Negative/--	A-/Watch Neg/--
Montpelier Re Holdings Ltd.	Reinsurance	May 9, 2008	BBB/Stable/--	BBB/Negative/--
Ocidental Companhia Portuguesa de Seguros S.A.	P/C	June 26, 2008	A+/Watch Neg/--	A+/Negative/--
Ocidental Companhia Portuguesa de Seguros S.A.	P/C	July 17, 2008	A+/Watch Neg/--	A/Stable/--
Ocidental Companhia Portuguesa de Seguros S.A.	P/C	September 29, 2008	A-/Developing/--	A/Stable/--
Ocidental Companhia Portuguesa de Seguros S.A.	P/C	October 6, 2008	BBB+/Developing/--	A-/Developing/--
Old Republic International Corp.	Title	April 8, 2008	A/Negative/A-1	A+/Watch Neg/A-1
Old Republic International Corp.	Title	August 26, 2008	A-/Negative/A-2	A/Negative/A-1
PMI Group Inc.	Mortgage	April 8, 2008	BBB+/Negative/--	A/Watch Neg/--
PMI Group Inc.	Mortgage	August 26, 2008	BBB-/Watch Neg/--	BBB+/Negative/--
Presidential Life Corp.	Life	April 29, 2008	B+/Positive/--	B/Stable/--
Radian Group Inc.	Mortgage	April 8, 2008	BBB/Watch Neg/--	A-/Watch Neg/--
Radian Group Inc.	Mortgage	August 26, 2008	BB+/Negative/--	BBB/Watch Neg/--
Safeco Corp.	P/C	April 23, 2008	BBB+/Watch Neg/A-2	BBB+/Stable/A-2
Safeco Corp.	P/C	September 25, 2008	BBB-/Stable/A-3	BBB+/Watch Neg/A-2
Scottish Re Group Ltd.	Reinsurance	May 23, 2008	CCC-/Watch Neg/--	B/Watch Neg/--
Security Benefit Life Insurance Co.	Life	May 9, 2008	BBB+/Negative/A-2	A/Watch Neg/A-1
Triad Guaranty Inc.	Mortgage	April 3, 2008	BB/Watch Neg/--	A-/Watch Neg/--
Triad Guaranty Inc.	Mortgage	July 3, 2008	B-/Watch Neg/--	BB/Watch Neg/--
Triad Guaranty Inc.	Mortgage	July 15, 2008	NR (Rating withdrawn)	B-/Watch Neg/--
Unitrin Inc.	P/C	September 3, 2008	BBB/Watch Neg/--	BBB+/Stable/--

Some insurers are more affected than others. Earlier this year, we placed negative outlooks on the U.S. mortgage insurance, and commercial lines P/C subsectors, because of weaker industry fundamentals. The current uncertainty in the housing and credit markets clearly will not help. Among the biggest insurers, AIG falls in a category all its own, because of the large credit default swap (CDS) positions of its noninsurance financial products unit. The global insurance giant received an \$85 billion loan facility from the federal government to avoid possible bankruptcy. We affirmed our ratings on Swiss Reinsurance Co., which also wrote CDS, because its exposure was small compared with AIG's, and its liquidity remains strong.

The relatively small U.S. mortgage insurance subsector has been problematic. While these insurers remain relatively well capitalized, we have a negative outlook on the industry, where returns on investment will continue to be linked to the falloff in home U.S. home prices. We have lowered our ratings on several mortgage insurers by a notch or more since the start of 2008.

The events shaking up the financial sector in the U.S. and abroad are moving quickly. No one can yet accurately predict how the value of impaired assets, the tight credit markets, or insurers' future investment strategies will ultimately affect profitability, liquidity, and ratings. We are monitoring the situation carefully. With many insurance markets already weak, further market disruptions could generate additional downgrades.

## ■ Differences Around The Globe

Insurers have too often been painted with the same broad brush of fear that has covered Wall Street, the federalized mortgage intermediaries, and some banks. We believe this ignores the insurance business model (that insurers typically are businesses with highly liquid balance sheets) and specific efforts some insurers have made to protect themselves.

There are also different levels of distress, reflected in our ratings, that insurers experience in different parts of the world. In Europe and the Pacific region, we believe capital adequacy generally remains high and exposure to subprime assets low. For Asian insurers, the exposure to subprime assets appears manageable in terms of impairment losses. However, we expect insurers with greater equity exposure or other risky assets to report significant drops in 2008 earnings as those security prices fall globally.

In Europe, we believe the impact of mortgage-related securities' losses, on a mark-to-market basis, is only \$7 billion in the insurance sector. Only a modest number of insurers have had sufficient losses relative to capital, liquidity, and/or earnings to require rating actions. However, we have taken ratings actions when the banking operations of large companies with both insurance and banking units encountered difficulty. We lowered our ratings on Fortis Group in late September. The government of The Netherlands has since acquired Fortis's Dutch banking and insurance operations for €16.8 billion, while BNP Paribas and the government of Belgium plan to acquire Fortis's Belgian insurance and banking operations. The Fortis Group's troubles stemmed, in part, from issues arising from exposure to subprime assets and obligations from mergers and acquisitions.

## ■ The Securities They Hold

In the coming weeks, we will begin to see the third-quarter financial reports of global insurers with noticeable U.S. residential-mortgage-backed securities (RMBS) exposure, and be able to better judge how this financial unrest has affected the industry. Our expectations are that many securities, some mortgage-related, some not, will be carried at a far lower fair value than they were in mid-2008. Volatile security prices will take a toll, although the recent strength of government bond prices could provide a partial offset. In addition, the current pressures in the financial services sector are expected to further strain insurers' statutory capital levels, given their higher-than-average corporate bond exposure.

The asset write-downs insurers will take are a complex accounting and regulatory matter: Depending on the particular security and the national regulatory framework, an asset's loss of value may result in a charge to earnings, a lower-valued asset on the balance sheet or, if the impairment is deemed temporary, no change at all. In turn, the elevated volatility in the financial markets and the heightened cost of hedging will make dynamic hedging strategies more expensive. This could hurt life insurers with large variable annuity books of business.

## ■ North American Insurers And RMBS

We surveyed North American life and P/C insurers at the end of 2007 to more closely identify the specific characteristics and credit quality of each insurer's direct subprime and Alt-A RMBS holdings. We then used data from this survey, combined with publicly available information, to identify the gross exposures, credit quality, collateral type, and vintage for each individual insurer (see table 2). For those insurers with missing or incomplete information, we applied a more conservative assumption (typically the most stressful vintage) in determining projected economic losses. Relative to our previous analysis, we were able to perform a more discreet analysis for most of the largest insurers, leading to a more refined projected economic loss expectation for the industry overall.

Expected Economic Losses--North American Insurers						
	Total subprime and Alt-A exposure (bil. \$)	Total capital (bil. \$)	New expected losses (bil. \$)	% of total adjusted capital	Previous expected losses (bil. \$)	% of total adjusted capital
Life	135.4	366.6	19.9	5.4	17.4	4.8
Property/Casualty	26.6	234.2	3.0	1.3	1.9	0.8
Total	162.0	600.6	23.0	3.8	19.3	3.2

Overall, we believe the North American insurance industry generally is well positioned to manage through the RMBS performance downturn. In our view, the industry, as a general matter, is well capitalized relative to its aggregate exposure and projected loss. P/C insurers, in particular, have modest exposure and, with expected losses of only 1.3% of capital, should have little problem moving through the current period of distress. We believe life insurers are much more exposed, with projected losses of more than 5% of capital. Although we believe the life insurance industry, as a whole, has a sufficient capital cushion to maintain its financial strength, there are individual outliers with a significant capital at risk.

Our analysis of projected losses focuses on each insurer's relative capital and earnings capacity to absorb these losses. While we recognize that losses will emerge over a period of several years, we view the projected loss as an immediate call on capital, which affects our current view of the company's financial strength. We expect downward rating pressure for the minority of insurers with outsize exposure relative to capital and earnings capacity, especially for those with an insufficient framework for enterprise risk management. We continue to monitor these companies closely and will take rating actions as necessary.

#### **The cycle could be tempered**

Recent history shows there may be some benefits for insurers and reinsurers from the current dislocation. In the months preceding the terrorist attacks of Sept. 11, 2001, world insurance markets were, as they are now, in the soft part of the underwriting cycle. The attacks precipitated a long period of pricing discipline for P/C insurers and reinsurers that allowed them to begin raising premiums again in light of the market's eagerness for insurance of all types. We subsequently raised our outlooks on many companies. Given continued pressure on insurers' investments, we expect moderation in any further price softening.

#### **A flight to quality**

How these uncertain markets will affect specific insurers largely is unknown. One clue could be the degree to which we see customers--whether large corporate P/C customers or those buying life insurance annuities and policies--cancel or let their policies lapse at a given insurer. That generally would happen if the market believed that an insurer had been so weakened that it could not meet its claims. With the exception of AIG, where some distributors are considering moving business previously written by AIG to other carriers--and regulators have moved to calm policyholder fears--there has been no discernable spike in policy cancellations or lapses in the P/C or life sector, partly, we believe, because of the disincentives built into some policies to switch carriers, and partly a sign that markets have some degree of faith in these insurers--a strength to the ratings. It is possible, however, that some customers across all subsectors will change insurers in a perceived flight to quality. We will be able to get a stronger read on this factor in the next few months as many annual policies come up for renewal.

We will continue monitoring the effect of the current credit turmoil on global insurers. Despite some negative outliers, we continue to see ratings stability among all insurance subsectors, given the industry's capital strength and sound liquidity, relative to other financial institutions. But we are aware that the U.S. real estate and mortgage crisis can spread to other asset classes too, such as commercial real estate. In total, U.S. life insurers have 9.6% of their invested assets in commercial mortgages and 1.7% in commercial real estate. These represent just over 90% of the industry's capital surplus. How developments in the political, financial, and credit marketplaces play out will ultimately signal the need for further rating actions.

Writer: Robert McNatt