Investment Woes Widen For Insurers; More Companies Reveal Big Credit Market Losses

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NEW YORK-Credit market turmoil spread to more insurers last week as several companies warned of expected large investment losses for the third quarter and some moved to raise capital.

Life insurers, including the life operations of Hartford Financial Services Inc., were hit the hardest, though XL Capital Ltd. also said it will book up to $1.2 billion in investment losses for the quarter (see story, page 32).

The losses stem from insurers' holdings of mortgage- and asset-backed securities as well as investments in such ``failed or bailed'' companies as Lehman Bros. Inc., American International Group Inc., Washington Mutual Inc. and mortgage giants Fannie Mae and Freddie Mac.

Hartford said last week that it will report about $2.2 billion in realized investment losses and simultaneously said it would receive a $2.5 billion capital infusion from Allianz S.E. of Munich, Germany. The deal sparked speculation that Allianz might eventually acquire Hartford, though terms of the agreement bar Allianz from buying more than a 25% stake in Hartford for 10 years.

Several life insurers, meanwhile, warned of sharply lower third-quarter earnings and disclosed sizable investment losses, including MetLife Inc., Prudential Financial Inc. and Lincoln National Corp. MetLife also raised $2 billion in new capital through a stock offering last week.

Life insurers are being squeezed not only by mortgage-related and financial institution investments-which they own more of than property/casualty insurers-but also by the plummeting stock market's effects on profitability and statutory capital required for their variable annuity business, analysts noted.

Asset impairments are ``a material issue for the industry when combined with the declining equity market,'' said Scott Robinson, vp with Moody's Investors Service in New York. ``It certainly is placing stress overall on the life industry.''

That stress could lead to consolidation in the industry, though ``the question is, Who's got the capital to consolidate?'' he added.

``Not many companies have excess capital at this point,'' said Jeffrey S. Berg, a Moody's senior vp.

A risk for life insurers is a cycle in which capital losses trigger downgrades by rating agencies that, in turn, lead to lost business and demands for collateral from counterparties, said John L. Ward, chief executive officer of Cincinnatus Partners L.L.P. in Cincinnati.

``One bad thing potentially leads to another bad thing, so the question is when the domino effect is going to see its last domino," Mr. Ward said.

Still, he said he was encouraged by the ability of Hartford and MetLife to raise capital: ``It's a sign that these companies are digging in. They're fighting," Mr. Ward said.

Moody's, while maintaining a negative outlook for the industry, also noted that it is healthier than others in the financial services sector and that life insurers are ``well-positioned to move through this credit crisis and the economic downturn with a strong financial profile."

Standard & Poor's Corp. also adopted a negative outlook for the life industry last week, citing ``higher-than-normal credit losses, lower fee-based revenues and reduced financial flexibility."

Hartford was among the first to estimate its third-quarter investment losses in an announcement last week. The insurer warned that it will report a net loss for the quarter, including net realized investment losses of $2.1 billion to $2.2 billion. It also estimated its net unrealized losses at $3.4 billion to $4.2 billion.

A large part of the realized losses stem from impairments to its holdings in the financial services sector, Hartford said.

In September, the insurer disclosed that it holds various combinations of debt, preferred stock and other instruments totaling $252 million from Lehman, $182 million from AIG, $126 million from Washington Mutual, and $520 million from Fannie Mae and Freddie Mac.

Hartford also reported last week that Allianz will invest $2.5 billion in the insurer, buying $750 million in convertible preferred stock and $1.75 billion in subordinated notes that are convertible to common stock over seven years.

The investment will potentially give Allianz a 23% stake in Hartford, according to a research note by Citigroup Global Markets.

The added capital will also leave Hartford with a margin of about $3.5 billion over the capital level required to maintain its ratings, the insurer said.

Ratings outlook

S&P and Moody's affirmed their respective AA- and Aa3 financial strength ratings of Hartford's property/casualty and life units. S&P adopted a negative outlook on Hartford, though, and Moody's placed its debt rating of the holding company under review for possible downgrade, citing its exposure to mortgage-backed securities and financial institution investments.

A.M. Best Co. Inc. placed the A+ ratings of Hartford's operating units under review with negative implications.

The Allianz deal prompted Citigroup analysts to speculate that the German insurer may eventually acquire Hartford: ``With Allianz having the equivalent of a 23% stake in the company, the idea of a buyout at some time seems more likely," the research note said.

Such a deal would face roadblocks, including Allianz's ability to raise enough cash for the transaction and the provisions limiting Allianz to a 25% investment through 2018, though ``it seems likely that this threshold could be increased by mutual agreement,'' the Citigroup analysts wrote.

A Hartford spokeswoman said the insurers ``will continue to operate as two separate companies.''

Hartford's shares, which rose to nearly $33 after the announcement, plummeted to just above $20 last Thursday amid broader concerns about life insurer investment losses. The shares closed at $19.23 on Friday.

The developments also rattled some policyholders, prompting Connecticut Insurance Commissioner Thomas R. Sullivan to issue a statement assuring consumers of Hartford's stability: The insurer's ``financial strength remains solid and (it) will continue to meet policyholder obligations,'' Mr. Sullivan's statement said.

Meanwhile, MetLife and Prudential followed Hartford in warning of third-quarter investment losses.

MetLife's realized credit-related losses of $490 million will be offset by other gains, the company said, but it will report $17 billion in unrealized losses on its $324 billion portfolio, up from $10 billion as of June 30. Unrealized losses include $1.7 billion for securities trading down 20% or more for six months, an increase from $400 million of such securities at June 30.

Prudential said it expects to report $325 million to $375 million in realized losses on impaired securities, including those of Lehman, AIG and Washington Mutual. The insurer did not estimate unrealized investment losses.

Other life insurers may need to follow the leads of Hartford and MetLife and raise capital, a task made more difficult by credit and equity market turmoil, observers said.

``If they haven't started on this already, they are a little late to the game,'' said Prakash Shimpi, a managing principal with Towers Perrin in New York.

Art Caption: Hartford's STOCK dives: Warning of investment losses in the third quarter, Hartford's stock fell.Art Credit: Source: financialcontent.com

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