

Massachusetts -- Liberty Mutual Calls Ratings Drop 'Surprise and Disservice': *Top*[09/30/08]

The nation's second-largest workers' compensation insurer, Liberty Mutual Insurance Cos., has taken a hit from Wall Street with a decision by Standard & Poor's to lower its financial-strength rating from "A" to "A-" (stable) in the wake of Liberty Mutual's finalization of its \$6.2 billion buyout of rival insurer Safeco Corp.

In what the Boston-based carrier called a "surprise and disservice," S&P dropped the rating last week and attributed the decision to the Safeco purchase. The rating house warned the Safeco purchase leaves Liberty Mutual with "diminished financial flexibility" and warned of "below-rating level earnings and aggressive pricing and growth strategy."

Liberty Mutual announced the purchase on April 23, and said the deal called for Liberty Mutual to acquire outstanding shares of Safeco common stock for \$68.25 a share. The carrier said the purchase was approved by shareholders and state regulators in California, Illinois, Indiana, Missouri, Oregon, Texas and Washington.

Liberty Mutual contends it has produced a superior five-year average return on capital and has maintained adequate capital for the "A" rating.

"Standard & Poor's states that reduced ability to access the capital markets is behind the downgrade, a criterion that in this environment would lead to downgrading the entire industry," Liberty Mutual said in a statement. The insurer said S&P's rating was based on an examination of return on revenue versus capital, which ignores the relative risks associated with different sources of revenue.

According to a ranking by A.M. Best, Liberty Mutual holds the second-largest share of the nation's workers' compensation market, with nearly \$5.6 billion in direct premium for 2007. The largest workers' comp carrier, American International Group (AIG), listed nearly \$6.2 billion in premiums for the year.

The Best rankings listed a total of nearly \$50 billion in premiums for the industry – with \$34.6 billion of that coming from the nation's top 25 companies.

AIG was considered hours away from bankruptcy two weeks ago when the Federal Reserve Bank of New York agreed to loan it \$85 billion in exchange for a 79.9% stake in the company.

Liberty Mutual spokesman John Cusolito did not return a telephone call Monday. Based on statements by the insurer, the Safeco acquisitions all will become part of Liberty Mutual's Agency Markets business unit, which now ranks third in personal lines and fifth in commercial lines in the independent agency distribution channel.

Combining Safeco's surety operations with Liberty Mutual's makes that unit the second-largest in the country, Liberty Mutual said.

In all, the acquisition puts Liberty Mutual among the nation's top five U.S. property and casualty companies.

S&P put Liberty Mutual on negative Credit Watch following the Safeco announcement last April, but said it would affirm Liberty Mutual's "A" rating if capitalization was not materially below what is required for the current rating.

Liberty argued its pre-tax operating income was nearly \$900 million during the first six months of 2008 and was 3% higher than the previous year.

Ratings by S&P and other agencies were among the key factors attributed to the 11th-hour scramble to bail out AIG. While talks between AIG and the Fed were ongoing, S&P cut AIG's long-term credit rating three notches to "A-" from "AA-," citing "reduced flexibility in meeting additional collateral needs and concerns over increasing residential

mortgage-related losses."

The financial strength of the nation's top two workers' compensation insurers remained a topic of discussion Monday as the broader financial markets took an historic plunge.

After the U.S. House voted to defeat a compromise \$700 billion bailout plan hatched by the Bush Administration and Congressional leaders for the subprime mortgage markets in a bid to save the banking industry, the Dow Jones dropped by 777.68 points – the largest single-day drop in the market's history. The free fall beat the 684.81-point record for declines set on the first trading day after the Sept. 11, 2001, terrorist attacks.

New York workers' compensation attorney, consultant and author Jon L. Gelman said in an interview that Liberty Mutual's ratings cut and the government takeover of AIG are signs the insurance industry is bracing for a "cascading effect" from the economic tumult and government actions so far.

"We haven't seen this ever before. We're witnessing the complete disintegration of private investments in the insurance market," Gelman said.

Gelman said investments in the subprime mortgage market – the key trouble behind AIG's admission in August that it suffered a \$5.36 billion loss for the second quarter – are so complex other insurers aren't sure how much they've invested or how much they stand to lose.

But Gelman said the biggest signal of a dynamic shift in the way insurance companies assess their risks and write their policies comes from the fact that the Federal Reserve is now the nation's largest property and casualty insurer – giving it the power to dictate rates and ignore some of the key factors in ratings schemes.

"Forget about the American Medical Association impairment guides and the other factors we discuss these days," he said.

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