P-C Sector Loss Reserves Seen Just Adequate By Moodyâ€™s

by National-Underwriter

U.S. property and casualty insurersâ€™ loss reserves appear to have dropped close to breakeven sometime during the second half of 2008, according to a report by Moody's Investors Service.

But the rating service said it has concluded that "overall reserve adequacy is still within reasonable bounds and close to a breakeven level, so that we do not expect to take broad rating actions as a result of this analysis.â€•

The firm noted "a wide range of reserve levels among individual companies" and said "those insurers with significant shortfalls could see their ratings affected, particularly if such a shortfall is combined with other stresses."

Within the report is a comparison of earlier Moody's estimates of the industry's reserve adequacy entering 2008 to the total amounts that insurance companies released from their loss reserves during the year.

Moodyâ€™s Vice President Paul Bauer, who wrote the report, said in a statement, "Given the size of the industry's announced reserve releases in relation to Moody's earlier redundancy estimates, we believe that P&C insurers have fully harvested their reserve redundancies, leaving them little or nothing in the way of a cushion."

Moody's estimated the industry carried about $5-to-$12 billion in excess loss reserves entering 2008 and as of the end of the third quarter about $9 billion of this amount had been depleted.

"Based on an early look at regulatory financial statements, the pattern of reducing loss reserves accelerated in the fourth quarter, with a total of about $14 billion in reserves being released for the year," explained Mr. Bauer.

He added that this situation has occurred across the entire industry, among personal and commercial lines and diversified carriers.

"The reduction in loss reserve strength warrants caution for two reasons," Mr. Bauer continued. â€œFirst, it implies lower profits for 2009, because p-c companies will be much less able to bolster current calendar-year earnings by using prior-year reserve releases, which has been the case in the recent past.

"Secondly, the decline in reserve adequacy implies a further weakening of balance sheet strength in what is already a difficult market environment."

He pointed out that the industry's normal cyclical trend is one where reserves are often built up during years with rising insurance prices, and then are drawn down later, thereby benefiting future reported earnings"if, of course, those reserves have not already been depleted by policyholder loss payouts.

Mr. Bauer said that to put the reserve decline in full perspective, "we note that the trend is negative, but we still believe the p-c industry's overall capital adequacy remains relatively strong, with generally conservative underwriting leverage and with adequate"although no longer comfortably redundant"reserve levels. As a result we would not expect to take any broad rating actions in the near or medium terms based solely on this trend."

"As the industry moves through 2009," Mr. Bauer said, "improved underwriting discipline and pricing will be key factors in reversing the current downward trend in reserve adequacy," and "vigilance and discipline will be required to insure that a modest weakness does not turn into a more serious threat to capital adequacy."

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