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TARP Capital Purchase Program Eligibility Is A Favorable Development For Life Insurers

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Several prominent life insurance companies have applied for participation in the Capital Purchase Program (CPP), one of several programs established under the Troubled Asset Relief Program (TARP). The CPP is a voluntary program in which the U.S. government, through the Treasury, invests in preferred equity securities issued by qualified financial institutions. Published reports have cited a Treasury Department statement that a number of life insurers have met the requirements for the CPP because of their bank holding company status. Several prominent life insurers applied for participation in the CPP prior to the Nov. 14, 2008, deadline. In response to market interest, Standard & Poor's Ratings Services is addressing how life insurer participation in the CPP, or other financial stability programs, could affect ratings.

The Capital Program Comes At A Good Time For Life Insurance Companies

Pending further details, Standard & Poor's likely would view life insurer eligibility for the CPP as a favorable development for the industry and eligible companies. Participation would bolster liquidity and capital at a time when these vital components of financial health are strained, largely because of other-than-temporary impairments and investment portfolios' declining market values. Holding companies are facing more stress as banks reduce credit exposure and as commercial paper and other sources of liquidity have become more difficult to access. (For more details, see "North American Insurance Holding Companies Are Facing Reduced Sources Of Cash Flow And External Funding," published Dec. 12, 2008, on RatingsDirect.) Standard & Poor's generally has viewed life insurance operating companies' liquidity as adequate. These companies benefit from relatively stable liability profiles that allow them to hold securities in unrealized loss positions to recovery. We continue to monitor trends in net flows, surrenders, and policy loans for signs of increased liquidity demands at the operating company level (see "Market Dislocation Sharpens The Focus On Liquidity Risk Management Practices In North American Life Insurance Companies," published Sept. 30, 2008, on RatingsDirect).

In recent months, we have lowered our ratings on several insurance groups, primarily reflecting the application of our incremental stress analysis on investment portfolios, as well as the effects of severe equity market declines and volatility in earnings and capital adequacy. (For details on our enhanced criteria, see "Methodology For Incorporating Incremental Stress Factors Into The Capital Adequacy Analysis Of North American Life And Health Insurers," published Feb. 18, 2009, on RatingsDirect.) Some companies have experienced capital erosion that could take several years to restore to previous levels. Participation in the CPP would accelerate capital replenishment. For companies that are facing fewer liquidity and capital pressures, eligibility would create additional financial flexibility at a time when access to capital markets has been reduced and terms have become more onerous. We should note that our ratings currently do not incorporate any potential participation in the CPP or any other TARP-related program.

Participation In The CPP Could Give A Boost To Some Life Insurers

In most cases, we do not expect participation in the CPP to result in upgrades, but participation could lead to revisions of outlooks to stable from negative. In some limited cases, we could raise ratings if capital adequacy is currently a significant weakness to the ratings and if other factors are supportive of a higher rating. In evaluating the potential ratings impact of participation in the CPP, we would consider the financial condition of the participating company and how the insurer expects to deploy the proceeds. At this time, we do not know whether insurance companies would have the same terms and conditions regarding repayment conditions or executive compensation as banks participating in the program do.

A sufficient capital raise via the CPP could improve a negative outlook to stable, where liquidity and capital adequacy are key drivers of the outlook. Additional cash at the holding company would be particularly helpful to companies with pending debt maturities. In the cases where liquidity and capital adequacy are supportive of the existing ratings, we would view a capital infusion as creating an additional buffer against the current market turmoil as well as additional financial flexibility to fund acquisitions or other growth initiatives. In any potential rating actions, we would also consider the resultant impact on insurers' capital structure and double leverage, as well as interest and fixed-charge coverage ratios. We would also need to understand any changes in corporate governance and company strategy, if any. On balance, we expect the potential improvements in liquidity, capital adequacy, and financial flexibility resulting from participation in the CPP to have favorable ratings implications, to the extent that leverage and coverage metrics remain within tolerances for the ratings.

Related Research

- "Criteria | Insurance | Life: Liquidity," published April 22, 2004.
- "Evaluating Liquidity Triggers In Insurance Enterprises," published Nov. 11, 2008.
- "Methodology For Incorporating Incremental Stress Factors Into The Capital Adequacy Analysis Of North American Life And Health Insurers," published Feb. 18, 2009.