National News

S&P Lowers Allstate's Operating Co. Ratings to 'AA-'; Outlook Negative

January 30, 2009

Standard & Poor's Ratings Services has lowered its counterparty credit and financial strength ratings on Allstate Corp.'s core property-liability (Allstate Protection) and life insurance (Allstate Financial) companies to 'AA-' from 'AA'. S&P also lowered its counterparty credit rating on Allstate to 'A-/A-2' from 'A+/A-1'. The outlook on all of the companies is negative.

"These rating actions reflect the significant deterioration in the operating companies' capital adequacy to the high end of the adequate range from strong," explained credit analyst Neil Stein.

S&P said: "Capital adequacy and surplus at Allstate Protection is noticeably lower than in the quarter ended Sept. 30, 2008, and is now inconsistent with what we had expected for the previous rating."

Stein added: "The two-notch downgrade of the holding company reflects both the downgrade of the operating companies and its weakened financial flexibility, as we view the assets of the holding company and its unregulated investment company Kennett Capital to support operating company needs."

In addition S&P explained that new rating "reflects an adjustment from a nonstandard two-notch gap between the holding company and operating company ratings to a standard three-notch one. In addition, the rating action reflects the potential for continued losses and capital strain at Allstate Financial and Allstate Protection's deteriorating underwriting results (which stemmed from catastrophe losses) and realized investment losses.

"Although we expect the very strong underlying earnings power from the group to contribute to meaningful improvements in capital in 2009, we believe there are several factors that will inhibit the company's return to historical levels of profitability and capital adequacy," the bulletin continued. "For one thing, Allstate's operating results will likely be hampered by continued investment losses (unrealized losses increased again in the fourth quarter to $8.8 billion for the year ended Dec. 31, 2008), lower investment income, declining top-line growth at Allstate Protection, and weaker operating income at Allstate Financial.

"Furthermore, we expect that the increasingly competitive environment, declines in auto sales, weakness in the housing market, and the overall impact of the recession will pressure results as Allstate's new business mix shifts from higher-premium polices to business with lower average premiums.

"In addition, financial flexibility at the holding company is now weaker, as our analysis of capital incorporates $2.0 billion of funds available from the holding company and Kennett. Although these funds were previously available to support potential capital shortfalls, the company had never used them. Now, it has used them to support operating-company shortfalls within Allstate Financial."

However, S&P also pointed out some positive factors. It said that "supporting the ratings on Allstate are its very strong and diversified national market presence in the U.S. as the second-largest domestic personal lines insurance company and 12th-largest life insurance company, very strong operating performance, and liquidity stemming from strong operating cash flows and increased cash and short-term holdings."

In addition S&P said that the "rating incorporates the expectation that Allstate will continue to sustain its competitive position while reducing its catastrophe exposure. However, we remain concerned that these efforts have not only hampered growth and reduced cross-selling opportunities but also threaten Allstate's reputation with customers and regulators."

S&P also indicated that it "expects Allstate Protection to experience flat premium growth as it maintains its focus on strong profitability rather than premium growth, with above-industry-average underwriting results. Furthermore, we expect that Allstate Financial will restore profitability and replenish capital while managing through volatile economic conditions.

"Allstate will likely maintain a modest amount of financial leverage and very strong fixed-charge coverage. We will also be mindful of the company's capital-management philosophy and expect that the operating companies will not pay dividends to the holding company in 2009 so they can replenish their capital.

"If Allstate is unsuccessful in meeting these expectations, if capital and capital adequacy decay further, or if there are any more unexpected adverse events (such as perceived changes to competitive position, large realized investment losses, weakened underwriting performance, or changes in liquidity profile), another downgrade would most likely result.

"Alternatively, if over the next two years, the company is able to demonstrate that it is able to replenish its capital base organically to levels consistent with a strong rating, there are no additional investment losses, and no negative surprises arise that dampen consolidated results, we could revise the outlook to stable."

Source: Standard & Poor's - www.standardandpoors.com

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