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DESPITE SIGNS OF ECONOMIC RECOVERY, THE PROGNOSIS FOR GLOBAL MULTILINE INSURERS REMAINS SUBDUED

Despite positive trends in equity markets, lower credit spreads over recent months, and signs of recovery in economies around the world, Standard & Poor's Ratings Services remains of the opinion that market conditions will continue to put pressure on its ratings on global multiline insurers' (GMIs).

Over the past two years, impairments on invested assets have substantially eroded GMIs' capitalization and operating performance, in some cases leading to downgrades. We still anticipate that impairments on certain asset classes of investments will eat into the GMIs' earnings in 2009 and potentially in 2010. We are also cautious on certain risk exposures, specifically exposure to commercial mortgage-backed securities, collaterized debt obligations (CDOs), commercial mortgages, commercial real estate, hybrid securities from financial institutions, and residential mortgage-backed securities (RMBS; that is, subprime and Alt-A). Investment returns, in our view, will likely remain subdued over the next two years, reflecting a combination of lower investment yields and significantly lower realizations of capital gains from equity investments.

Our ratings on six of the 12 GMIs featured in this report carry negative outlooks compared with four at the end of 2008. In most cases, this reflects our assessment that lower investment returns will likely continue to constrain the GMIs' earnings potential in 2009 and 2010 and that the capital adequacy of many GMIs is still below what we consider commensurate with the respective ratings, despite improvements since April 2009.

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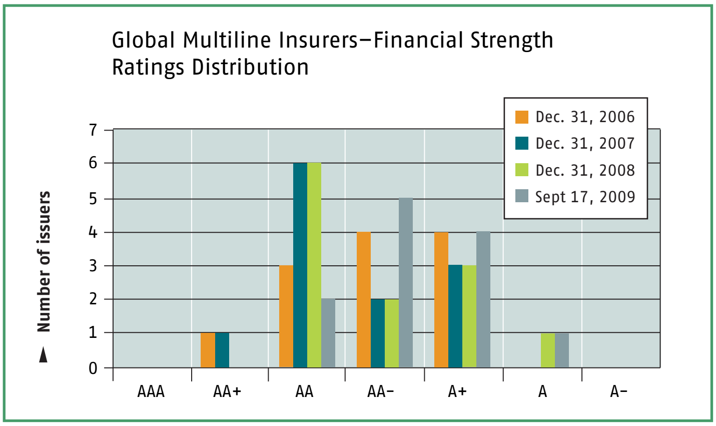
CHART 1



Standard & Poor's economists observe that the risk of a double-dip recession remains, and the scale and likely pace of a potential global upswing is still unclear. In addition, we believe it is too early to consider the current financial market rebound evidence of a lasting recovery. Corporate and structured credit defaults are likely to remain at elevated levels in line with previous recessions in which defaults were still prevalent at the beginning of the market recovery. We therefore remain guarded about the GMIs' investment risk, particularly with respect to mark-to-market valuation pressures and credit risk.

In the following, we provide an overview of GMIs' investment exposure at the end of the second quarter of 2009, followed by an update of our view of each GMI's investment strategy. It is important to note that in analyzing the data included in the tables below, direct comparisons are not always possible because the level of disclosure and the presentation of figures vary among GMIs. We have highlighted the scope of the published figures in the footnotes to the tables and these should be taken into account when making any comparisons.

LOWER SENSITIVITY TO EQUITY MARKETS

Since the last financial crisis in 2001-2003, insurers' investment portfolios have shifted toward fixed-income instruments and away from equities. GMIs are no exception to this trend (see table 1). At the end of the second quarter of 2009, equity holdings were less than 10% of total invested assets across all GMIs. In addition to selling equities, most GMIs have extensive hedging programs to reduce the vulnerability of capital and earnings to equity markets.

TABLE 1 **Global Multiline Insurers--Investment Portfolio Composition***

(%)	Equities	Fixed-income instruments	Structured securities	Mortgages	Property	Cash and short-term investments	Other¶
ACE§	1.0	63.0	27.0	0.0	0.0	6.0	3.0
Aegon**	1.2	36.0	13.8	15.8	2.4	26.5	4.0
AIG¶¶	3.6	52.3	9.6	5.2	N.A.	10.0	19.0
Allianz§§	6.4	79.6	5.5	4.5	1.9	1.3	1.0
Aviva***	6.0	59.0	N.A.	17.0	4.0	10.0	4.0
AXA	4.1	72.2	2.6	4.3	4.9	6.9	6.0
Generali	8.0	73.0	N.A.	3.0	5.0	2.0	9.0
ING	3.0	63.0	N.A.	20.0	2.0	6.9	4.0
Prudential	3.0	53.0	16.0	13.0	0.0	6.0	9.0
QBE	5.0	41.0	N.A.	N.A.	N.A.	51.0	2.0
XL	0.2	53.3	22.9	N.A.	N.A.	11.9	12.0
ZFS	2.8	55.9	11.1	6.7	5.0	8.2	10.0

*As of June 30, 2009, unless otherwise stated. ¶Mainly includes policy loans and alternative investments, such as private equity and hedge funds. §The majority of structured securities relates to mortgage-backed securities predominantly held in Federal agency securities (Freddie Mac and Fannie Mae). **Cash and short-term investments include treasury and agency securities; Fixed income consists of corporate bonds. ¶¶AIG: 'Other' includes finance receivables ($25.3 billion) and flight equipment primarily under operating leases ($44.7 billion). §§Allianz: Data shows consolidated insurance portfolios including the corporate segment. ***Participating fund assets and shareholder assets. N.A.--Not available. Source: Company reports and Standard & Poor's calculations.

The precipitous decline in stock markets seen until the end of March 2009 has depressed GMIs' operating earnings and net investment income. This was particularly so for those GMIs with a significant exposure to life insurance, owing to lower asset-based fees, higher costs associated with guaranteed benefits, and increased write-offs of deferred acquisition costs. The current revival in stock markets has, we believe, mitigated some of these pressures as demonstrated by second-quarter results and augurs well for further improvements in operating results in the third quarter of this year. However, we believe the risk of a downward correction remains. Should markets reverse course and decline significantly, our ratings on those GMIs with a relatively higher unhedged equity exposure could therefore come under renewed pressure.

CREDIT RISK REMAINS IN THE SPOTLIGHT

The global recession has taken its toll on corporate credit quality generally. The number of downgrades has increased dramatically across all regions over the past 12 months. Against this backdrop, credit risk continues to attract significant management attention. As of Oct. 1, 2009, 223 global issuers had defaulted, up from 126 for all of 2008. The number of companies on our list of global ‘weakest links’ (companies rated 'B-' or lower with either a negative outlook or ratings on CreditWatch negative) was 278 at the end of August, signaling still high corporate default risk. For further details see ‘Slow Stabilization For Asian, European, And U.S. Corporate Credit Quality,’ published on Sept. 28, 2009, on RatingsDirect.

Generally, we expect credit risk inherent in GMIs' corporate bond portfolios to be manageable, although we note that exposure has been increasing in recent years as companies reduce their equity holdings in favor of higher yielding corporate bonds. This view is also based on our opinion that most GMIs have either strong or excellent controls for credit risk. As of June 30, 2009, five of the GMIs covered in this article held more than 25% of their investments in corporate bonds (see table 2). Seven of the 12 groups have at least 40% in 'AAA' rated instruments (see table 3). However, we are mindful that the scope of the published data varies among companies, which in some cases inflates the lower-rated exposures as well as investments in nongovernment securities.

TABLE 2 **Global Multiline Insurers--Fixed-Income Portfolio Composition***

(%)	Government	Corporate	Financials	Structured securities	Covered bonds	Other
ACE¶	16.0	29.0	N.A.	30.0	0.0	25.0
Aegon§	0.0	51.0	16.0	29.0	N.A.	3.0
AIG	37.0	29.0	18.0	15.0	N.A.	N.A.
Allianz	34.4	16.3	9.0	6.1	26.5	7.7
Aviva**	38.7	52.2	N.A.	8.3	N.A.	0.8
AXA	49.3	21.7	25.5	3.4	N.A.	N.A.
Generali**	57.0	11.0	30.0	2.0	N.A.	0.0
ING	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Prudential	25.0	44.0	7.0	24.0	0.0	0.0
QBE	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
XL	33.8	19.8	16.6	29.8	N.A.	N.A.
ZFS	43.0	16.0	14.0	17.0	10.0	N.A.

*As of June 30, 2009, unless otherwise stated. ¶The majority of structured securities relates to mortgage-backed securities predominantly held in Federal agency securities (Freddie Mac and Fannie Mae). Non-U.S. fixed maturities are shown under 'Other'. §Aegon U.S. only. Data excludes cash, treasury and agency securities. **Data as of year-end 2008. N.A.--Not available. Source: Company reports and Standard & Poor's calculations.

TABLE 3 **Global Multiline Insurers--Credit Quality Of Fixed-Income Portfolio***

(%)	AAA	AA	A	BBB	Below BBB¶	Not rated
ACE	55.0	9.0	15.0	11.0	10.0	0.0
Aegon§	21.0	8.5	32.5	30.2	7.7	0.1
AIG	19.0	29.0	26.0	19.0	6.0	1.0
Allianz	50.0	14.0	23.0	7.0	1.0	5.0
Aviva**	44.0	16.2	25.5	9.0	1.7	3.6
AXA¶¶	13.0	22.0	41.0	18.0	Below BBB and unrated together 6.0	
Generali**	40.0	29.0	25.0	4.0	0.4	1.6
ING	42.7	15.9	27.1	11.1	Below BBB and not rated together 3.2	
Prudential	AAA, AA, and A together, 68.0			23.0	Below BBB and not rated together 9.0	
QBE	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
XL	56.7	14.7	16.8	7.8	4.0	0.0
ZFS	56.1	11.2	24.6	6.2	Below BBB and not rated together 2.0	

*As of June 30, 2009, unless otherwise stated. ¶Speculative grade. §Data excludes cash, treasury, and agency securities. **Data as of year-end 2008. ¶¶Data relates to corporate bond portfolio only. N.A.--Not available. Source: Company reports and Standard & Poor's calculations.

STRUCTURED ASSETS CONTINUE TO POSE SIGNIFICANT RISK

Turbulence in the capital markets caused a sharp drop in the overall credit quality of structured securities in 2008, spurring an average 3.2-notch rating decline for the sector over the course of the year. Data for the first half of 2009 shows that the ongoing credit market disruption has continued to cast a shadow over the ratings on structured investments (see table 4). At the start of the disruption, credit deterioration was limited to certain U.S. structured finance assets and global financial institutions. However, the onset of a broader economic recession has led to rising credit risk across most classes of financial assets relevant for structured finance, residential and commercial mortgages, consumer finance, and corporate credit (see ‘Transition Study: Structured Finance Rating Transition And Default Update As Of Sept. 25, 2009,’ published Oct. 2, 2009).

TABLE 4 **Standard & Poor's Global Structured Finance Trailing-12-Month Rating Transitions***

Rating categories	Beginning number of ratings	Upgraded/stable (%)	Downgraded (%)
Global structured finance			
AAA	13,254	73.8	26.2
AA	13,893	59.8	40.2
A	11,047	63.8	36.2
BBB	11,350	58.7	41.3
BB	6,819	49.4	50.6
B	5,425	35.2	64.8
CCC	7,419	25.2	74.8
CC	5,658	37.3	62.7
C	6	100.0	--

*As of Sept. 25, 2009. 'AAA' ratings from the same transaction are treated as a single rating in our calculation. We used full rating categories to determine rating transitions such as upgrades and downgrades.

Most GMIs have more limited exposure to structured assets (see table 5). Among the 12 groups, AEGON N.V., ING, and U.S.-based Prudential Financial Inc. and XL Capital Ltd. still have, in our view, relatively higher exposure to structured credit risks.

TABLE 5 **Global Multiline Insurers--Structured Credit Portfolio***

(%)	CMBS	Prime RMBS	CDO/CLO	U.S. Agency	Subprime	Alt-A	Consumer ABS	Other
ACE¶	18.0	13.0	N.A.	64.0	0.0	N.A.	3.0	1.0
Aegon§	32.0	3.0	5.0	8.0	7.0	11.0	22.0	11.0
AIG	20.0	17.0	9.0	30.0	1.0	6.0	15.0	1.0
Allianz	25.0	13.0	7.0	36.0	N.A.	N.A.	11.0	8.0
Aviva**	15.0	10.0	2.0	28.0	N.A.	2.0	N.A.	43.0
AXA	24.0	19.0	34.0	N.A.	6.0	N.A.	14.0	2.0
Generali**	9.0	26.0	32.0	N.A.	0.0	N.A.	33.0	0.0
ING	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Prudential	31.0	0.0	0.0	37.0	13.0	0.0	19.0	0.0
QBE	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
XL	19.0	9.0	8.0	40.0	5.0	4.0	7.0	8.0
ZFS	25.0	14.0	N.A.	41.0	N.A.	N.A.	14.0	6.0

*Data as of June 30, 2009, unless otherwise stated. ¶'Other' includes $1,541 million in non-agency RMBS. §Aegon U.S. only, Alt-A includes negative amortization floaters and reverse mortgage floaters. **Data as of year-end 2008. CMBS--Commercial mortgage-backed securities. RMBS--residential mortgage-backed securities. CDO--Collateralized debt obligations. CLO--Collateralized loan obligations. N.A.--Not available. Source: Company reports and Standard & Poor's calculations.

The full version of this article, which includes recent rating actions and the rating outlooks for all the Global Multiline insurers included in this article, is available on http://www2.standardandpoors.com/portal/site/sp/en/ap/page.article/3,1,1,0,1204851488820.html, or by emailing open_door@standardandpoors.com