AIG, Chubb, Allstate Buybacks Portend Lower Premiums, Stocks

By Hugh Son and Zachary R. Mider

July 27 (Bloomberg) -- U.S. property and casualty insurers are buying back stock at the fastest rate in at least 20 years, and that spells trouble for shareholders.

While repurchases typically boost share prices, in the insurance industry, they're a sign that competition is pushing premiums low enough to threaten profit growth. Property and casualty stocks are lagging behind both life insurers and U.S. benchmarks as commercial insurance prices decline the most since they started falling in 2004.

``Insurance companies know they're going into a softer cycle, and they're pleading with their shareholders not to lower valuations on their stocks,'' said Stuart Quint, who helps manage $30 billion for Columbus, Ohio-based Nationwide Funds Group and pared holdings of American International Group Inc. and Hartford Financial Services Group Inc. in the first quarter.

Nineteen of 25 insurers tracked by analysts at Credit Suisse Group purchased $4 billion of their stock in the first quarter, following what was at least a 20-year high of $7.1 billion during all of 2006. In 1999, when premiums hovered near a record low relative to net worth, the companies bought $5.3 billion.

``Buybacks are a way for insurers to make the best of a bad situation, but it's still a bad situation,'' said Rob Haines, a debt analyst at CreditSights Inc. in New York.

Shares of New York-based AIG, the world's largest insurer by market value, dropped 7 percent this year, giving back all the gains that followed the company's March announcement of a record $5 billion in buybacks this year. The Standard & Poor's Property & Casualty Index fell 7.8 percent this year, while the S&P Life & Health Index gained 5.2 percent and the S&P 500 rose 4.5 percent.

The property and casualty industry is a boom or bust business. When insurers are making money, they cut prices to gain market share until premiums fail to cover their claims. That leads to underwriting losses that force insurers to raise prices until profits return.

The average rate on commercial insurance fell 12 percent in the second quarter, the biggest drop since the slide began three years earlier, according to the Council of Insurance Agents & Brokers in Washington. The decline slowed in 2005 when record hurricane claims spurred increases on catastrophe coverage.

``We are beginning to see behaviors we haven't seen since the late '90s in the commercial market,'' Liberty Mutual Group Chief Executive Officer Edmund Kelly said on a July 24 conference call for debt investors in the closely held Boston-based business insurer. ``It's pretty disturbing to see.''

The insurers buying stock wouldn't have to resort to repurchases if competitors weren't driving prices to potentially unprofitable levels, said Donald Light, an analyst at Celent LLC, a Boston-based financial research and consulting firm.

``Buybacks should limit price declines, but they're also a sign of falling prices,'' he said. ``You don't think there's a lot of attractive new business when you're buying back your own shares.''

The industry's return on net worth, or assets minus liabilities, slipped to an annualized 12.9 percent in the first quarter from 14 percent in 2006, when the industry earned a record $63.7 billion after property insurers raised prices for storms that never came. The Insurance Information Institute, a New York-based research firm funded by insurers, said the return may fall to 1 percent by 2011, assuming past patterns repeat.

``They always say, `We're going to do the right thing with the capital,''' said Phil Sundell, an analyst who helps manage $105 billion at American Century Investments, a Kansas City, Missouri-based firm that held shares of AIG and Travelers Cos. as of March. ``The problem with that is insurance is a product you sell today and figure out the profitability tomorrow.''

As so-called soft markets go, this one may be less dramatic, said Charles Gates, the Credit Suisse analyst in New York who's been tracking the buybacks and has an ``outperform" rating on stocks including AIG and Allstate Corp. As a percentage of the industry's net worth, the insurers in his group are on pace to buy about twice as much stock as they did in 1999, he said.

The industry is better off on the claims side too, said Bob Hartwig, president of the Insurance Information Institute. Smaller asbestos-related judgements and a decline in the rate of car accidents are helping protect profit margins, he said.

``You can drop rates if the number of claims is decreasing," he said. ``The question is, are you willing to go to the point where the profit margin is virtually nonexistent? That's the competition that characterized the late 1990s. We don't have that today."

Progressive Corp., in Mayfield Village, Ohio, and Northbrook, Illinois-based Allstate, the two biggest publicly traded auto insurers, bought a total of $2.8 billion of their shares in the first half and their stocks rank as two of the four worst performers among the 24 insurers in the S&P this year. Allstate fell 15 percent, and Progressive dropped 11 percent.

Companies such as AIG and Hartford Financial, which also sell life insurance and investment products, haven't lagged behind as much as those that primarily offer property and casualty coverage. Hartford Financial, based in Hartford, Connecticut, has gained 2.5 percent this year, while St. Paul, Minnesota-based Travelers, the second-largest commercial insurer after AIG, has fallen 4.5 percent, and Chubb Corp. of Warren, New Jersey, the second-biggest insurer of corporate boards, is down 1.9 percent. Hartford Financial bought $800 million of stock in the first half, while Travelers spent $1.3 billion and Chubb, $1.1 billion.

Buybacks ``help on the margin, but the reality is, there is still a lot of excess capital," said Gabriel Solomon, who helps oversee $350 billion at T. Rowe Price Group Inc., the Baltimore-based fund manager that held 30.9 million shares of AIG and 656,390 shares of Allstate as of March. ``I don't think there's anyone who doesn't think pricing is getting worse."

--With reporting by Erik Holm in New York. Editor: Stock (scc)

To graph the relative stock performance of AIG and benchmark indexes, see {AIG US COMP D}. For today's top insurance news, see {INSN}. For more information useful to the insurance industry, see {BINS}.

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