

## Fitch Downgrades Tower Group on Reserve Charge

Written by Australian Business

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CHICAGO--( [BUSINESS WIRE](#) )--Fitch Ratings has downgraded Tower Group International, Ltd.'s (TWGP) Issuer Default Rating (IDR) to 'B' from 'BBB' and Tower's operating subsidiaries' (collectively referred to as Tower) Insurer Financial Strength (IFS) ratings to 'BB' from 'A-'. All ratings remain on Rating Watch Negative pending the company's exploration of strategic alternatives. A full list of rating actions follows at the end of this release.

### KEY RATING DRIVERS

Fitch's rating actions follow Tower's announcement today that it will be taking \$364 million in adverse reserve development and writing down \$214 million in goodwill in conjunction with its delayed second quarter 2013 earnings release. The company has also announced that it has engaged investment bankers to explore strategic alternatives.

The company's inability to effectively place adequate controls on the loss reserving process where potential charges were first announced on Aug. 7 followed by additional events, including a drop in the company's share price and the lack of new capital raising, have led to a material weakening in the insurer's financial profile. Further, Fitch is concerned that TWGP's competitive position has been materially damaged, negatively impacting the company's financial flexibility and ability to write new business.

The magnitude of the second quarter charges was large enough to cause several key ratios to fall well outside of previously established ratings downgrade triggers, which resulted in the multi-notch downgrade.

The combined charges equate to approximately 63% of year-end 2012 shareholders' equity. The majority of the reserve development came from accident years 2008-2011, and primarily emanates from business acquired during the Specialty Underwriters Alliance, Inc. (SUA) acquisition, which Tower acquired in 2009.

On Aug. 8, 2013 Tower had provided guidance to the market that loss reserves could be deficient by between \$60-110 million and the goodwill could be impaired depending on

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the settlement of reserve estimates. Fitch had earlier placed Tower's ratings on Rating Watch Negative on Aug. 7, 2013 after the company announced a delay in filing its June 2013 10Q.

After the charges, financial leverage and annualized operating leverage are forecasted to be 45% and 3.3 times (x). These reflect a sharp deterioration from 29% and 1.6x, respectively, as of Q1 2013.

Near-term pressure on the holding company cash flows are at risk as \$70 million due under the bank credit is at risk of acceleration. With limited to no access to funds from the operating companies the funds to pay off this debt must come from selling assets or raising new capital.

The Rating Watch Negative reflects the potential that ratings could be lowered further depending upon the company's ability to seek strategic alternatives and future reserve development. Fitch notes that the situation at Tower is very dynamic and will update its ratings accordingly.

Fitch may provide Recovery Ratings in the future, which is typical for IDRs of 'B+' or lower.

### RATING SENSITIVITIES

The following is a list of key rating triggers that could lead to the ratings being affirmed:

--No other material adverse reserve development or negative announcements by the company;

--Evidence that competitive positioning can be sustained

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The following is a list of key rating triggers that could lead to a ratings downgrade:

--Further adverse reserve developments or announcement of additional losses by the company;

--Inability to materially de-risk the balance sheet;

--Inability to meet financial obligations of the operating or holding company including accelerated payments.

Fitch has downgraded the following ratings, and they remain on Rating Watch Negative:

Tower Group International, Ltd.

--IDR to 'B' from 'BBB'.

Tower Group, Inc.

--IDR to 'B' from 'BBB';

--5% senior convertible debt rating to 'B-' from 'BBB-'.

Tower Insurance Company of New York

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Tower National Insurance Company

Preserver Insurance Company

CastlePoint National Insurance Company

York Insurance Company of Maine

Hermitage Insurance Company

CastlePoint Florida Insurance Company

North East Insurance Company

Massachusetts Homeland Insurance Company

CastlePoint Insurance Company

Kodiak Insurance Company

--IFS ratings to 'BB' from 'A-'.

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Additional information is available at ' [www.fitchratings.com](http://www.fitchratings.com) '.

Applicable Criteria and Related Research:

--'Insurance Rating Methodology' (Aug. 19, 2013).

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Insurance Rating Methodology

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=715468](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715468)

Additional Disclosure

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