The NAIC Capital Markets Bureau monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. Previously published NAIC Capital Markets Bureau Special Reports are available via its web page and the NAIC archives (for reports published prior to 2016).

U.S. Insurance Industry's High-Yield Bond Exposure Grows Following COVID-19-Related Credit Deterioration in 2020

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Executive Summary

Following more than 10 years of a relatively benign credit environment, the economic and financial

or BBB- at Moody's and Standard & Poor's [S&P], respectively) were also vulnerable, with s

Chart 1: U.S. Insurance Industry High-Yield Bond Exposure by Bond Type, Year-End 2020

Note: The "Other" bond type includes agency-backed RMBS, agency-backed CMBS, hybrid securities, and U.S. Government bonds

While the share of bank loans decreased to 18% from 22% at year-end 2019, the shares of corporate bonds, ABS and other structured securities, and private-label CMBS each increased in 2020. Corporate bonds' share increased to 67.7% at year-end 2020 from 65.8% at year-end 2019, ABS and other structured securities' share increased to 5.7% from 4.6%, and private-label CMBS share increased to 2.8% from 1.1%. The share of the remaining asset classes experienced minimal changes YOY, if any.

Despite the

Table 2: Credit Distribution of U.S. Insurance Industry High-

Chart 2: Historical U.S. Insurance Industry Exposure to High-Yield Bonds, 2011–2020 (BACV $ in Billions)

High-yield bond exposure increased for all insurer types at year-end 2020 compared to year-end 2019. (See Chart 3.) Exposure as a percentage of total bonds at year-end 2020 was near or at its highest point for all insurer types, except for title companies, since 2012.

Chart 3: U.S. Insurance Industry High-Yield Bond Exposure as a Percentage of Total Bonds by

Title companies' high-yield bond exposure has been more volatile compared to other insurer types. Between 2012 and 2020, it peaked at more than 9% of total bonds at year-end 2017 but has been reduced significantly in recent years to levels more in line with the industry average.

Credit Environment Improves but Risks Remain

The overall credit environment has stabilized and is improving, with rating upgrades outpacing downgrades in 2021. For corporate bonds, while sectors that were significantly impacted by the COVID-19 pandemic will take a few more years to fully recover, other sectors are expected to return to pre-pandemic operating levels much sooner. For example, in North America, S&P Global Ratings (S&P) expects the credit metrics of the telecom, technology, health care, and building materials sectors to recover to 2019 levels by the end of 2021, while that of commercial aerospace, airlines, and cruise operators are not expected to fully recover until later than 2023.[1] (See Chart 4.)

expects the U.S. trailing 12-month speculative-grade corporate default rate to decline to 4% by March 2022 from 6.3% in March 2021. In addition, the European trailing 12-month speculative-grade corporate default rate is expected to also decline to 5.25% from 6.1% for the same periods. Lower default rates reflect stabilizing credit metrics, vaccination progress, favorable lending conditions, and a strong economic rebound.

The NAIC Capital Markets Bureau will continue to monitor trends in the U.S. insurance industry's high yield bond investments and report as deemed appropriate.

Questions and comments are always welcome. Please contact the Capital Markets Bureau at CapitalMarkets@naic.org

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