The \_\_\_\_\_\_ monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the <u>INDEX</u>.

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## **Executive Summary**

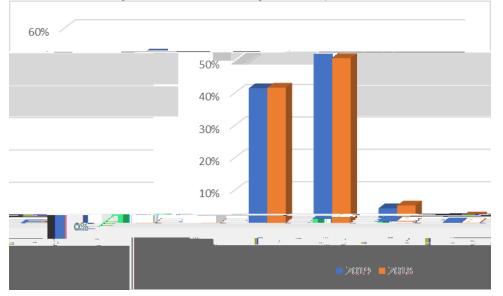
U.S insurer exposure to foreign investments decreased by 5% to \$566 billion in book/adjusted carrying value (BACV) at year-end 2019 from \$597.7 billion at year-end 2018 (including bonds, common

In comparison, at year-end 2018, corporate bonds and foreign government bonds also accounted for 88% (\$496.7 billion) and 10% (\$53.2 billion), respectively, foreign bond exposure, which was \$562.7 billion.

S&P Global Ratings (S&P) downgraded 21 sovereign debt ratings over the last 12 months to July 2020; 19 occurred since March 1, 2020, due in part to the global reach of the COVID-19 pandemic.<sup>1</sup> In addition, about one-fifth of the sovereign ratings (24 in total) are on Negative Outlook. According to S&P, while it does not expect most sovereign debt to default, it believes losses given defaults could be high, particularly for emerging market countries. While averall inductry expecting to expect to expect the sovereign debt is relatively low.

overall industry exposure to sovereign debt is relatively low, exposure, and in turn credit risk, may vary by individual insurer.

About 94% of foreign bonds carried NAIC1 and NAIC2 designations at year-end 2019, compared to 93% of total foreign bonds at year-end 2018. (See Chart 2.)



## Chart 2: NAIC Designations of Total Foreign Bond Exposure, Year-End 2019 and Year-End 2018

The 10 largest countries accounted for 76% of total foreign bond holdings as of year-end 2019, which was similar to year-end 2018. (See Table 3.) The UK was the largest single country exposure at \$106.1 billion and \$112.2 billion at year-end 2019 and year-end 2018, respectively, and was about 20% of total foreign bond exposure for both years. Canada accounted for the second largest country exposure at year-end 2019 and year-end 2018, at \$102.2 billion and \$104.0 billion, respectively. Note that the top 10 countries with the largest foreign bond exposure at exposures did not change year-over-year (YOY). A table identifying the breakout of financial, government and other no

year-end 2019 may be found in the Appendix.

<sup>&</sup>lt;sup>1</sup> S&P Global Ratings,

The average price of oil in 2019 was \$57 per barrel as measured by the West Texas Intermediate Orude (WTI), but oil prices have been volatile since the beginning of 2020, ranging between a low of \$16.5 per barrel and \$57.5 per barrel. In March, the price of crude oil as measured by the WTI dipped to its lowest level in 18 years as a result of a Saudi Arabia-Russia disagreement that resulted in a large oversupply. Then on April 19, the price of oil fell below zero (intraday), to -\$37.63 per barrel, as the oil market was also being pressured on the demand side with the rapid spread of the coronavirus weakening the short-term global economic outlook along with oil demand. Lower economic activity due to the unprecedented lockdowns in much of the U.S and Europe had significantly reduced oil consumption, and oil and gas companies were the most directly affected by ensuing depressed oil prices.

As of year-end 2019, U.S insurers reported a total exposure of about \$115 billion in foreign bonds and stocks to oil-producing countries.<sup>2</sup> Table 4 identifies the top 10 global oil producers in order of largest number of barrels produced per day to smallest, in 2019, but excluding the U.S, which ranked first, according to the U.S Energy Information Administration.

Table 4: U.S. Insurers' Exposure to the Top Oil Producing Countries, Year-End 2019

Total exposure to EU bonds for U.S insurers was approximately \$140 billion, including Eurozone countries and non-euro area members. (See Table 5.) Total EU exposure represented 26 foreign bonds. Government bonds (which not only includes sovereign debt but other types of government bonds) accounted for only 3% of total EU bonds, while 22% were in the financial sector (e.g., banks, financial institutions, etc.), and the majority was in other corporate sectors (i.e., consumer, industrial, etc.). The largest EU country exposure was the Netherlands at 34% of total EU bonds, followed by 23% in France.

Table 5: U.S. Insurers' Bond Exposure to Eurozone Countries by Sector, Year-End 2019 (\$BACV)

Note: The EU is comprised of 25 member states. The result of this analysis reflects only 23 member states as insurers did not have an()-10 g1x2z0lthi ulnB/F1 ar/F1 ETa nBTeW\*24 (thi)Es mprisri2

Approximately \$77 billion, or 14% of total foreign bonds, was denominated in foreign currencies. The British pound (GBP) represented the largest portion at \$24.9 billion at year-end 2019, followed by the Canadian dollar (CAD) and the euro (EUR) at \$22.9 billion and \$20.5 billion, respectively. (See Table 6.) The Australian dollar (AUD) and Japanese yen (JPY) followed, totaling about \$4.1

## Table 7: U.S. Insurers' Foreign Stock Exposures by Industry, Year-End 2018 and Year-End 2019 (\$BACV)

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naffiliated foreign stock at about \$3.6 billion, or

17% of the total, followed by Switzerland and Canada each at 12% of the total, or \$2.7 billion and \$2.6 billion, respectively, at year-end 2019. (See Table 8.) The 10 largest countries with unaffiliated foreign stock exposure at year-end 2019 accounted for 83% of the U.S insurance unaffiliated foreign stock exposure, at \$18.1 billion.

Table 8: U.S. Insurers' Top 10 Unaffiliated Foreign Stock Exposures by Country, Year-End 2019 (\$BACV)

Overall, total foreign stock exposure was about 4 exposure, and less than 1% of total cash and invested assets at year-end 2019. That said, the potential risk of large losses from falling stock prices is

Trade tensions between the U.S and China seem to have lessened since the onset of the COVID-19 pandemic. According to the IMF Global Financial Stability Report, China was the first to experience the COVID-19 outbreak; however, financial conditions in China have been broadly stable, in contrast with other countries may have reflected, among other things, still limited external financial linkages, a strong role of government-owned financial institutions and firms, and early proactive efforts by the authorities that helped stabilize market conditions and sentiment<sup>3</sup>

Appendix

U.S. Insurers' Top 25 Foreign Bond Exposures by Country, Year-End 2019