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U.S. Insurance Industry's High-Yield Bond Exposure Declines at Year-End 2022 Amid Rising Interest Rates

Analyst: Michele Wong

Executive Summary

- As of year-end 2022, U.S. insurance companies' exposure to high-yield bond investments declined 8.8% to $269 billion compared to the prior year.
- High-yield bond exposure accounted for 5.3% of total bonds at year-end 2022, a relatively large decline from 6% at year-end 2021, as U.S. insurers reduced risk amid a rising rate environment.
- Corporate bonds and bank loans represented the majority of the year-end 2022 high-yield exposure at 60.6% and 23.8%, respectively.
- The credit distribution of the industry's high-yield exposure remained relatively unchanged, with 61% of the industry's exposure at year-end 2022 to bonds with NAIC 3 designations.
- High-yield exposure, in terms of book/adjusted carrying value (BACV) and

The credit quality of the U.S. insurance industry's bond portfolio has materially improved following credit deterioration that resulted from the broad-based economic and financial effects of the COVID-19 global pandemic. As of year-end 2022, U.S. insurance companies' exposure to high-yield bond investments declined 8.8% compared to year-end 2021, reporting book/adjusted carrying value (BACV) of $269 billion. (Refer to Table 1.) The year-over-year (YOY) decrease in high-yield exposure is the first decline in four years.

Table 1: Total U.S. Insurance Industry's High-Yield Bond Exposure by Bond Type, Year-End 2022 (BACV $ in Millions)

Note: The "Other" bond type includes agency-backed residential mortgage-backed securities (RMBS), agency-backed commercial mortgage-backed securities (CMBS), hybrid securities, U.S. government bonds, and certificates of deposit. Numbers in the table have been rounded.

High-yield bond exposure declined at all insurer types. The largest percentage decreases were evident at title and property/casualty (P/C) insurance companies with YOY declines in BACV exposure of 28% and 16%, respectively. Corporate bonds were the primary contributor to the decrease in exposure at all insurers. Meanwhile, exposure to high-yield bank loans and private-label residential mortgage-backed securities (RMBS) increased at both life and health insurance companies.

Chart 1 shows that corporate bonds accounted for the majority, or 60.6%, of the year-end 2022 high-yield exposure, and bank loans represented 32.8%. High-yield corporate bond exposure has been declining, from approximately 63% and 68% in 2021 and 2020, respectively. On the other hand, high-yield bank loan exposure has been increasing from about 18% and 20% at year-end 2020 and year-end 2021, respectively, to

Chart 1: U.S. Insurance Industry's High-Yield Bond Exposure by Bond Type, Year-End 2022

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

respectively, compared to 26% and 25% at life and title companies, respectively. Furthermore, NAIC 3 exposure at P/C and health was 05% and 58%, respectively, of total high-yield bonds, while it was 65% and 68%, respectively, at life and title companies.

Share of High-Yield Bonds Falls to Near Pre-Pandemic Level

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Chart 3: U.S. Insurance Industry's High-Yield Bond Exposure as a Percentage of Total Bonds by Insurer Type, 2013–2022

Higher-for-Longer Interest Rates Pose a Big Challenge for High-Yield

High-yield companies are vulnerable to high interest rates, and particularly so if they remain elevated for an extended period of time. Additional challenges include slowing economic growth amid limited financing opportunities, as banks tighten capital availability and investors become risk averse. As borrowing costs rise, high-yield companies typically have less financial flexibility than investment-grade companies and are unable to withstand the credit and financing pressures, leading to

2024.[2] If it reaches this expected level, the default rate would exceed the long-term historical average of 4.1% for the first time since mid-2021, when credit markets were in the midst of recovering from the effects of the COVID-19 pandemic. In addition, the European trailing-12-month speculative-grade corporate default rate is expected to also rise to 3.75% from 3% for the same periods.

Chart 4: U.S. Trailing 12-Month Speculative-Grade Default Rate, January 2019–June 2023

Sources: S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence CreditPro©

With the significant credit pressures in a high interest rate environment, U.S. insurers' high-yield investments are at risk of downward credit migration. While U.S. insurance companies reduced their overall high-yield exposure in 2022, individual insurers with concentrated exposures, particularly as a percentage of capital and surplus, could be at risk of significant losses if default rates continue to thei