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 Investments Near $300 Billion at Year-End 2021

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Executive Summary

- The U.S. insurance industry reported $295 billion in high-yield bond investments at year-end 2021, an increase of 3% compared to year-end 2020, amid the credit markets recovering from the impact of the COVID-19 pandemic.
- High-yield bonds accounted for 6% of the industry's total bond exposure, just below the highest level in more than 10 years of 6.1% recorded at year-end 2020.
- Bank loans and asset-backed securities (ABS) and other structured securities were the primary contributors to the increase in high-yield exposure in 2021.
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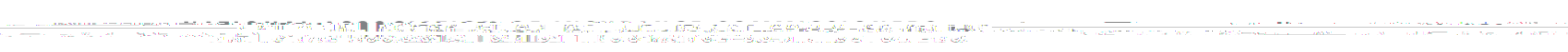
U.S. insurance companies reported high-yield bond investments with a book/adjusted carrying value (BACV) of $295 billion as of year-end 2021, an increase of 3% compared to year-end 2020. (See Table 1.) The modest year-over-year (YOY) increase in exposure follows a sharp increase of more than 25% in 2020. Additionally, for the first time in three years, the industry's high-yield bond exposure increased at a slower pace than the growth in total bond exposure. Credit quality stabilized and began to recover in 2021 following significant credit deterioration the prior year due to the economic and financial effects of the COVID-19 pandemic globally.

Table 1: Total U.S. Insurance Industry's High-Yield Bond Exposure by Bond Type, Year-End 2021 (BACV $ in Millions)

Note: The "Other" bond type includes agency-backed RMBS, agency-backed CMBS, hybrid securities, and U.S. government bonds. Numbers in the table have been rounded.

High-yield bond exposure at life insurance companies decreased 1% YOY, while it increased significantly at property/casualty (P/C), health, and title insurance companies evidenced by



of 2022 versus the comparable period in 2021. While high-yield issuers took advantage of the abundant credit availability and attractive yields in 2021 and prior years to refinance existing debt, their financial flexibility will be reduced significantly in a higher interest rate environment and amidst lower economic growth prospects.

Leveraged loan activity has also been affected despite their relative attractiveness in a rising rate environment due to their floating rate nature. According to Standard & Poor's (S&P) data, leveraged loan issuance for 2022 has declined roughly 70% in Europe and 40% in the U.S.

While the U.S. insurance industry's high-yield exposure is likely manageable given its overall capital strength, individual insurers with concentrated exposures, particularly as a percentage of capital and surplus, could be at risk of significant losses if default rates spike or rise dramatically. S&P expects the U.S. trailing 12-month speculative-grade corporate default rate to rise to 3.5% by June 2023 from 1.4% in June 2022. While this is a significant increase, the expected default rate will remain lower than the long-term historical average of 4.2%. Furthermore, the European trailing 12-month speculative-grade corporate default rate is expected to also rise to 3% from 1.1% for the same periods. Default rates are expected to climb amid slowing economic growth, rising interest rates, and deteriorating credit metrics as profit margins decline amid persistent inflation.

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.12 0 612 792 reW*nBT/F16l2 r1 nBa4(.9 nBs)-8(a14(alwa4(alcETsur)-6(a) (ke)n)5iwa4(