The NAIC's Capital Markets Bureau monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. Please see the Capital Markets Bureau website at INDEX.

U.S. Insurers' CLO Exposure Continues Double-Digit Increase for Year-End 2021 Albeit at a Slower Pace

Analysts: Jennifer Johnson, Michele Wong and Jean-Baptiste Carelus

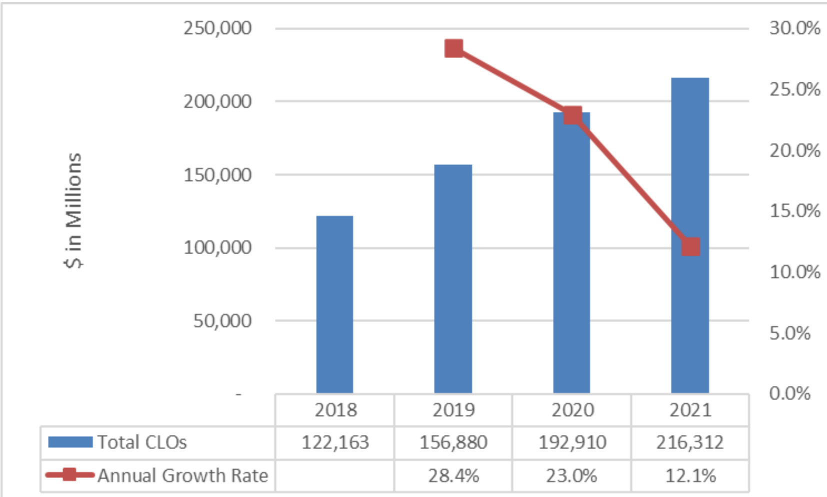
Executive Summary

- As of year-end 2021, U.S. insurers' collateralized loan obligation (CLO) exposure increased by about 12% to $216.3 billion in book/adjusted carrying value (BACV) from $192.9 billion at year-end 2020.
- The pace of growth in insurers' CLO investments slowed in 2021 from 23% and 28% in 2020 and 2019, respectively.
- The credit quality of U.S. insurers' CLO investments shifted marginally in 2021 compared to 2020, with AAA-rated tranches declining to 39.6% of total CLO exposure from 42% and AA-rated tranches increasing to 22% of total exposure from 21%.
- About 90% of U.S. insurers' CLO investments were investment grade at year-end 2021—rated BBB- and higher—with only about 3% rated below investment grade.
- CLOs continue to represent a small proportion of total assets at approximately 2.7% of total cash and invested assets at year-end 2021, which is relatively consistent with that of year-end 2020 but on an increasing trend over the last several years.
- Most U.S. insurer CLO investments continue to be held by large life companies—i.e., those with at least $10 billion in invested assets—many of which have CLO asset manager subsidiaries.
- The top 10 U.S. insurance groups accounted for 41% of the U.S. insurance industry's total CLO exposure.

U.S. insurers' exposure to CLOs increased significantly over the last few years, as they have represented an attractive alternative investment with higher yields than traditional investments. As of year-end 2021, U.S. insurers' exposure to CLOs collateralized predominantly by leveraged bank loans and middle market loans increased by 12% to $216.3 billion in BACV from $192.9 billion at year-end 2020 and

$156.9 billion at year-end 2019 (see Chart 1).[1] However, the pace of growth has slowed from 23% and 28% at year-end 2020 and year-end 2019, respectively.

Chart 1: U.S. Insurance Industry CLO Exposure, 2018–2021



Consistent with years prior, the majority of total CLO exposure was held by life companies, followed by property/casualty (P/C) companies (see Table 1). Life companies' share of the industry's total exposure declined to 76% at year-end 2021 from 80% at year-end 2019, while P/C companies' share rose to 21% from 17% over the same time period. Health and title companies continue to have minimal exposure to CLOs.

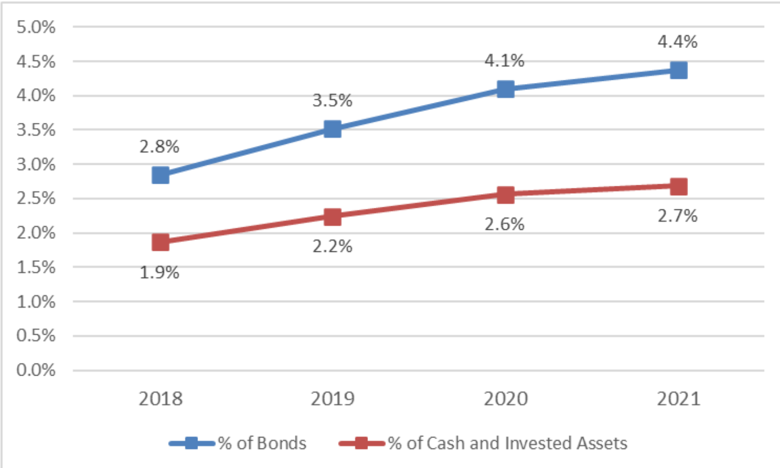
Table 1: U.S. Insurer Exposure to CLOs, 2019–2021

Industry Type	YE 2021	% of Total	YE 2020	% of Total	YE 2019	% of Total
Life	163,645	75.7%	152,398	79.0%	125,922	80.3%
P/C	45,499	21.0%	35,193	18.2%	27,201	17.3%
Health	7,166	3.3%	5,318	2.8%	3,756	2.4%
Title	1	0.0%	0	0.0%	0	0.0%
Total	**216,312**	**100%**	**192,910**	**100%**	**156,880**	**100%**

CLOs have accounted for a relatively small portion of the industry's cash and invested assets, as well as overall bond investments, but the two metrics have been trending higher over at least the last few years (see Chart 2). CLOs accounted for 2.7% of total cash and invested assets at year-end 2021, a slight increase from 2.6% the prior year but a more meaningful increase from 1.9% at year-end 2018. As a percentage of total bond investments, CLOs have increased to 4.4% at year-end 2021 from 2.8% at year-end 2018.

[1] Since 2018, U.S. insurers' CLO exposure has been determined via data reported in the annual statement filings, as well as through additional analysis that was completed with third-party data sources, allowing for a more granular and thorough review.

Chart 2: CLO Exposure as a Percentage of Cash and Invested Assets and Bond Investments, 2018–2021



As shown in Table 2, large companies accounted for almost 80% of the U.S. insurance industry's CLO exposure at year-end 2021, consistent with prior years. Insurance companies with assets between $1 billion and $10 billion accounted for an additional 18% of the industry's exposure.

Table 2: CLO Exposure by Insurer Size, Year-End 2021 ($BACV in millions)

Industry Type	Less than $250MM	Between $250MM and $500MM	Between $500MM and $1B	Between $1B and $2.5B	Between $2.5B and $5B	Between $5B and $10B	Greater Than $10B	Total
Life	270	380	1,151	3,893	4,543	4,830	148,577	163,645
P/C	1,290	1,517	1,863	6,377	6,049	7,708	20,695	45,499
Health	308	612	1,320	2,135	1,409	487	895	7,166
Title	1	-	-	-	-	-	-	1
Total	**1,869**	**2,509**	**4,334**	**12,405**	**12,002**	**13,026**	**170,168**	**216,312**
% of Total	1%	1%	2%	6%	6%	6%	79%	100%

Note: Numbers in the table have been rounded.

At year-end 2021, the top 10 U.S. insurance groups with CLO exposure accounted for 41% of total CLO exposure, compared to 45% at year-end 2020 and year-end 2019. The top 14 U.S. insurance groups accounted for half of the total CLO exposure, compared to the top 10 at year-end 2020. At least six of the top 10 have CLO management subsidiaries. As such, these insurers benefit from having internal CLO infrastructure and knowledge. The top 25 insurer groups accounted for 64% of the industry's CLO exposure at year-end 2021 compared to 70% at year-end 2020. The decrease in percentages year-over-year (YOY) implies a more diverse CLO investor base than in prior years.

The credit quality of U.S. insurers' CLO investments shifted in 2021 compared to 2020. As of year-end 2021, AAA-rated tranches accounted for 39.6% of total U.S. insurers' CLO exposure (see Chart 3), a decline from 42% as of year-end 2020 (see Chart 4). Exposure shifted marginally to AA-rated tranches, which increased to 22.4% of total CLO exposure from 21.1% at year-end 2020. While exposure to BBB-rated tranches declined to 11.2% of total 2021 exposure from 12.6% the prior year, CLO tranches rated BB+ and below increased to 3.3% of total exposure from 2.7%. Despite these shifts in exposure from one rating category to another, overall, about 80% of U.S. insurer CLO investments were rated BBB or higher as of year-end 2021, which was consistent with the two prior years. (Note: This excludes CLO investments rated BBB-).

The share of non-rated CLO tranches increased to 8.3% of exposure in 2021 compared to 6.4% in 2020. The non-rated category includes CLO debt tranches that were reported without a rating, as well as CLO equity tranches that are not rated by the nationally recognized statistical rating organizations (NRSROs).

Chart 3: U.S. Insurer CLO Credit Quality as of Year-End 2021

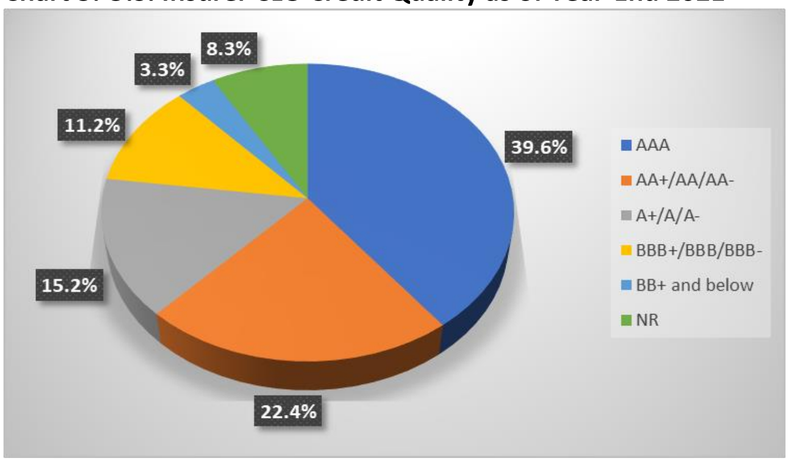
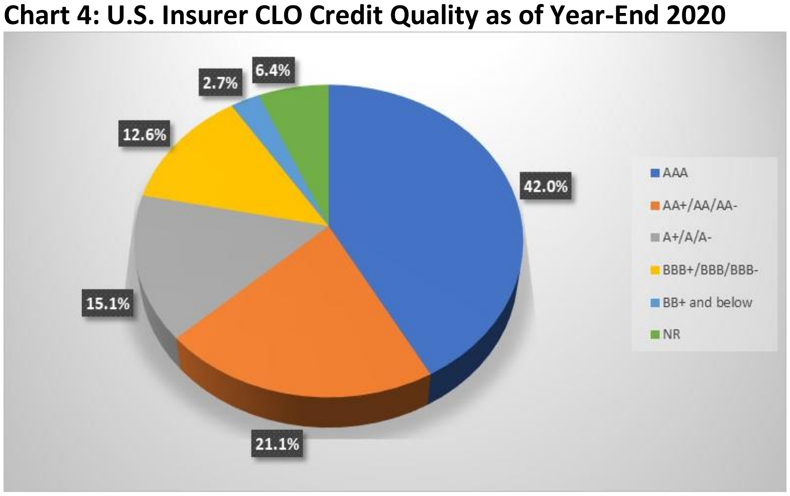


Chart 4: U.S. Insurer CLO Credit Quality as of Year-End 2020



For private equity (PE)-owned U.S. insurers alone, exposure to CLOs was approximately $46 billion at year-end 2021, 89% of which carried NAIC 1 and NAIC 2 Designations. In comparison, at year-end 2020, PE-owned insurers' CLO exposure was about $47 billion based on the current total of PE-owned insurers.

Risk is dependent, in part, on the credit quality of the CLO collateral, which for the most part is mitigated by the relatively high percentage of AAA-rated tranches held by insurers. In addition, risk is also dependent on the concentration of exposure within each insurer's investment portfolio, particularly as a percentage of a company's total capital and surplus.

CRE CLO Investments

U.S. insurers' exposure to commercial real estate (CRE) CLOs has also increased over the last few years. While similar in structure to other CLO types, the underlying collateral in CRE CLOs includes shorter-term loans on transitional real estate properties.

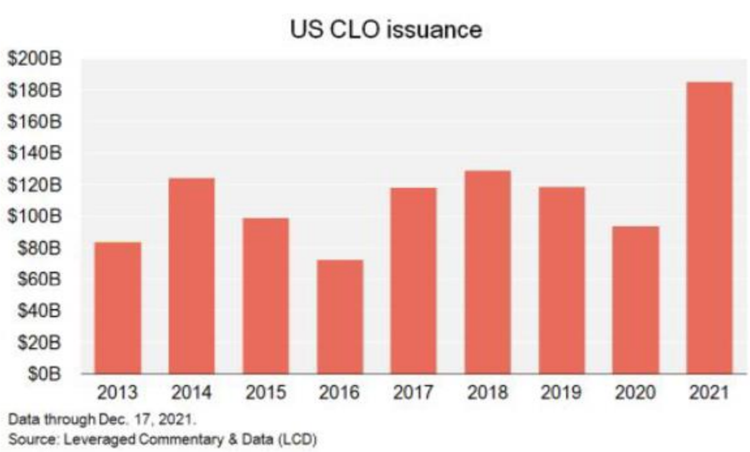
In addition to the CLO investments collateralized primarily by leveraged bank loans and middle market loans, at year-end 2021, U.S. insurers held approximately $9.6 billion in CRE CLOs, representing an 84% increase from $5.2 billion at year-end 2020 and almost triple the $3.7 billion held at year-end 2019. The YOY growth in BACV is in part due to the attractiveness of the relatively shorter duration of CRE CLO debt tranches, which limits interest rate risk. About 71% of U.S. insurers' CRE CLO exposure was held by life companies, a decrease from 78% at year-end 2020, followed by 23% with P/C companies, an increase from 19% at year-end 2020. All U.S. insurers' exposure to CRE CLOs carried NAIC 1 and NAIC 2 Designations at year-end 2021; NAIC 1 Designations accounted for 84%, implying the highest credit quality.

CLO and Leveraged Loan Market Trends

CLO Issuance and Volume

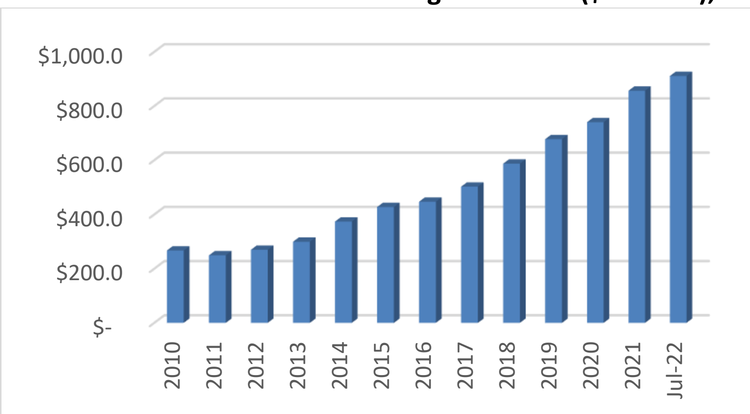
Through mid-December 2021, new U.S. CLO issuance reached $185.2 billion according to S&P Global research (see Chart 5), exceeding a previous calendar-year record of $128.2 billion in 2018. However, CLO issuance slowed in 2022 due to tightening financial conditions, recession concerns, and market uncertainty lowering investor demand. There was about $80 billion of new CLO issuance through Q2 2022.

Chart 5:



According to Bank of America (BofA) Securities, there was about $856.4 billion in outstanding CLOs at year-end 2021, representing a 16% increase from $740.3 billion as of year-end 2020 (see Chart 6). Note that based on reported exposure, U.S. insurers held approximately one-quarter of total outstanding CLOs at year-end 2021. In addition, through Q2 2022, total U.S. CLOs outstanding collateralized by leveraged bank loans totaled about $910 billion according to BofA.

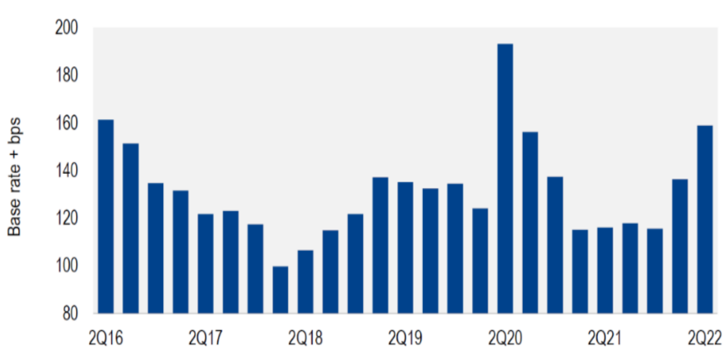
Chart 6: Historical CLOs Outstanding in the U.S. ($ billions), 2010–2021



Source: BofA Securities.

U.S. insurer exposure to CLOs has continued to increase, as they are mainly floating rate, and they have offered an attractive yield alternative to other more traditional asset types, such as investment grade corporate bonds. Spreads on new-issue AAA-rated CLOs, which are the most commonly held rated tranches by U.S. insurers, were about 116 basis points (bps) over three-month London Interbank Offered Rate (LIBOR) as of Q4 2021 (see Chart 7) compared to 137 bps a year prior. Spreads tend to decrease with a presumed decrease in risk and may also move based on other factors, such as supply and demand. With inflation continuing for a longer period than expected, the increase in the federal funds rate by the Federal Reserve twice so far this year, and more rate raises expected, there is demand by investors for floating-rate debt as yields increase with rising rates.

Chart 7: AAA-Rated CLO Spread



Data through June 30, 2022.
Source: Leveraged Commentary & Data (LCD)

However, these same factors have led to wider spreads in 2022. With more CLOs being priced referencing the Secured Overnight Financing Rate (SOFR), the average spread on senior notes widened to about 160 bps over the SOFR in Q2 2022—a 20 bp increase from Q1—due in part to market disruption from the Ukraine war and the continued impact of COVID-19.[2]

For more background on CLOs, please see the NAIC Capital Markets Bureau (CMB) primer published in August 2018.

CLOs Drive Leveraged Bank Loan Issuance

CLOs have been the driver for new leveraged bank loan issuance, which reached a record $615 billion in 2021, surpassing the previous record of $503 billion in 2017. However, loan issuance has slowed dramatically in 2022, given rising interest rates and market uncertainty. Approximately $150 billion of new leveraged loans were issued through Q2 2022, with $55.1 billion issued in the second quarter. This was the lowest quarterly issuance since Q2 2020; i.e., the onset of the COVID-19 pandemic.[3] In Q2 2022, leveraged loans rated B/B+ accounted for 39% of new issuance in Q2 2022, a high since Q1 2020 and up from 27% for Q1 2021.

More background on leveraged bank loans can be found in the NAIC CMB primer on Leveraged Bank Loans published in November 2018, and a special report on U.S. insurers' exposure to leveraged bank loans at year-end 2021 was published in June 2022.

CRE CLO Market Trends

For the first half of 2022, $24 billion in CRE CLOs were issued, $15.3 billion of which were in Q1,[4] and about $20 billion was in multifamily properties. The decrease in Q2 2022 issuance (from Q1) was attributed to continued inflation, Federal Reserve rate hikes, and an overall sluggish economy. In comparison, there was $20.3 billion in new CRE CLO issuance for the first half of 2021 and a total of $45.4 billion in CRE CLO new issuance for the year. U.S. insurers continue to participate in the market, as demonstrated by the significant increase in exposure YOY from 2020 to 2021; although, it is a relatively small exposure of $9.6 billion; less than 1% of total cash and invested assets. The NAIC CMB published a CRE CLO primer in July 2021.

Transition to SOFR from LIBOR

Beginning with Jan. 1, 2022, newly issued leveraged loans and CLOs are to be priced based off SOFR as LIBOR is phased out; previously existing transactions, or legacy CLOs—i.e., issued before 2022—are to be transitioned away from LIBOR by June 30, 2023. According to the Federal Reserve Bank of New York, "SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasuries in the repurchase agreement market." SOFR is more resilient than LIBOR because of the depth and liquidity of

[2] FitchRatings, *Global CLO Quarterly Market Review – 2Q22,* July 2022.
[3] S&P Global, *Q2 Wrap: Loan Issuance Plummets as Headwinds Mount, Secondary Falls*, June 2022.
[4] Trepp, *Checking in on Once Flourishing CRE CLO Market: Issuance Update*, July 2022.

its underlying markets, with the volume of transactions exceeding most other markets. Almost all new leveraged loan issuance through Q2 2022 referenced SOFR, and increasingly, CLOs are also being priced with SOFR.

According to S&P Global, as of June 30, 2022, "the average U.S. broadly syndicated loan (BSL) CLO transaction has about 12.5% of its assets tied to SOFR, with a handful of them having exposure of 30% to SOFR-indexed assets."[5] Once most CLO assets are indexed to non-LIBOR rates, the rates on most existing CLO debt will be able to transition to SOFR. Because the transition to SOFR from LIBOR was announced well in advance, the CLO market has had time to prepare; i.e., most legacy CLO documents, although not all, include "fallback language" that is intended to govern CLO liabilities' transition to the new benchmark. S&P Global has performed stress testing under various scenarios to assess the potential impact, and results indicate that the transition to SOFR should have a limited impact on CLOs' excess spread, as well as their credit ratings.[6]

The NAIC CMB will continue to monitor trends with CLOs and report as appropriate.

Questions and comments are always welcome. Please contact the Capital Markets Bureau at [CapitalMarkets@naic.org.](mailto:CapitalMarkets@naic.org)

[5] S&P Global, *Scenario Analysis: LIBOR Transition, Excess Spread, And U.S. CLO Ratings,* June 2022.
[6] Ibid.