

U.S. Insurer CLO Exposure at Risk of Ratings Downgrade (05/13/2020)

Analysts: Jennifer Johnson and Michele Wong

At year-end 2019, U.S. insurers had approximately \$158 billion in book/adjusted carrying value (BACV) of collateralized loan obligation (CLO) exposure, representing a 23% increase from about \$128 billion at year-end 2018. Based on analysis performed by the NAIC Capital Markets Bureau and Structured Securities Group (SSG), within U.S. insurers' CLO exposure at year-end 2019, about \$5.95 billion,¹ or 3.7% of the total, are at risk of ratings downgrade, evidenced by the credit watch negative (CWN) or comparable status from S&P Global or Moody's Investors Service as of May 11, 2020. As shown in Table 1, the largest rating category at risk for downgrade for U.S. insurers are CLO tranches rated BBB-, totaling \$4.3 billion in BACV, which accounted for 73.1% of the total. Overall, CLO tranches rated BBB- and below accounted for \$5.3 billion, or almost 90% of total U.S. insurers' CLO exposure at risk for downgrade.

Table 1: U.S. Insurer CLO Exposure as of Year-End 2019 on Credit Watch Negative (or Comparable Status)

Current Ratings	\$BACV	% of Total
A	109,614,297	1.8%
A-	183,984,732	3.1%
BBB+	149,866,785	2.5%
BBB	147,645,627	2.5%
BBB-	4,351,217,561	73.1%
BB+	3,172,664	0.1%
BB	59,305,332	1.0%
BB-	881,250,572	14.8%
B+	10,573,849	0.2%
B	7,726,195	0.1%
B-	43,784,250	0.7%
CCC+	2,663,787	0.0%
Grand Total	5,950,805,651	100.0%

Note that the \$5.95 billion total is spread across 920 U.S. insurers, which was approximately 20% of the total number of U.S. insurers as of year-end 2019. Lending further comfort, the total BACV at risk for ratings downgrade was less than 1% of the \$925.5 billion aggregate total capital and surplus for these insurers. However, risk for ratings downgrade should be reviewed per insurer, particularly as it relates to the exposure as

¹ This number is limited to those securities where NAIC staff were able to map the insurance company reported identifier to the nationally recognized statistical rating organization (NRSRO)-provided identifier.

a percentage of its total capital and surplus. For example, only five insurers had exposure that was greater than 50% of total capital and surplus (and only 15 had more than 25%).

To provide some perspective, as of May 3, S&P Global had about 400 CLO tranches, for which it had assigned credit ratings, on CWN, according to a CLO Spotlight publication.² The majority, or about 200, were for tranches in the BB-category (i.e., current ratings of BB+, BB or BB-), followed by approximately 170 tranches in the B ratings category. The affected tranches were across 305 U.S. broadly syndicated loan (BSL) CLOs rated by S&P Global, and approximately 55% of these CLOs were 2015 vintage or prior.

The significant number of CWN placements is due in part to credit deterioration on the underlying bank loan collateral; in turn, there has been an increase in the number of bank loan ratings downgrades and, consequently, an increase in bank loans rated CCC in CLO portfolios. Negative corporate rating actions have been taken by the nationally recognized statistical rating organizations (NRSROs) on issuers in many industries that have been negatively affected by the COVID-19 pandemic, as well as oil price volatility. The hotel, restaurant, leisure and entertainment industries represent most of the negative rating actions affecting U.S. BSL CLOs since March.

The NAIC Capital Markets Bureau expects to publish an updated special report on the U.S. insurance industry's CLO exposure as of year-end 2019 shortly, and it also plans to conduct stress test modeling on this exposure.

The NAIC Capital Markets Bureau will continue to monitor the impact of the coronavirus and other market events on the financial markets and report, as deemed appropriate.

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

The views expressed in this publication do not necessarily represent the views of NAIC, its officers or members. NO WARRANTY IS MADE, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY OPINION OR INFORMATION GIVEN OR MADE IN THIS PUBLICATION.

© 1990 – 2020 National Association of Insurance Commissioners. All rights reserved.

² S&P Global, *CLO Spotlight: U.S. CLO Exposure to Negative Corporate Rating Actions (as of May 3, 2020)*, May 2020.