National Association of Insurance Commissioners & The Center for Insurance Policy and Research
Capital Markets Special Report

The **NAIC's Capital Markets Bureau** monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of US insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the **index**

U.S. Insurance Industry's Exposure to Restricted Assets as of Year-End 2016

By Jennifer Johnson

Among its investments, the U.S. insurance industry has exposure to assets that are not under its exclusive control. That is, they are restricted. Insurers disclose these restricted assets and code them as such in their annual statement filings. There are several different code categories, depending on the purpose of the restriction. For example, some investments are held as collateral for repurchase agreements, while others may serve as pledged collateral to the Federal Home Loan Bank (FHLB). Assets identified as restricted may be admitted or nonadmitted, depending on specific Statement of Statutory Accounting Principles (SSAP) limitations, and/or whether certain criteria are met. Insurers disclose whether restricted assets are admitted or nonadmitted in the financial statements, and they also provide information on the extent of the restricted assets in comparison to total assets. Similar to any investment held by U.S. insurers, when assets are restricted, insurers may be exposed to market risk and liquidity risk, among other types of risks. Note also that insurers must be able to freely substitute restricted assets with the corresponding counterparties in order for the assets to be admitted.

Accounting Guidance and Risk-Based Capital (RBC)

According to *SSAP No. 4—Assets and Nonadmitted Assets*, "Assets that are pledged as collateral, or otherwise restricted (not under the exclusive control of the insurer...) shall be identified in the investment schedules pursuant to the codes in the annual statement instructions, disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for assets pledged as collateral or otherwise restricted." With regard to the codes in the annual statement instructions, the amounts reported in the investment schedules (e.g., Schedule D, Part 1 – Bonds) may only be applicable to a limited portion of the entire reported asset. That is, insurers generally report these assets in total by Committee on Uniform Security Identification Procedures (CUSIP), and only a portion of the assets may actually be pledged or otherwise restricted. In the investment schedules, insurers are required only to identify the assets that are *associated* with the pledged collateral and not the specific amount pledged. Note, however, that the disclosure requirements in SSAP No. 1 state that insurers must report the actual amount of the restricted assets and the nature of their pledges (i.e., allocated across the various restricted asset categories) in the *Notes to the Financial Statements* (Note 5 – Investments – Restricted Assets).

For restricted assets identified in the General Interrogatories, a "restricted asset" reserve requirement is applied to the RBC charge. This represents an additional RBC charge, as the admitted assets reported in the financial statements also receive a "standard" RBC charge for the particular investment (based on investment type, quality and other factors). Note that some restricted assets are not identified in the General Interrogatories (for example, assets pledged under reinsurance agreements), and as such, they are not required to have the "additional" RBC charge applied.

U.S. Insurer Exposure as of Year-End 2016

As reported by U.S. insurers in the Notes to the Financial Statements (per the disclosure captured in Note 5 for *Restricted Assets*), a total of approximately $431 billion in book/adjusted carrying value (BACV) was identified as admitted restricted assets as of year-end 2016. By type, the largest amount, about 22% of reported restricted assets as shown in Table 1 (or $94.7 billion in BACV), was reported as "other." Items captured as "other" often reflect restricted assets pertaining to reinsurance or derivative agreements.

The second largest type of restricted assets held by insurers as of year-end 2016 was FHLB pledged collateral at approximately $91 billion, or 21% of the total, followed by 19% in "pledged collateral in categories not captured by other categories." For more detail about U.S. insurer exposure to FHLB (including pledged collateral to FHLB), please see the NAIC Capital Markets Bureau Special Report titled *U.S. Insurer Exposure to the FHLB System as of Year-End 2016* published on Jan. 9, 2018. Also note that U.S. insurer exposure to FHLB capital stock—which is also discussed in the aforementioned special report—can only be redeemed by the FHLB at cost, but it is a very small proportion of the industry's restricted assets at year-end 2016.

Table 1: Total U.S. Insurer Admitted Restricted Assets ($bil BACV)

Restricted Asset Type	Total Admitted Restricted Assets Year-End 2016	% of Total at Year-End 2016	Total Admitted Restricted Assets Year-End 2015	% of Total at Year-End 2015
Collateral held under securities lending agreement	51,420	12%	48,415	12%
FHLB capital stock	3,972	1%	3,524	1%
Letter stock or securities restricted as to sale - excluding FHLB capital stock	23,354	5%	29,496	8%
On deposit with other regulatory bodies	10,178	2%	10,020	3%
On deposit with states	47,374	11%	51,938	13%
Placed under options contracts	109	0%	39	0%
Pledged as collateral not captured in other categories	79,803	19%	55,039	14%
Pledged as collateral to FHLB	90,721	21%	74,539	19%
Subject to contractual obligation for which liability not shown	252	0%	161	0%
Subject to dollar repurchase agreement	718	0%	1,060	0%
Subject to repurchase agreement	24,634	6%	24,905	6%
Subject to reverse repurchase agreement	3,876	1%	3,999	1%
Other restricted assets	94,769	22%	88,373	23%
Grand Total	**431,180**	**100%**	**391,508**	**100%**

In comparison, as of year-end 2015, U.S. insurers reported a total $391.5 billion BACV in total admitted restricted assets. However, in percentage terms, the distribution across restricted asset types was relatively similar between 2015 and 2016. Similar to year-end 2016, "other restricted assets" was the largest category at 23% of the total (or $88.3 billion) at year-end 2015, followed by collateral pledged to the FHLB at 19% (or $74.5 billion) and assets pledged as collateral not captured in other categories at 14% (or $55 billion). The year over year (YOY) growth was mostly attributable to an increase in pledged collateral to the FHLB and pledged collateral not captured in other categories.

By industry type, life companies accounted for the largest exposure to restricted assets at year-end 2016 at almost $300 billion, or 69% of total U.S. insurer restricted assets (shown in Table 2), followed by property/casualty (P/C) companies at $116.9 billion, or 27% of the total. Health companies followed at a distant 2% of total restricted assets. Overall, total restricted assets accounted for about 7% of total cash and invested assets held by the U.S. insurance industry at year-end 2016.

Table 2: U.S. Insurer Total Admitted Restricted Assets as of Year-End 2016 ($bil BACV)

Restricted Asset Type	Life	P/C	Fraternal	Title	Health	Total	% of Total
Collateral held under securities lending agreements	45,899	3,095	1,288	-	1,138	51,420	12%
FHLB capital stock	3,558	297	4	-	113	3,972	1%
Letter stock or securities restricted as to sale - excluding FHLB capital stock	4,001	19,207	32	-	114	23,354	5%
On deposit with other regulatory bodies	2,844	4,816	2,252	84	182	10,178	2%
On deposit with states	3,855	40,650	14	131	2,723	47,374	11%
Placed under options contracts	51	22	37	-	-	109	0%
Pledged as collateral not captured in other categories	61,850	15,847	38	5	2,062	79,803	19%
Pledged as collateral to FHLB	80,878	7,180	290	5	2,368	90,721	21%
Subject to contractual obligation for which liability not shown	89	44	7	-	111	252	0%
Subject to dollar repurchase agreement	696	22	-	-	-	718	0%
Subject to repurchase agreement	23,746	877	-	-	10	24,634	6%
Subject to reverse repurchase agreement	2,649	1,228	-	-	-	3,876	1%
Other restricted assets	69,453	23,599	-	-	1,717	94,769	22%
Grand Total	**299,570**	**116,883**	**3,963**	**225**	**10,540**	**431,180**	**100%**
% of industry type total restricted assets	69%	27%	1%	0%	2%	100%	

U.S. Insurer Large Exposures to Restricted Assets

Collateral Pledged to the FHLB

The aforementioned NAIC Capital Markets Special Report published in January 2018 (relative to U.S. insurers' exposure to FHLB) provided an update on the U.S. insurance industry's exposure to FHLB capital stock, debt and advances (borrowings) in addition to pledged collateral as of year-end 2016. For U.S. insurers that are members of the FHLB (that is, where insurers are required to own membership stock in the FHLB), insurers must pledge collateral to the FHLB in order to receive advances. FHLB advances represent a stable source of low-cost funding for insurers, with maturities ranging from short-term to 30 years, based on the specific U.S. insurer's need. The fair value of collateral pledged to an FHLB is required to exceed the amount of the FHLB advance in order to provide a "cushion" (known as overcollateralization) in the event the FHLB member defaults. According to the January 2018 special report, from 2015 to 2016, insurers increased the amount of assets pledged as collateral to FHLB by $23 billion for current and/or future borrowings. That is, in some cases, the amount pledged does not relate to an actual advance, but is intended to maintain opportunity for an open but undrawn liquidity source.

Reinvested Collateral from Securities Lending Agreements

When U.S. insurers engage in securities lending agreements, they loan bonds or stocks or other securities to another financial institution in the over-the-counter market. In turn, the borrower pledges collateral to the insurer in the form of cash or securities. *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* provides the key accounting guidance for securities lending transactions. Specifically, any cash or securities received by an insurer as collateral in a securities lending agreement (i.e., securities lent) is reported "on balance sheet" if the insurer has the ability to sell or repledge this collateral. Thus, the collateral received, or any reinvested collateral, is identified as a *restricted asset*. Note that any collateral received that an insurer is *not* permitted to sell or repledge is considered "off balance sheet" and, therefore, is not captured in the financial statements.

Collateral received by the insurer in exchange for securities lent must have a fair value of at least 102% of the fair value of the loaned securities on the transaction date. If at any time during the agreement the collateral received from the borrower is less than 100% of the fair value of the loaned securities, the borrower is obligated to deliver additional collateral by the next business day so that the fair value of the total collateral received equals 102% of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100% of the fair value of the loaned securities at a reporting date, then the loaned securities will be designated as nonadmitted for the difference between the fair value of the collateral received and the loaned securities.

As reported by U.S. insurers at year-end 2016, 30% of the collateral received and/or reinvested under securities lending transactions reported on balance sheet (as reported in Schedule DL Part 1 and Part 2) consisted of cash and cash equivalents. Even though the cash and cash equivalents are "restricted" due to the nature of the securities lending agreement (i.e., they are held by the insurer until they have to be returned at the end of the securities lending agreement), they are generally liquid investments.

Restricted Assets' Risks to Insurers

Liquidity

Similar to other financial institutions, insurers must mitigate liquidity risk—that is, the risk of not having the ability to meet claims paying and debt obligations (expected and unexpected) without incurring any large losses or affecting its overall financial condition. Restricted assets are pledged by borrowers/counterparties to insurers for specific agreements. As the admitted asset requirements for pledged assets compels insurers to have the ability to readily substitute the pledged securities, insurers can often unwind short-term transactions, resulting in a release of the pledged assets (particularly with repurchase or securities lending agreements), which generally limits any additional risk that comes from the assets being pledged. In adverse market conditions, however, the pledged assets may not be easily liquidated. In addition, insurers must include detailed information in the statutory financial statements via the different restricted asset categories so that the aggregate totals can be used to complete any liquidity assessments.

Credit and Counterparty Risk

Insurer access to restricted collateral that is pledged to a borrower, such as in the case of securities lent, is contingent upon the borrower returning the assets as stipulated in the agreement in terms of timing and amount. As such, the credit quality of the borrower plays a role in the probability that the insurer (the lender) will receive the pledged assets back on a full and timely basis. That is, the better the credit quality of the borrower, the more likely it is to repay the insurer as indicated in the respective agreement.

Market Risk

As collateral requirements for some restricted assets (such as with securities lending) are based on fair value according to the various SSAPs, when markets are volatile, the fair value of the pledged collateral also fluctuates, which may affect the "cushion" it is intended to provide against the borrowed or loaned securities. As such, market risk increases with adverse economic conditions, resulting in a possible decline of the restricted assets' fair value and ability for the borrower to return the full amount when due. In some cases, where there is a minimum amount of pledged collateral required, any deficiencies caused by a decline in market value of the pledged collateral may have to be "topped off," depending on the terms of the agreement and the fair value of the borrowed security. For example, with regard to restricted assets comprised of collateral pledged to the FHLB, in the event of a market decline, the insurer would in turn pledge additional collateral to the FHLB to reflect the necessary overcollateralization required by the FHLB.

Summary

U.S. insurers' exposure to restricted assets was approximately $431.1 billion in BACV as of year-end 2016, compared to about $391 billion at year-end 2015. While 23% of assets that were reported as restricted were identified as "other restricted assets" by insurers, about 19% included collateral that was pledged to the FHLB (related to advances) at year-end 2016. Restricted assets that meet specific conditions are considered admitted assets and may be subject to an additional RBC "restricted asset" charge. U.S. insurers' restricted assets may reflect pledges to collateralize other investments, such as securities lending. They are subject to market, liquidity and other risks, which are often mitigated through SSAP reporting requirements for admittance (either of the pledged asset, or the related investment).

The NAIC Capital Markets Bureau will monitor trends and developments regarding U.S. exposure to restricted assets and report as deemed appropriate.

March 23, 2018 Major Insurer Share Prices			Change %			Prior		
		Close	Week	QTD	YTD	Week	Quarter	Year
Life	Aflac	$43.35	(4.2)	(1.2)	(1.2)	$45.25	$43.89	$43.89
	Ameriprise	144.89	(7.8)	(14.5)	(14.5)	157.10	169.47	169.47
	Genworth	2.90	(2.0)	(6.8)	(6.8)	2.96	3.11	3.11
	Lincoln	70.36	(7.9)	(8.5)	(8.5)	76.36	76.87	76.87
	MetLife	44.08	(6.8)	(12.8)	(12.8)	47.32	50.56	50.56
	Principal	57.76	(7.0)	(18.1)	(18.1)	62.11	70.56	70.56
	Prudential	100.64	(7.4)	(12.5)	(12.5)	108.65	114.98	114.98
	UNUM	46.98	(6.6)	(14.4)	(14.4)	50.28	54.89	54.89
PC	Axis Capital	56.09	(1.9)	11.6	11.6	57.18	50.26	50.26
	Allstate	92.25	(5.4)	(11.9)	(11.9)	97.53	104.71	104.71
	Arch Capital	83.41	(1.9)	(8.1)	(8.1)	85.04	90.77	90.77
	Cincinnati	71.61	(4.7)	(4.5)	(4.5)	75.13	74.97	74.97
	Chubb	134.57	(4.5)	(7.9)	(7.9)	140.98	146.13	146.13
	Everest Re	248.63	(4.9)	12.4	12.4	261.40	221.26	221.26
	Progressive	59.68	(3.6)	6.0	6.0	61.92	56.32	56.32
	Travelers	134.90	(4.5)	(0.5)	(0.5)	141.32	135.64	135.64
	WR Berkley	70.22	(1.6)	(2.0)	(2.0)	71.34	71.65	71.65
	XL	55.33	0.0	57.4	57.4	55.33	35.16	35.16
Other	AON	$137.17	(6.0)	2.4	2.4	$145.97	$134.00	$134.00
	AIG	53.41	(1.6)	(10.4)	(10.4)	54.30	59.58	59.58
	Assurant	87.49	(2.7)	(13.2)	(13.2)	89.93	100.84	100.84
	Fidelity National	39.87	1.7	1.6	1.6	39.22	39.24	39.24
	Hartford	50.29	(6.7)	(10.6)	(10.6)	53.93	56.28	56.28
	Marsh	80.54	(4.5)	(1.0)	(1.0)	84.33	81.39	81.39
Health	Aetna	$168.11	(3.3)	(6.8)	(6.8)	$173.91	$180.39	$180.39
	Cigna	164.00	(2.8)	(19.2)	(19.2)	168.67	203.09	203.09
	Humana	261.60	(4.1)	5.5	5.5	272.73	248.07	248.07
	United	212.55	(6.7)	(3.6)	(3.6)	227.86	220.46	220.46
Monoline	Assured	$34.94	(1.7)	3.2	3.2	$35.54	$33.87	$33.87
	MBIA	9.10	4.6	24.3	24.3	8.70	7.32	7.32
	MGIC	12.25	(1.1)	(13.2)	(13.2)	12.39	14.11	14.11
	Radian	18.26	(0.5)	(11.4)	(11.4)	18.35	20.61	20.61
	XL Capital	55.33	0.0	57.4	57.4	55.33	35.16	35.16

March 23, 2018 Major Market Variables	Close	Change % Week	Change % QTD	Change % YTD	Prior Week	Prior Quarter	Prior Year
Dow Jones Ind	23,533.20	(5.7)	(4.8)	(4.8)	24,946.51	24,719.22	24,719.22
S&P 500	2,588.26	(6.0)	(3.2)	(3.2)	2,752.01	2,673.61	2,673.61
S&P Financial	445.64	(7.2)	(3.9)	(3.9)	480.30	463.94	463.94
S&P Insurance	381.01	(5.1)	(5.2)	(5.2)	401.38	402.08	402.08
US Dollar $		Change %			Prior		
/ Euro	$1.24	0.6	3.0	3.0	$1.23	$1.20	$1.20
/ Crude Oil bbl	65.98	5.8	9.8	9.8	62.34	60.11	60.11
/ Gold oz	1,347.40	2.7	3.2	3.2	1,312.30	1,305.20	1,305.20
Treasury Ylds %	%	Change bp			%	%	%
1 Year	2.02	0.02	0.27	0.27	2.00	1.75	1.75
10 Year	2.82	(0.03)	0.41	0.41	2.84	2.41	2.41
30 Year	3.06	(0.01)	0.32	0.32	3.08	2.74	2.74
Corp Credit Spreads -bp		Change %			Prior		
CDX IG	68.97	28.8	40.7	40.7	53.54	49.02	49.02

March 23, 2018 Major Insurer Bond Yields	Company		Coupon	Maturity	Weekly Change Price Current	Price Change	Yield	Spread over UST B.P.	Spread over UST Change	YTD Spread Change
Life	Ameriprise	AMP	3.700%	10/15/2024	$101.18	($0.08)	3.50%	78	6	14
	Lincoln National	LNC	3.350%	3/9/2025	$97.58	($0.53)	3.75%	96	14	13
	MassMutual	MASSMU	3.600%	4/9/2024	$101.46	$0.09	3.33%	61	3	6
	MetLife	MET	4.050%	3/1/2045	$94.80	($1.21)	4.38%	134	10	30
	New York Life	NYL	2.350%	7/14/2026	$91.84	$0.04	3.49%	68	2	10
	Pacific Life	PACLIF	5.125%	1/30/2043	$107.92	($0.23)	4.59%	156	4	0
	Principal	PFG	6.050%	10/15/2036	$120.96	($1.03)	4.39%	141	8	18
	Prudential	PRU	4.600%	5/15/2044	$103.77	($1.96)	4.36%	132	13	25
	Allstate	ALL	4.500%	6/15/2043	$104.77	($1.50)	4.19%	115	12	16
	Berkshire Hathaway	BRK	4.300%	5/15/2043	$104.01	($0.87)	4.04%	103	7	13
	Travelers	TRV	4.600%	8/1/2043	$107.60	($0.07)	4.11%	109	2	12
	XL Group	XL	6.250%	5/15/2027	$115.34	($0.95)	4.21%	135	11	(6)
Other	AON	AON	4.250%	12/12/2042	$94.65	($0.97)	4.62%	158	9	19
	AIG	AIG	6.820%	11/15/2037	$125.83	($1.19)	4.78%	177	5	19
	Hartford	HIG	4.300%	4/15/2043	$98.49	($0.77)	4.40%	137	6	22
	Nationwide	NATMUT	5.300%	11/18/2044	$109.18	($1.29)	4.69%	163	10	19
Health	Aetna	AET	6.750%	12/15/2037	$128.30	($0.36)	4.56%	159	4	19
	CIGNA	CI	6.150%	11/15/2036	$116.75	($0.43)	4.78%	182	6	45
	United Healthcare	UNH	4.750%	7/15/2045	$108.04	($1.02)	4.25%	121	8	24

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