The HOT SPOT

Moody's Lowering City of Chicago Debt Rating to 'Junk' Status Has Small Impact on Overall Insurance Industry Holdings (5/15/2015)

Moody's Investors Service (Moody's) on May 12 lowered the credit rating on the city of Chicago's $8.1 billion outstanding general obligation (GO) bonds to Ba1 from Baa2, along with the credit ratings on approximately $800 million tax revenue debt and authorized motor fuel tax revenue debt. The downgrade is a consequence of a ruling by the Illinois Supreme Court last week that limited Chicago and the state of Illinois' ability to handle unfunded pension plans. It also includes Moody's expectation that the city's elevated unfunded pension liabilities will continue to grow.

In addition, according to Moody's, "The Ba1 rating on the sales tax and motor fuel tax debt reflects the absence of legal segregation of pledged revenue from the general operations of the city. This lack of separating caps the ratings at the city's GO rating." Moody's has also kept a negative outlook on the revised rating. Moody's currently has a long-term rating of A3 on the state of Illinois with a negative outlook.

Notwithstanding, Standard & Poor's (S&P) and Fitch Ratings (Fitch) both maintain an investment grade rating on Chicago's GO bonds. S&P on May 14 lowered Chicago's GO bond ratings to A- from A+ and placed the ratings on CreditWatch with negative implications. According to S&P, the rating action reflects the city's short-term liquidity pressures. S&P also warned that it could lower Chicago's long-term GO debt rating further "if the city does need to access its own internal liquidity at levels we feel compromise its overall liquidity strength." Fitch has an A- credit rating assigned to Chicago's GO bonds, with a negative outlook.

As of year-end 2014, the U.S. insurance industry had approximately $7.2 billion in Chicago municipal debt outstanding (not including the exposure of financial guarantors), a large proportion of which was held by property/casualty (P/C) companies. In the event S&P or Fitch lowers the rating on Chicago's GO bonds to below investment grade, the result would be an NAIC Designation below NAIC 2. In turn, P/C and health insurers would have to hold these bonds at the lower of cost or fair value. Given the relatively small exposure of Chicago municipal debt compared to the industry's approximate $5.5 trillion in total invested assets, this exposure does not result in significant cause for concern. However, individual company exposures may be significant as a percent of capital and surplus.

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