NAIC 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**

New Issuance of Corporate Bonds and U.S. Insurer Corporate Bond Portfolios

Bonds are typically an insurance company's largest asset allocation. Within that category, corporate bonds are, in most cases, insurers' largest bond allocations. Insurers may acquire corporate bonds in the primary market (also known as the "new issue market") or the secondary market (i.e. seasoned, not newly issued bonds). Most corporate debt is traded in the primary market, with liquidity varying over time, depending on macroeconomic trends, and is interrelated to the health of the industry (for more background on liquidity, see the NAIC's Special Report dated March 6, 2013, titled, "U.S. Insurance Company Asset Liquidity").

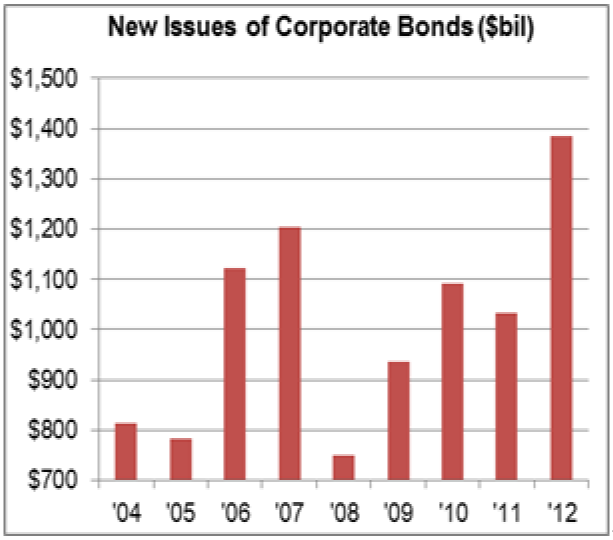
The NAIC Capital Markets Bureau analyzed trends in the new issuance corporate bond market utilizing data provided by the Securities Industry and Financial Markets Association (SIFMA) over the nine years from 2004 through 2012 and compared them to trends in the U.S. insurance industry's year-end corporate bond exposure. Our findings indicate that, despite fluctuations in the volume of newly issued corporate bonds, insurance companies reported exposure to corporate bond holdings that were fairly stable year-over-year. According to the fourth quarter 2013 report titled, "Financial Accounts of the United States" (provided by the Board of Governors of the Federal Reserve System), U.S. insurers were the largest domestic investors of corporate bonds, followed by mutual funds.

New Issuance vs. Year-End Insurer Exposure

Chart 1 below tracks the volume of corporate bonds issued annually from 2004 to 2012 (according to SIFMA). Chart 2 shows the outstanding year-end balances of corporate bonds reported by all U.S. insurers. Chart 2 shows that insurers held corporate bonds steady at approximately $1.5 trillion for the years 2004 through 2008, after which holdings gradually increased. By contrast, corporate bond new issuance dipped sharply in 2008. The drop-off in new issuance in 2008 was due mostly to poor market conditions amidst a financial crisis where investors, faced with uncertain economic and capital market conditions, allocated away from riskier assets and toward higher-quality assets (i.e., a "flight to quality"), such as U.S. government securities and cash.

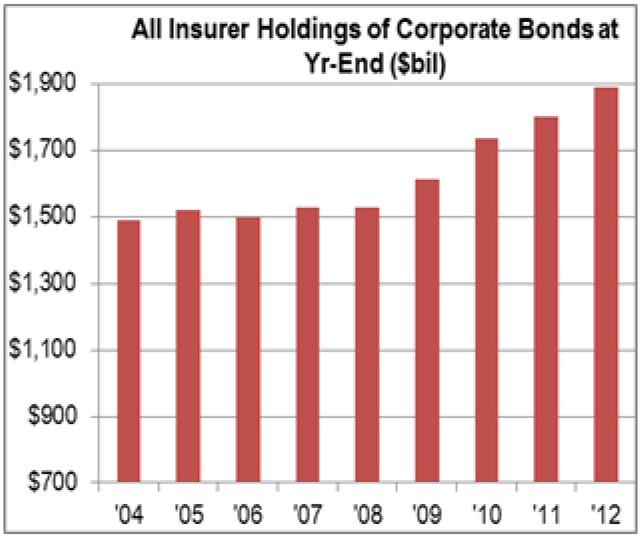
Many companies, unable to access the capital markets during this time, delayed issuing new debt, while others withdrew planned debt issuances due to spreads being wider than economically feasible. In general, only companies that needed financing issued new debt at that time. A similar flight to quality occurred in 2011 following the European sovereign debt crisis. Since 2011, market conditions have rebounded and the volume of newly issued corporate bonds has increased. Corporate bond new issuance rose by 34% in 2012 (to nearly $1.4 trillion) as investor demand for corporate bonds increased and as corporations moved to refinance existing, maturing debt and to lock in low interest rates ahead of an expected rise in rates.

Chart 1



Source: SIFMA

Chart 2



Life Insurer and Property/Casualty Insurer Exposure to Corporate Bonds

Chart 3 shows year-end life insurer holdings of corporate bonds from 2004 through 2012. Among insurers, life companies hold the largest proportion of corporate bonds, which is why, in part, the pattern in Chart 3 is so similar to that of Chart 2. Another observation is that, despite the swings in the market for newly issued corporate bonds over this time period, life insurance companies' holdings did not change in tandem. That is, life insurers did not depend solely on the primary market for new issues. Even at the low point, the new issue market provided $750 billion of new corporate debt. Also, because outstanding corporate bonds repay gradually, either through redemptions or maturities, entire holdings did not need to be replaced. Life insurers, and indeed all insurers, source their corporate bond exposure both from the primary market and the secondary market. This flexibility explains why, in 2008, insurers were able to increase their year-end holdings of corporate bonds, even as the volume of newly issued corporate bonds fell sharply.

Chart 3

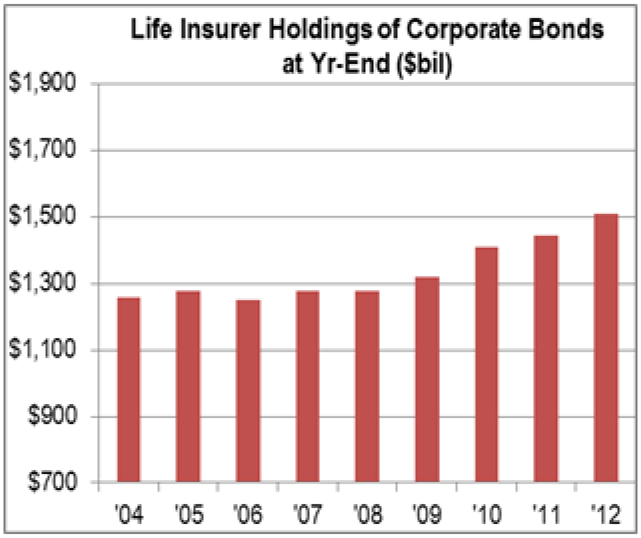
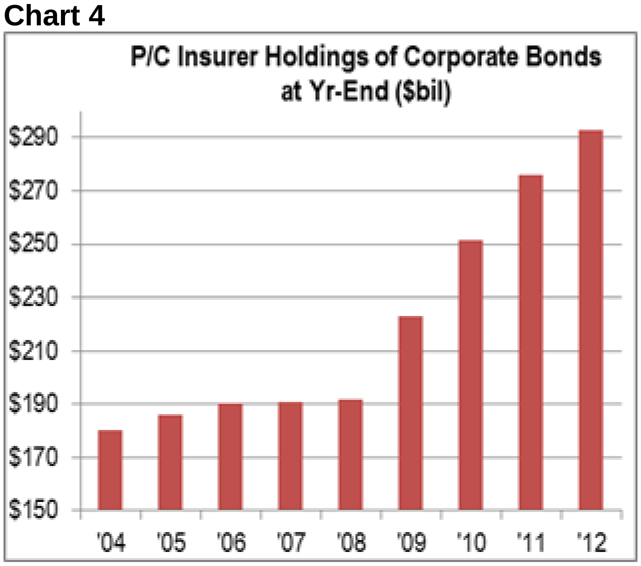


Chart 4 shows year-end property/casualty (P/C) insurer holdings of corporate bonds over the same nine-year period. As the insurance industry's second-largest investor in corporate bonds, the pattern for P/C companies is similar to that of life insurers, although the amounts held are different. P/C insurers reported year-end 2012 corporate bond holdings of $293 billion, or less than 20% of life company holdings. In general, P/C companies have a higher allocation of municipals bonds to corporate bonds, and they invest a reasonable portion of cash in common stocks (for more background on U.S. insurance industry investment allocations, please see the NAIC Capital Markets Bureau Special Report dated Sept. 24, 2013, titled, "Update on Insurance Industry Investment Portfolio Asset Mixes"). Although their holdings were less than life insurers, P/C insurers reported a higher rate of growth in their corporate bond holdings over the past few years.

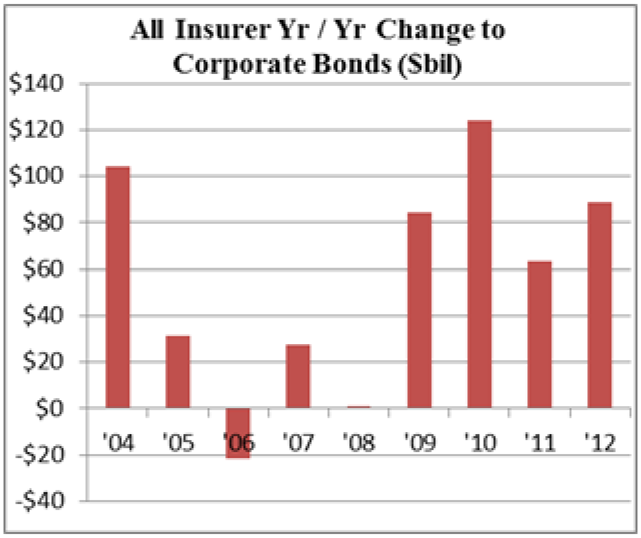
Chart 4



Insurer Year-Over-Year Change in Corporate Bond Exposure

Chart 5 below shows the year-over-year change in insurance industry holdings of corporate bonds from 2004 to 2012. Note that the negative value in 2006 indicates a net decrease in holdings, the result of corporate bond sales, repayments, redemptions and impairments exceeding the amount of corporate bonds purchased. As Chart 5 shows, 2006 was the only year in which overall insurer allocations to corporate bonds declined. The $20.4 billion decrease occurred at the same time total cash and invested assets for all insurers rose by $200 billion, or 4.6%. On a net basis, insurer holdings of all bond types increased by $46 billion in 2006, as the drop in corporate bonds was more than offset by an increase in residential and commercial mortgage-backed securities ($50.8 billion) as well as municipal bonds ($28.8 billion). For each year after 2006, insurers increased their overall holdings of corporate bonds, with the largest increase occurring in 2010.

Chart 5



Note then, that fluctuations in new issuance of corporate bonds have not had a significant impact on insurers' year-over-year corporate bond exposure. There was a small net increase in corporate bond exposure in 2008, despite the sharp drop that year in newly issued corporate bonds.

Investment Grade and Non-Investment Grade Corporate Bond Issuance

According to SIFMA data, non-investment grade bonds averaged 17% of new corporate bond issuance for the years 2004 through 2012. That average rose to 22% for the period from 2009 to 2012, due, in part, to improving economic conditions and the increased ability of below investment grade companies to access the capital markets post-recession. Chart 6 shows the split between high-yield and investment grade corporate bonds among newly issued corporate bonds for the years 2004 through 2012. Chart 7 shows the split between high-yield and investment grade corporate bonds reported at year-end by U.S. insurers over the same period.

Chart 6

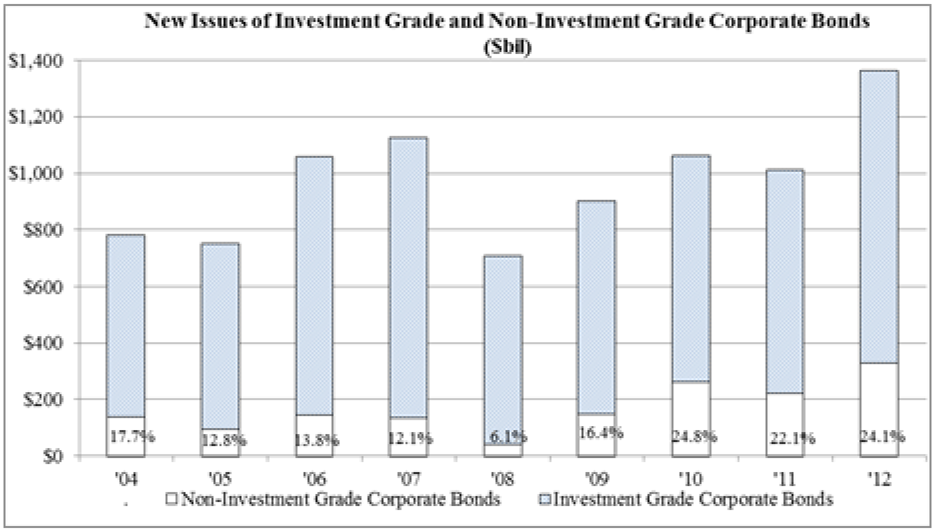
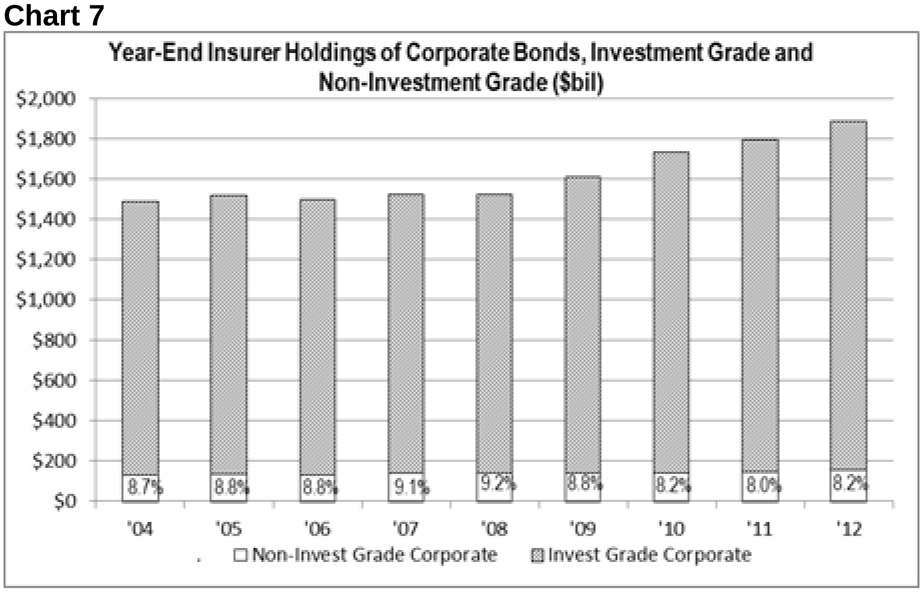


Chart 7

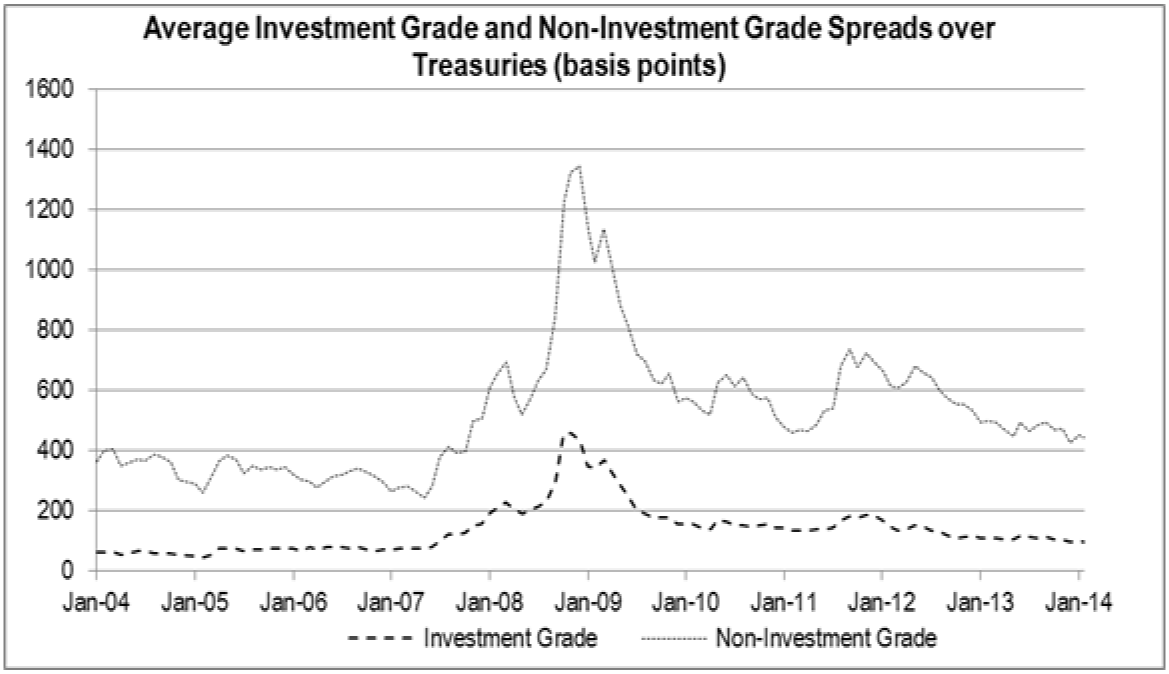


The risk-reward tradeoff for investing in non-investment grade corporate bonds has been attractive, even as credit spreads have declined. P/C insurers increased their exposure to non-investment grade corporate bonds by $17.5 billion from 2008 to 2012, the largest increase for any of the five major insurer types for this time period. This trend with P/C companies could be due, in part, to a “reach for yield” in a low-interest rate environment. By comparison, over the same period life and fraternal companies decreased their high-yield corporate bond holdings by a combined $5.1 billion. Despite the increase, P/C companies’ non-investment grade corporate bond holdings at year-end 2012 represented less than 2.2% of total cash and invested assets. For all insurers, non-investment grade bonds were, on average, less than 3% of total cash and invested assets and less than 9% of total corporate bonds at year-end 2012. Interestingly, according to SIFMA, newly issued non-investment grade corporate bonds increased from an average of 14% of total corporate bond new issuance between 2004 and 2007, to an average of 19% from 2008 to 2012. And, as market conditions have generally improved in the U.S., it is no surprise that new issuance of non-investment grade corporate bonds doubled from 2007 to 2012.

Corporate Bond Spreads

Chart 8 tracks the historical spread of investment grade and non-investment grade corporate bonds to U.S. Treasuries with the same maturities based on Moody's Investors Service data. A wider spread — which is impacted by risk, structural features and market conditions — means that more compensation is demanded by investors to own the bond. The higher yield of a corporate bond (compared to U.S. Treasuries) reflects credit risk, or the higher risk of default, among other types of risks, and limits the price investors are willing to pay for the bond. Chart 8 shows that spreads for both investment grade and below investment grade bonds peaked in 2008 due to the financial crisis. Note that spreads on the bonds prior to the crisis were lower than post-crisis spreads, meaning that spreads on corporate bonds have not yet returned to pre-crisis levels for either investment grade bonds or non-investment grade bonds.

Chart 8

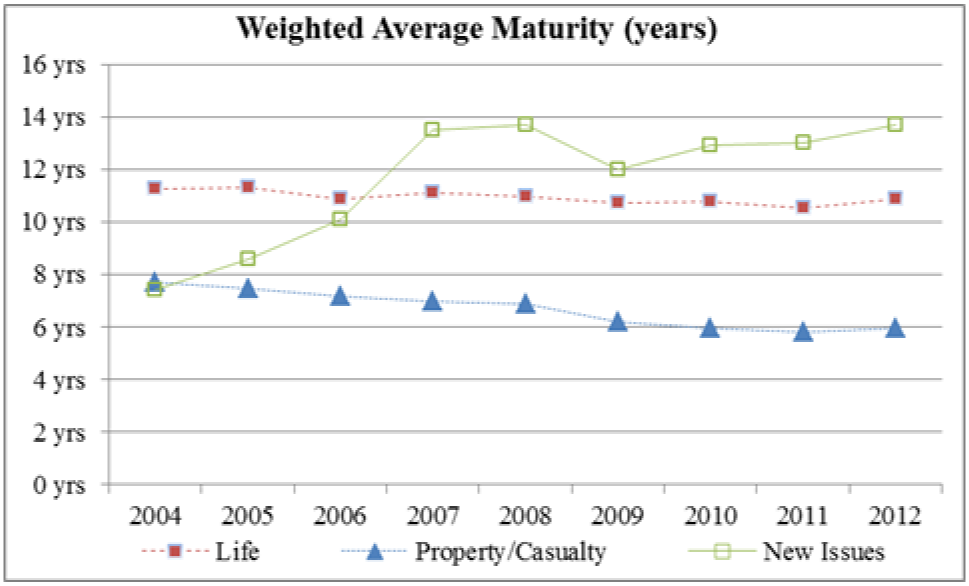


Source: Moody's Investors Service

Average Maturity of Corporate Bonds Held by Insurers vs. the New Issue Market

Chart 9 below compares the average maturity of newly issued corporate bonds (as calculated by SIFMA) to the year-end weighted average maturity of corporate bonds held by life and P/C insurers for the years 2004 through 2012. The average maturity of newly issued corporate bonds increased 85% over the period, from an average of 7.4 years in 2004 to 13.7 years in 2012. The increase in maturity was due, in part, to the shape of the yield curve, which had been relatively flat and low. A flat yield curve encourages issuers to extend the maturities of newly offered bonds to capture the lower interest rates over a longer period of time. Despite the trend toward increased average maturities of newly issued bonds, the chart also shows that the weighted average maturity of corporate bonds held by life and P/C companies from 2004 to 2012 remained relatively stable.

Chart 9



Source: SIFMA

Conclusion

The new issue corporate bond market is a large source of investment opportunities for insurance companies as investors, and, in particular, life companies, because they are the largest holders of corporate bonds within the insurance industry. P/C companies also invest a significant portion of their cash in corporate bonds, although they are generally not the largest bond allocation. Note that insurers might also invest in secondary market corporate bonds as an alternate source of investment opportunities. From 2004 to 2012, new issuance of corporate bonds fluctuated for various reasons, mostly due to market conditions. The aforementioned time period includes a boom of new issuance activity, as well as slowdown due to an economic recession. Despite the changes in market conditions and accompanying variations in new issuance, U.S. insurance industry data suggests that insurers have maintained a relatively consistent investment pattern in terms of credit quality (i.e., investment grade vs. high yield) and weighted average maturity.

The Capital Markets Bureau will continue to track developments in the new issuance market as it relates to insurer exposure and publish additional research as deemed appropriate.

February 28, 2014								
Major Insurer Share Prices			**Change %**			**Prior**		
		Close	**Week**	**QTD**	**YTD**	**Week**	**Quarter**	**Year**
Life	Aflac	$64.08	2.8	0.6	21.2	$62.36	$63.72	$52.89
	Ameriprise	108.99	2.0	17.4	74.5	106.89	92.84	62.45
	Genworth	15.54	2.0	20.4	107.4	15.24	12.91	7.49
	Lincoln	50.13	0.2	16.4	94.5	50.02	43.08	25.77
	MetLife	50.67	0.2	6.3	54.7	50.56	47.66	32.76
	Principal	45.35	1.8	4.5	59.8	44.55	43.39	28.38
	Protective	52.14	1.5	19.1	83.1	51.36	43.76	28.47
	Prudential	84.58	0.6	7.9	59.3	84.10	78.39	53.09
	UNUM	34.78	3.6	13.2	67.8	33.56	30.72	20.73
PC	ACE	$97.87	0.6	5.5	23.1	$97.25	$92.78	$79.50
	Axis Capital	43.97	0.9	(0.7)	27.6	43.58	44.30	34.46
	Allstate	54.26	0.7	3.7	35.5	53.90	52.33	40.05
	Arch Capital	56.12	0.6	2.1	28.1	55.79	54.96	43.82
	Cincinnati	46.88	0.3	(1.6)	20.4	46.73	47.63	38.95
	Chubb	87.48	0.5	(1.5)	16.6	87.06	88.80	75.01
	Everest Re	149.24	0.4	1.0	36.1	148.65	147.73	109.67
	Progressive	24.49	2.4	(10.4)	16.6	23.93	27.33	21.01
	Travelers	83.84	0.0	(1.0)	17.2	83.80	84.66	71.53
	WR Berkley	41.24	1.3	(3.1)	9.7	40.73	42.54	37.59
	XL	30.40	3.3	(2.4)	21.9	29.44	31.14	24.94
Other	AON	$85.60	(0.8)	17.6	54.5	$86.25	$72.76	$55.41
	AIG	49.77	1.4	0.6	41.1	49.06	49.48	35.28
	Assurant	65.63	3.2	18.8	90.3	63.61	55.23	34.48
	Fidelity National	33.06	(0.6)	26.3	40.2	33.25	26.18	23.58
	Hartford	35.19	2.5	11.7	57.2	34.35	31.52	22.39
	Marsh	48.16	0.5	10.7	40.4	47.92	43.51	34.30
Health	Aetna	$72.71	3.2	9.5	57.5	$70.45	$66.40	$46.17
	Cigna	79.59	2.9	0.5	49.4	77.36	79.22	53.29
	Humana	112.46	9.2	16.5	64.3	103.01	96.52	68.43
	United	77.27	4.5	5.8	42.8	73.92	73.01	54.12
	WellPoint	90.59	2.2	3.8	49.2	88.61	87.24	60.73
Monoline	Assured	$24.55	6.3	25.6	73.9	$23.09	$19.54	$14.12
	MBIA	13.55	8.0	27.1	71.1	12.55	10.66	7.92
	MGIC	8.96	0.4	24.4	231.9	8.92	7.20	2.70
	Radian	15.55	0.9	11.3	152.8	15.41	13.98	6.15
	XL Capital	30.40	3.3	(2.4)	21.9	29.44	31.14	24.94

February 28, 2014							
Major Market Variables		**Change %**			**Prior**		
	Close	**Week**	**QTD**	**YTD**	**Week**	**Quarter**	**Year**
Dow Jones Ind	16,321.71	1.4	8.3	24.6	16,103.30	15,072.58	13,099.80
S&P 500	1,859.45	1.2	10.0	30.8	1,837.86	1,689.92	1,422.10
S&P Financial	292.07	1.2	8.1	32.1	288.72	270.26	221.17
S&P Insurance	276.02	1.1	4.4	38.2	273.14	264.30	199.67
US Dollar $		**Change %**			**Prior**		
/ Euro	$1.38	0.5	1.9	4.6	$1.37	$1.36	$1.32
/ Crude Oil bbl	102.45	0.2	(1.1)	11.8	102.24	103.60	91.62
/ Gold oz	1,325.60	0.0	1.2	(20.8)	1,325.00	1,309.80	1,673.70
Treasury Ylds %	**%**	**Change bp**			**%**	**%**	**%**
1 Year	0.11	0.00	0.01	(0.04)	0.11	0.10	0.14
10 Year	2.66	(0.07)	0.01	0.90	2.73	2.65	1.76
30 Year	3.59	(0.10)	(0.13)	0.64	3.69	3.72	2.95
Corp Credit Spreads -bp		**Change %**			**Prior**		
CDX.IG	17.07	(7.2)	(31.8)	(70.1)	18.38	25.04	57.04

February 14, 2014									
Major Insurer Bond Yields				Weekly Change					YTD
				Price			Spread over UST		Spread
	Company	Coupon	Maturity	Current	Change	Yield	B.P.	Change	Change
Life	Aflac	8.500%	5/15/2019	$129.30	($0.33)	2.50%	86	(2)	(42)
	Ameriprise	5.300%	3/15/2020	$114.62	($0.09)	2.67%	75	(6)	(43)
	Genworth	6.515%	5/15/2018	$116.18	($0.05)	2.48%	120	(5)	(271)
	Lincoln National	8.750%	7/15/2019	$129.74	($0.39)	2.75%	105	(1)	(79)
	MassMutual	8.875%	6/15/2039	$148.42	($0.63)	5.36%	182	2	(66)
	MetLife	4.750%	2/15/2021	$110.56	($0.15)	3.06%	86	(2)	(22)
	New York Life	6.750%	11/15/2039	$127.66	($0.63)	4.86%	131	3	(32)
	Northwestern Mutual	6.063%	3/15/2040	$118.02	$0.41	4.84%	126	(7)	(19)
	Pacific Life	9.250%	6/15/2039	$143.71	($0.48)	5.90%	238	1	(93)
	Principal	6.050%	10/15/2036	$116.82	($0.28)	4.82%	142	(0)	(39)
	Prudential	4.500%	11/15/2020	$109.22	($0.12)	2.98%	85	(2)	(56)
	TIAA	6.850%	12/15/2039	$127.52	($0.23)	4.95%	141	(1)	(29)
P&C	ACE INA	5.900%	6/15/2019	$118.13	($0.59)	2.26%	57	3	(20)
	Allstate	7.450%	5/15/2019	$125.44	($0.25)	2.27%	62	2	(48)
	American Financial	9.875%	6/15/2019	$131.19	($0.24)	3.41%	167	(5)	(145)
	Berkshire Hathaway	5.400%	5/15/2018	$115.42	($0.22)	1.62%	38	(2)	(25)
	Travelers	3.900%	11/15/2020	$106.63	($0.37)	2.81%	67	0	2
	XL Group	6.250%	5/15/2027	$114.77	$0.84	4.73%	173	(9)	(68)
Other	AON	5.000%	9/15/2020	$112.20	($0.23)	2.95%	88	2	(44)
	AIG	5.850%	1/15/2018	$114.98	($0.21)	1.85%	75	(1)	(45)
	Hartford	5.500%	3/15/2020	$113.90	($0.28)	2.99%	107	1	(65)
	Marsh	9.250%	4/15/2019	$130.69	($0.37)	2.81%	116	(3)	(80)
	Nationwide	9.375%	8/15/2039	$144.52	($0.40)	5.96%	241	(1)	(80)
Health	Aetna	3.950%	9/15/2020	$106.69	($0.48)	2.82%	72	4	(48)
	CIGNA	5.125%	6/15/2020	$112.41	($0.43)	2.96%	92	0	(52)
	United Healthcare	3.875%	10/15/2020	$106.49	($0.44)	2.80%	73	3	(23)
	Wellpoint	4.350%	8/15/2020	$107.30	($0.56)	3.10%	107	6	(31)

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

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