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**

**Part 1 of 2: Insurance Industry Investment Acquisitions and Dispositions – Reaching for Yield?**

In the current low-interest rate environment, sourcing investments that not only generate income but that also fit within insurance company investment parameters is challenging. The NAIC's Capital Markets Bureau has reviewed the U.S. insurance industry's acquisition and disposition activity over the eight quarters ending fourth quarter 2011 (that is, commencing first quarter 2010) to identify any noteworthy trends and to what degree the industry has been "reaching for yield."

While the assets generating the highest nominal yield generate the most income, if material to the portfolio, they also could introduce certain risks that may compromise the safety and soundness of the investment portfolio. Such risks include: credit risk (whereby investing in riskier albeit higher yielding assets could effectively trade credit quality for income); market risk; and liquidity risk.

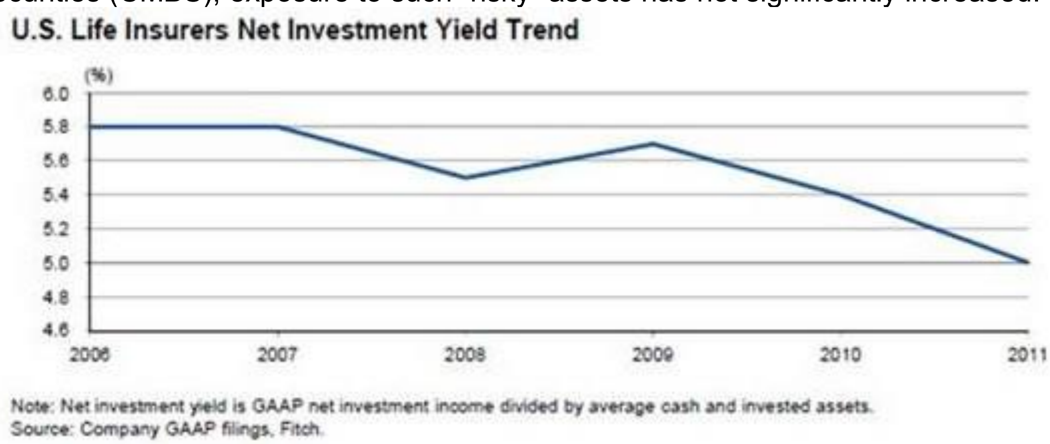
Depending on the insurance company type (i.e., life, property/casualty, etc.) the preferred tenor of investments varies to appropriately match assets to liabilities. For example, life companies generally invest in longer-term assets, such as 30-year bonds, to match long-term liabilities. Such a strategy also has associated risks, such as duration risk, whereby the longer the term (or maturity) of the bond, the more sensitive the bond is to potential changes in interest rates over time. And to mitigate any interest rate mismatch between assets and liabilities, insurers might enter into hedging agreements, thereby introducing counterparty risk.

In an economic environment that is struggling to recover from a financial crisis — and where a housing crisis and high unemployment persists, along with continued effects from the Eurozone crisis — investing in a significant amount of high-yielding and, consequently, more risky investments, could over time negatively impact earnings and the overall investment portfolio. Previous research conducted by the Capital Markets Bureau — particularly a Special Report published in August 2011 titled, "**Analysis of Insurance Industry Investment Portfolio Asset Mixes**" — analyzed the types of assets the U.S. insurance industry invested in as of year-end 2010 (at the time, the most current date), in comparison to invested assets as of year-end 2008 (midst-crisis) and year-end 2005 (financial boom). This included not only a breakdown of the types of bonds but also a breakdown of the industry sectors within the corporate bond exposure as of year-end 2010. In this previous article, we noted that, in a strong economy, risk appetite tends to increase and the converse is true during poor economic conditions. And, while insurance company investment teams not only match assets to liabilities, they also take into account macroeconomic trends and fundamental credit analysis in making their investment decisions. Results from our asset mix study showed that bonds, particularly corporate bonds, were the largest industry investment — regardless of year (and, therefore, economic conditions) or insurance company type. And banking/finance-related bonds were the largest corporate exposure. We concluded that despite changing economic conditions, the insurance industry's asset mix does not appear to have changed significantly.

*Life Insurer Earnings Outlook*

Life companies are the largest investors in the U.S. insurance industry, responsible for approximately 80% of the industry's cash and invested assets. In July 2012, Fitch Ratings (Fitch) published an article on the earnings outlook for life insurers. Based on their research, Fitch has mixed views, but "anticipates modest improvement in industry profitability in 2012 driven by growth related to prior-year international acquisition activity at a few companies…" among other reasons. According to the Federal Reserve, interest rates are at historically low levels and could remain at these levels through 2014. Low interest rates are a drag on insurance company earnings; they also reduce net investment income interest margins with respect to spread-based products. Current macroeconomic conditions will make improving both returns and earnings a challenge.

According to Fitch, however, insurers' realized credit-related investment losses are at reduced levels – a trend that is expected to continue for the remainder of the year. In search of yield, Fitch believes that life companies might be taking on slightly more risk in 2012 through allocations to long-term bonds and alternative investments. Fitch also noted that insurer mortgage origination has also increased, and while insurers have found some value in non-agency residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS), exposure to such "risky" assets has not significantly increased.




Source: Fitch Ratings.

Fitch's analysis has also found that insurers have generally reduced their overall exposure to credit risk and strengthened sector diversification. A reduction in investment losses in 2010 and 2011, for the most part, was due to an improvement in the corporate bond and structured finance markets.

*A Quarterly Review of Industry Acquisitions and Dispositions: 2010 and 2011*

In our current study of the U.S. insurance industry's acquisitions and dispositions, we analyzed to what degree insurers are "reaching for yield" in this low-interest rate environment. On a quarterly basis, beginning with first quarter 2010, we reviewed the industry's reported acquisitions and dispositions through fourth quarter 2011 to identify any noteworthy trends or outstanding outliers.

<u>Acquisitions</u>

In terms of acquisitions, our analysis showed that, not surprisingly, bonds were the largest asset type acquired in all eight quarters by an overwhelming majority. The table below shows a breakdown of the asset types acquired on a quarterly basis as a percentage of total actual cost. Note that other long-term invested assets (as reported in Schedule BA) include only unaffiliated investments. For the purpose of this study, affiliated investments were not included.

**Acquisitions – by Asset Type**

| Asset Type: (% of actual cost) | Q1/2010 | Q2/2010 | Q3/2010 | Q4/2010 | Q1/2011 | Q2/2011 | Q3/2011 | Q4/2011 | Total 2010 | Total 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Bonds | 85.1% | 90.3% | 90.4% | 84.7% | 88.8% | 85.2% | 80.5% | 79.2% | 87.4% | 82.6% |
| Equities | 4.3% | 4.3% | 3.9% | 10.4% | 3.5% | 3.8% | 6.6% | 14.7% | 6.2% | 8.3% |
| Real Estate | 0.6% | 0.3% | 0.3% | 0.3% | 0.5% | 0.6% | 0.3% | 0.4% | 0.4% | 0.4% |
| Mortgage Loans | 3.2% | 4.0% | 4.3% | 3.9% | 5.8% | 8.5% | 6.5% | 4.5% | 3.9% | 6.1% |
| Other Long-Term Invested Assets | 6.9% | 1.1% | 1.2% | 0.7% | 1.4% | 1.9% | 6.0% | 1.1% | 2.1% | 2.6% |
| Grand Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 99.8% | 100.0% | 100.0% |

We further examined acquisitions by bond types and found that corporate bonds were the largest acquired in each of the eight quarters. This is not surprising, given that corporate bonds represent the largest bond type invested by the industry. U.S. government bonds were the second-largest bond type acquired (as of year-end totals). Affiliated investments that were part of other long-term invested assets (as reported in Schedule BA) were a sizeable portion of acquisitions during this time period; however, we removed them from the table below because they might be reflective of broader corporate goals and not just changes in investment strategies. For example, some affiliated investments in this category represent "seed capital" insurers have invested relative to a new business venture.

**Acquisitions (% of total measured by actual cost)**

| *Bonds* | Q1/2010 | Q2/2010 | Q3/2010 | Q4/2010 | Q1/2011 | Q2/2011 | Q3/2011 | Q4/2011 | Total 2010 | Total 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Corporate | 39.3% | 37.8% | 41.3% | 29.6% | 44.3% | 42.1% | 34.4% | 26.7% | 36.3% | 35.1% |
| Municipal | 10.9% | 14.2% | 8.8% | 10.6% | 7.6% | 7.0% | 7.7% | 5.7% | 10.9% | 6.8% |
| U.S. Government | 11.0% | 12.5% | 14.0% | 19.1% | 8.2% | 9.1% | 11.4% | 17.9% | 14.9% | 12.6% |
| Structured Finance (ABS/CDO/CLO)* | 4.4% | 4.9% | 4.1% | 3.3% | 4.2% | 4.6% | 3.6% | 3.5% | 4.1% | 3.9% |
| Agency RMBS | 9.7% | 9.8% | 11.6% | 10.3% | 14.8% | 9.6% | 8.0% | 9.6% | 10.4% | 10.1% |
| Non-Agency RMBS | 1.2% | 1.1% | 1.2% | 0.9% | 1.5% | 3.6% | 1.4% | 2.2% | 1.1% | 2.1% |
| Non-Agency CMBS | 2.4% | 2.8% | 2.5% | 1.3% | 1.9% | 2.5% | 2.8% | 1.3% | 2.1% | 2.1% |
| Credit Tenant Loan | 0.1% | 0.1% | 0.2% | 0.2% | 0.1% | 0.0% | 0.0% | 0.0% | 0.1% | 0.0% |
| Foreign Government | 2.0% | 2.6% | 2.7% | 2.9% | 3.0% | 2.9% | 4.4% | 5.7% | 2.6% | 4.3% |
| Hybrid Securities | 0.5% | 0.2% | 0.1% | 0.2% | 0.2% | 0.2% | 0.1% | 0.1% | 0.2% | 0.1% |
| Other | 3.6% | 4.3% | 3.8% | 6.2% | 3.2% | 3.6% | 6.6% | 6.5% | 4.7% | 5.3% |
| **Total Bonds** | **85.1%** | **90.3%** | **90.4%** | **84.7%** | **88.8%** | **85.2%** | **80.5%** | **79.2%** | **87.4%** | **82.6%** |
| *Equities* | | | | | | | | | | |
| Preferred Stock | 0.3% | 0.4% | 0.1% | 0.3% | 0.3% | 0.3% | 1.3% | 0.2% | 0.2% | 0.5% |
| Common Stock | 4.0% | 3.9% | 3.8% | 10.1% | 3.2% | 3.5% | 5.3% | 14.7% | 6.0% | 7.8% |
| **Total Equities** | **4.3%** | **4.3%** | **3.9%** | **10.4%** | **3.5%** | **3.8%** | **6.6%** | **14.9%** | **6.2%** | **8.3%** |
| **Total Other Long-Term Invested Assets**** | **6.9%** | **1.1%** | **1.2%** | **0.7%** | **1.4%** | **1.9%** | **6.0%** | **1.1%** | **2.1%** | **2.6%** |
| **Total Real Estate** | **0.6%** | **0.3%** | **0.3%** | **0.3%** | **0.5%** | **0.6%** | **0.3%** | **0.4%** | **0.4%** | **0.4%** |
| **Total Mortgage Loans***** | **3.2%** | **4.0%** | **4.3%** | **3.9%** | **5.8%** | **8.5%** | **6.5%** | **4.5%** | **3.9%** | **6.1%** |
| GRAND TOTAL | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

*CDO = Collateralized Debt Obligations; CLO = Collateralized Loan Obligations; ** Unaffiliated only, and as reported in Schedule BA; *** in good standing.

In comparing 2010 and 2011 totals, the percentage of mortgage loans acquired in 2011 (6.1%) was almost double the amount purchased in 2010 (3.9%). Activity in this market peaked in 2007 and dropped substantially from 2008 to 2010. Note that the industry's investment in mortgage loans did increase as of year-end 2011 (approximately $338 billion) compared to year-end 2010 (approximately $322 billion). As a percentage of assets, the exposure to this asset class remains less than what it was at its peak. There was a similar increase in activity in 2011 for foreign government bonds. Analysis of the industry's exposure in non-U.S. investments has been the subject of other Capital Markets Bureau special reports, given the many issues in Europe stemming from the Eurozone crisis. Conversely, insurers acquired more municipal bonds in 2010 vs. 2011. The higher number in 2010 reflects the impact of the federally subsidized Build America Bonds program. And, more equity investments were made in 2011 compared to 2010, a substantial majority of which were in unaffiliated common stock in each of the eight quarters.

Dispositions

In terms of dispositions, our analysis showed that similar to acquisitions, bonds were the largest asset type sold for all eight quarters, as shown in the table below.

**Dispositions – by Asset Type**

| Asset Type: (% of consideration) | Q1/2010 | Q2/2010 | Q3/2010 | Q4/2010 | Q1/2011 | Q2/2011 | Q3/2011 | Q4/2011 | Total 2010 | Total 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Bonds | 81.9% | 83.2% | 81.1% | 74.0% | 87.9% | 83.9% | 82.1% | 69.2% | 78.9% | 78.4% |
| Equities | 11.3% | 8.5% | 6.0% | 7.5% | 5.7% | 7.2% | 6.5% | 7.9% | 8.1% | 7.1% |
| Real Estate | 0.3% | 0.1% | 0.2% | 0.2% | 0.1% | 0.2% | 0.3% | 0.3% | 0.2% | 0.2% |
| Mortgage Loans | 5.0% | 5.7% | 5.2% | 4.4% | 4.8% | 6.6% | 6.4% | 3.5% | 4.9% | 5.0% |
| Other Long-Term Invested Assets | 1.5% | 2.5% | 7.5% | 14.0% | 1.5% | 2.1% | 4.7% | 19.1% | 7.8% | 9.3% |
| Grand Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

A further breakdown of bonds showed that corporate bonds were also the largest type sold, as shown in the table below, followed by U.S. government bonds (as of total 2010 and total 2011). Agency RMBS were the third largest. Unlike affiliated other long-term invested assets acquired, those disposed were not an overwhelming majority as a percentage of the total; therefore, they have been included in the table below.

**Dispositions (% of total as measured by consideration)**

| *Bonds* | Q1/2010 | Q2/2010 | Q3/2010 | Q4/2010 | Q1/2011 | Q2/2011 | Q3/2011 | Q4/2011 | Total 2010 | Total 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Corporate | 29.7% | 30.1% | 32.6% | 20.2% | 41.7% | 35.0% | 30.0% | 17.6% | 26.7% | 28.3% |
| Municipal | 11.5% | 12.3% | 9.7% | 4.6% | 9.4% | 10.8% | 10.9% | 5.8% | 8.6% | 8.6% |
| U.S. Government | 16.9% | 19.7% | 16.6% | 10.7% | 17.4% | 17.0% | 17.2% | 11.0% | 15.0% | 14.7% |
| Structured Finance (ABS/CDO/CLO) | 3.3% | 3.6% | 3.9% | 4.7% | 3.4% | 4.0% | 4.7% | 4.6% | 4.0% | 4.3% |
| Agency RMBS | 7.9% | 6.2% | 7.0% | 17.4% | 5.6% | 5.8% | 7.2% | 15.9% | 11.1% | 10.1% |
| Non-Agency RMBS | 1.1% | 1.1% | 1.4% | 6.7% | 0.8% | 0.7% | 0.7% | 4.8% | 3.3% | 2.4% |
| Non-Agency CMBS | 3.2% | 2.9% | 3.4% | 3.5% | 1.5% | 1.7% | 1.6% | 2.9% | 3.3% | 2.1% |
| Credit Tenant Loan | 0.1% | 0.0% | 0.0% | 0.2% | 0.0% | 0.1% | 0.1% | 0.2% | 0.1% | 0.1% |
| Foreign Government | 1.5% | 1.9% | 1.5% | 1.2% | 2.8% | 2.2% | 3.5% | 1.9% | 1.5% | 2.5% |
| Hybrid Securities | 1.4% | 1.0% | 0.6% | 1.0% | 0.7% | 1.9% | 0.9% | 0.7% | 1.0% | 1.0% |
| Other | 5.2% | 4.3% | 4.2% | 3.8% | 4.7% | 4.8% | 5.3% | 3.6% | 4.2% | 4.4% |
| **Total Bonds** | **59.2%** | **87.6%** | **89.7%** | **83.2%** | **88.0%** | **79.8%** | **67.5%** | **78.6%** | **79.6%** | **77.3%** |
| *Equities* | | | | | | | | | | |
| Preferred Stock | 1.0% | 0.8% | 0.5% | 0.4% | 0.6% | 2.8% | 0.4% | 1.0% | 0.6% | 1.2% |
| Common Stock | 10.3% | 7.7% | 5.6% | 7.1% | 5.2% | 4.4% | 6.1% | 6.9% | 7.5% | 5.9% |
| **Total Equities** | **11.3%** | **8.5%** | **6.0%** | **7.5%** | **5.7%** | **7.2%** | **6.5%** | **7.9%** | **8.1%** | **7.1%** |
| *Other long-term invested assets** | | | | | | | | | | |
| Unaffiliated | 0.9% | 1.4% | 0.8% | 3.2% | 1.0% | 1.7% | 2.1% | 3.1% | **1.9%** | **2.2%** |
| Affiliated | 0.6% | 1.0% | 6.7% | 10.8% | 0.5% | 0.4% | 2.6% | 16.0% | **5.9%** | **7.1%** |
| **Total Other Long-Term Invested Assets** | **1.5%** | **2.5%** | **7.5%** | **14.0%** | **1.5%** | **2.1%** | **4.7%** | **19.1%** | **7.8%** | **9.3%** |
| **Real Estate** | **0.3%** | **0.1%** | **0.2%** | **0.2%** | **0.1%** | **0.2%** | **0.3%** | **0.3%** | **0.2%** | **0.2%** |
| **Mortgage Loans**** | **5.0%** | **5.7%** | **5.2%** | **4.4%** | **4.8%** | **6.6%** | **6.4%** | **3.5%** | **4.9%** | **5.0%** |
| GRAND TOTAL | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

* as reported in Schedule BA; ** in good standing

Net Acquisitions/Dispositions

As shown in the table below, on a net basis insurers acquired corporate bonds in all eight quarters, with a much greater amount acquired in 2010 than in 2011, though the total amount of corporate bonds outstanding as of year-end 2011 and year-end 2010 was relatively consistent, at $1.8 trillion. There also appears to be a trend in dispositions in the fourth quarter of each year (especially in 2010), perhaps due to relative value trades. Also in both years, the industry reduced exposure to non-agency RMBS but increased exposure to foreign bonds. And, while the industry acquired $30.3 billion in municipal bonds in 2010 on a net basis, $10.4 billion of municipal bonds were sold (on a net basis) in 2011. Conversely, there was a net disposition of common stock (predominantly unaffiliated) in 2010, with slightly more than double the amount acquired in 2011. Note that in terms of book/adjusted carrying value, as of year-end 2011, the industry's investment in equities increased by approximately 3% from year-end 2010.

**Net Acquisitions and Dispositions – Actual Cost Less Consideration ($ bil)**

| *Bonds* | Q1/2010 | Q2/2010 | Q3/2010 | Q4/2010 | Q1/2011 | Q2/2011 | Q3/2011 | Q4/2011 | Total 2010 | Total 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Corporate | 19.9 | 21.6 | 50.4 | 28.7 | 8.5 | 21.2 | 38.3 | 30.4 | 120.6 | 98.5 |
| Municipal | (1.3) | 6.1 | 4.8 | 20.7 | (3.0) | (6.5) | 0.6 | (1.5) | 30.3 | (10.4) |
| U.S. Government | (12.1) | (12.3) | 5.2 | 27.7 | (16.9) | (14.6) | (1.2) | 23.4 | 8.4 | (9.3) |
| Structured Finance (ABS/CDO/CLO) | 2.2 | 3.4 | 3.7 | (6.3) | 2.0 | 2.0 | 1.2 | (5.2) | 3.0 | (0.0) |
| Agency RMBS | 3.6 | 8.7 | 19.0 | (30.9) | 18.8 | 9.2 | 8.5 | (26.9) | 0.3 | 9.7 |
| Non-Agency RMBS | 0.3 | 0.3 | 0.3 | (23.3) | 1.4 | 6.6 | 2.5 | (10.7) | (22.4) | (0.2) |
| Non-Agency CMBS | (1.8) | 0.3 | 0.1 | (9.1) | 0.9 | 2.1 | 4.6 | (6.6) | (10.5) | 1.0 |
| Agency CMBS | 0.0 | 0.0 | (0.1) | (0.0) | 0.0 | 0.1 | 0.1 | 0.1 | (0.1) | 0.2 |
| Credit Tenant Loan | 0.1 | 0.2 | 0.4 | (0.3) | 0.1 | (0.1) | (0.1) | (0.7) | 0.4 | (0.9) |
| Foreign Government | 1.1 | 1.7 | 4.5 | 6.2 | 0.7 | 1.8 | 5.6 | 13.5 | 13.5 | 21.6 |
| Hybrid Securities | (1.9) | (1.5) | (1.0) | (3.2) | (1.0) | (3.4) | (1.3) | (2.4) | (7.6) | (8.0) |
| Other | (3.3) | 0.7 | 2.1 | 7.8 | (2.6) | (1.9) | 8.2 | 10.2 | 7.3 | 14.0 |
| **Total Bonds** | **6.8** | **29.2** | **89.3** | **17.9** | **8.9** | **16.6** | **67.0** | **23.8** | **143.2** | **116.2** |
| *Equities* | | | | | | | | | | |
| Preferred Stock | (1.6) | (0.7) | (0.9) | (0.4) | (0.5) | (5.1) | 2.9 | (3.5) | (3.6) | (6.2) |
| Common Stock | (12.8) | (6.9) | (0.9) | 9.1 | (3.6) | (1.4) | 3.1 | 27.8 | (11.4) | 26.0 |
| **Total Equities** | **(14.4)** | **(7.6)** | **(1.8)** | **8.7** | **(4.1)** | **(6.5)** | **6.0** | **24.3** | **(15.1)** | **19.8** |
| **Total Other Long-Term Invested Assets*** | **101.5** | **4.0** | **(10.5)** | **(46.2)** | **1.6** | **14.9** | **61.3** | **(67.7)** | **48.8** | **10.1** |
| **Total Real Estate** | **0.6** | **0.4** | **0.4** | **0.6** | **0.9** | **0.9** | **0.4** | **0.5** | **1.9** | **2.6** |
| **Total Mortgage Loans** | **(3.8)** | **(2.6)** | **1.3** | **(2.9)** | **2.5** | **5.3** | **5.8** | **2.9** | **(7.9)** | **16.4** |
| Grand Total | 90.6 | 23.5 | 78.8 | (22.0) | 9.7 | 31.1 | 140.4 | (16.3) | 170.9 | 165.0 |

* as reported in Schedule BA

*Credit Quality Industry of Acquisitions and Dispositions*

Our analysis of acquisitions and dispositions also included a review of the credit quality of bonds acquired and sold in the eight quarters ending fourth quarter 2011, excluding U.S. government securities and agency bonds. The purpose of this analysis was to ascertain whether insurers were compromising credit quality for yield; that is, investing in lower-quality assets in exchange for higher yield.

Acquisitions

As the table below shows, excluding U.S. government and agency bonds (which are, for the most part, rated AAA, the highest credit quality rating), the majority of bonds acquired by the industry in all eight quarters were rated A or BBB, meaning they were all investment grade. There was also a relatively significant amount of even higher credit quality (AA-rated) bonds acquired during this time period.

| Acquisitions Rating Breakdown (% of total acquisitions; exludes U.S. government and agency bonds) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Rating Category | 1Q2010 | 2Q2010 | 3Q2010 | 4Q2010 | 1Q2011 | 2Q2011 | 3Q2011 | 4Q2011 | Total 2010 | Total 2011 |
| AAA | 8.5% | 9.3% | 8.6% | 8.9% | 7.8% | 7.2% | 8.9% | 9.2% | 8.8% | 8.4% |
| AA | 18.8% | 20.7% | 15.5% | 19.3% | 15.3% | 16.0% | 16.6% | 20.8% | 18.5% | 17.4% |
| A | 33.9% | 29.1% | 31.5% | 30.9% | 35.1% | 31.1% | 34.0% | 26.4% | 31.3% | 31.3% |
| BBB | 31.0% | 32.8% | 35.7% | 29.8% | 33.5% | 35.7% | 30.8% | 31.8% | 32.4% | 32.8% |
| BB | 4.7% | 5.2% | 5.1% | 5.0% | 4.0% | 5.3% | 5.3% | 6.1% | 5.0% | 5.3% |
| B | 2.1% | 2.1% | 2.7% | 3.6% | 3.2% | 3.6% | 3.5% | 4.0% | 2.7% | 3.6% |
| C | 0.5% | 0.5% | 0.5% | 1.0% | 0.5% | 0.6% | 0.6% | 1.0% | 0.6% | 0.7% |
| D | 0.2% | 0.0% | 0.1% | 0.2% | 0.1% | 0.2% | 0.1% | 0.2% | 0.1% | 0.1% |
| N/A | 0.3% | 0.3% | 0.2% | 1.3% | 0.4% | 0.3% | 0.2% | 0.6% | 0.6% | 0.4% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

<u>Dispositions</u>

Similar to bond acquisitions, not including U.S. government and agency bonds, most dispositions during the eight quarters studied were rated A or BBB; that is, they were investment grade credit quality. The industry also disposed of a fair amount of AA-rated bonds; we suspect they were relative-value trades.

| Dispositions Rating Breakdown (% of total dispositions; exludes U.S. government and agency bonds) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Rating Category | 1Q2010 | 2Q2010 | 3Q2010 | 4Q2010 | 1Q2011 | 2Q2011 | 3Q2011 | 4Q2011 | Total 2010 | Total 2011 |
| AAA | 5.8% | 5.3% | 4.0% | 5.7% | 7.3% | 6.1% | 7.7% | 9.6% | 5.2% | 7.7% |
| AA | 14.8% | 13.9% | 10.6% | 8.9% | 12.1% | 13.3% | 16.5% | 15.5% | 11.8% | 14.4% |
| A | 37.4% | 37.7% | 42.7% | 38.8% | 37.6% | 36.1% | 40.4% | 37.6% | 39.2% | 37.8% |
| BBB | 26.8% | 28.1% | 29.3% | 29.9% | 27.7% | 29.1% | 25.9% | 24.3% | 28.6% | 26.7% |
| BB | 8.0% | 7.2% | 6.6% | 7.4% | 7.5% | 7.1% | 4.5% | 6.3% | 7.3% | 6.4% |
| B | 3.5% | 4.2% | 3.6% | 5.0% | 4.4% | 4.4% | 2.3% | 2.8% | 4.1% | 3.5% |
| C | 1.9% | 1.6% | 1.7% | 2.9% | 2.1% | 2.6% | 1.7% | 2.0% | 2.1% | 2.1% |
| D | 1.0% | 1.3% | 0.7% | 0.7% | 0.4% | 0.4% | 0.3% | 0.7% | 0.9% | 0.5% |
| N/A | 0.7% | 0.6% | 0.8% | 0.7% | 0.8% | 0.8% | 0.8% | 1.2% | 0.7% | 0.9% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

<u>Net Acquisition/Dispositions</u>

On a net basis, as the table below shows, the industry generally acquired investment-grade securities in exchange for below-investment-grade securities, thereby lending comfort that insurers were not compromising the credit quality of the industry's portfolio to achieve higher yield.

In particular, the largest amount of net acquisitions was with BBB-rated securities for both years, at approximately $71 billion and $66 billion in 2010 and 2011, respectively. Overall, the industry acquired almost $180 billion of investment-grade securities in 2010 and approximately $118 billion in 2011. The largest dollar amount of net dispositions was in the second-lowest credit quality (C-rated bonds) for both years. Overall, the industry disposed of about $14 billion in below-investment-grade bonds in 2010 and almost $10 billion in 2011.

| Net Acquisitions/Dispositions – Rating Breakdown ($ bil; excludes U.S. government and agency bonds) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Rating Category | 1Q2010 | 2Q2010 | 3Q2010 | 4Q2010 | 1Q2011 | 2Q2011 | 3Q2011 | 4Q2011 | Total 2010 | Total 2011 |
| AAA | 4.4 | 7.2 | 10.9 | 9.2 | 0.9 | 2.2 | 6.0 | 3.5 | **31.6** | **12.5** |
| AA | 7.7 | 13.8 | 15.7 | 24.6 | 4.5 | 5.2 | 8.7 | 16.2 | **61.9** | **34.6** |
| A | 2.2 | 0.3 | 7.8 | 4.9 | (1.5) | (1.9) | 11.0 | (3.5) | **15.2** | **4.1** |
| BBB | 9.9 | 15.6 | 30.4 | 15.3 | 8.5 | 12.3 | 21.3 | 24.2 | **71.2** | **66.3** |
| BB | (2.8) | (0.4) | 1.6 | (0.8) | (4.0) | (1.5) | 3.6 | 2.4 | **(2.5)** | **0.5** |
| B | (1.1) | (1.5) | 0.7 | (0.1) | (1.2) | (0.5) | 3.0 | 3.4 | **(2.1)** | **4.7** |
| C | (1.5) | (1.0) | (1.1) | (2.2) | (1.9) | (2.3) | (0.9) | (0.9) | **(5.7)** | **(6.0)** |
| D | (0.9) | (1.4) | (0.7) | (0.6) | (0.4) | (0.3) | (0.2) | (0.6) | **(3.6)** | **(1.5)** |
| N/A | (0.3) | (0.2) | (0.5) | 1.5 | (0.5) | (0.5) | (0.5) | (0.5) | **0.5** | **(2.0)** |
| Total | 17.6 | 32.2 | 64.8 | 51.7 | 4.3 | 12.8 | 52.1 | 44.1 | 166.3 | 113.3 |

*Summary*

The low-interest rate environment poses a challenge to insurers as investors in capital markets, particularly relative to floating rate investments. Life insurers, as the majority of industry investors, are particularly vulnerable to interest-rate risk because of their long-term asset-liability matching strategy. For all investors, given current macroeconomic conditions, interest-rate risk increases as rates remain low, because maturing high-yield assets are, in turn, reinvested in lower-yielding assets.

This theme has been the subject of numerous reports and surveys over the past year and will likely continue to be a major topic of discussion for some time. While we noted earlier in this article research that was completed by Fitch, similar analyses have been done by other related firms, including a survey by Goldman Sachs Asset Management ("Seeking Return in an Adverse Environment") of insurance chief investment officers from 152 global insurance companies, the results of which were published in July 2012. In addition, in April 2012, the NAIC's Center for Insurance Policy and Research published an article titled, "Low Interest Rates and Implications on Life Insurers,"and, most recently, the Capital Markets Bureau issued a Hot Spot, "Reaching for Yield with Structured or Esoteric Investments," to highlight this topic.

Thus far, our study has shown that, despite economic conditions, insurers have not substantially changed their investment strategy in terms of the types of assets that they find attractive, which is consistent with the previous study conducted by the Capital Markets Bureau in August 2011. Neither are insurers compromising the credit quality of their investment portfolios by noticeably investing in riskier assets with higher yields.

Insurers continue to net invest in investment-grade bonds and continue to find value, for the most part, in corporate bonds. They have also net disposed of below-investment-grade bonds, thereby reducing credit risk.

The Capital Markets Bureau will continue to monitor the industry's investment activity relative to the low-interest rate environment and report as deemed appropriate. In the second part of this study, we will analyze the maturity dates and coupon rates of assets acquired and disposed of within the eight quarters ended fourth quarter 2011, along with a sector breakdown of the corporate bonds that were bought and sold during this time same period. We expect to publish the results of this study shortly.

**August 22, 2012**

**Major Insurer Share Prices**

| | | Close | Change % | | | Prior | | |
|---|---|---|---|---|---|---|---|---|
| | | | Week | QTD | YTD | Week | Quarter | Year |
| Life | Aflac | $46.08 | 1.5 | 7.6 | 6.5 | $45.42 | $42.81 | $43.26 |
| | Ameriprise | 54.88 | 1.0 | 5.0 | 10.6 | 54.33 | 52.29 | 49.64 |
| | Genworth | 5.36 | 14.2 | (6.1) | (18.2) | 4.70 | 5.71 | 6.55 |
| | Lincoln | 23.84 | 3.2 | 11.5 | 22.8 | 23.11 | 21.38 | 19.42 |
| | MetLife | 34.86 | 1.2 | 13.9 | 11.8 | 34.43 | 30.60 | 31.18 |
| | Principal | 27.20 | 3.9 | 4.2 | 10.6 | 26.18 | 26.11 | 24.60 |
| | Protective | 28.76 | (1.4) | (2.3) | 27.5 | 29.17 | 29.43 | 22.56 |
| | Prudential | 54.64 | 1.8 | 13.3 | 9.0 | 53.65 | 48.21 | 50.12 |
| | UNUM | 19.32 | 0.8 | (0.3) | (8.3) | 19.16 | 19.37 | 21.07 |
| PC | ACE | $74.31 | 1.8 | (0.1) | 6.0 | $72.98 | $74.35 | $70.12 |
| | Axis Capital | 33.99 | (0.6) | 1.7 | 6.4 | 34.21 | 33.43 | 31.96 |
| | Allstate | 38.36 | 0.7 | 9.1 | 40.0 | 38.10 | 35.17 | 27.41 |
| | Arch Capital | 39.95 | 0.6 | (0.1) | 7.3 | 39.72 | 40.00 | 37.23 |
| | Cincinnati | 39.10 | 2.5 | 2.0 | 28.4 | 38.15 | 38.34 | 30.46 |
| | Chubb | 73.49 | 1.1 | 0.6 | 6.2 | 72.72 | 73.06 | 69.22 |
| | Everest Re | 103.56 | (1.0) | (1.3) | 23.2 | 104.61 | 104.94 | 84.09 |
| | Progressive | 19.73 | (0.6) | (4.5) | 1.1 | 19.85 | 20.66 | 19.51 |
| | Travelers | 65.45 | 2.2 | 2.3 | 10.6 | 64.01 | 63.95 | 59.17 |
| | WR Berkley | 37.23 | (0.2) | (5.3) | 8.3 | 37.32 | 39.30 | 34.39 |
| | XL | 23.27 | 0.9 | 10.7 | 17.7 | 23.06 | 21.03 | 19.77 |
| Other | AON | $52.70 | 2.2 | 11.3 | 12.6 | $51.58 | $47.35 | $46.80 |
| | AIG | 33.57 | 4.2 | 5.6 | 44.7 | 32.22 | 31.78 | 23.20 |
| | Assurant | 34.59 | (4.5) | (0.7) | (15.8) | 36.21 | 34.84 | 41.06 |
| | Fidelity National | 18.71 | 0.2 | (3.1) | 17.5 | 18.68 | 19.31 | 15.93 |
| | Hartford | 18.25 | 5.4 | 4.8 | 12.3 | 17.32 | 17.41 | 16.25 |
| | Marsh | 33.82 | (0.6) | 4.1 | 7.0 | 34.01 | 32.48 | 31.62 |
| Health | Aetna | $39.59 | 5.1 | 2.8 | (6.2) | $37.66 | $38.53 | $42.19 |
| | Cigna | 44.71 | 1.8 | 4.2 | 6.5 | 43.94 | 42.92 | 42.00 |
| | Humana | 68.93 | 1.4 | (10.1) | (21.3) | 67.95 | 76.66 | 87.61 |
| | United | 54.00 | 2.9 | (3.9) | 6.6 | 52.49 | 56.17 | 50.68 |
| | WellPoint | 58.52 | 2.2 | (6.1) | (11.7) | 57.27 | 62.31 | 66.25 |
| Monoline | Assured | $13.92 | 15.6 | (0.8) | 5.9 | $12.04 | $14.03 | $13.14 |
| | MBIA | 10.64 | 9.1 | (2.3) | (8.2) | 9.75 | 10.89 | 11.59 |
| | MGIC | 1.22 | 15.7 | (58.6) | (67.4) | 1.05 | 2.94 | 3.73 |
| | Radian | 3.41 | 14.3 | 0.4 | 45.5 | 2.98 | 3.39 | 2.34 |
| | XL Capital | 23.26 | 0.9 | 10.6 | 17.7 | 23.06 | 21.03 | 19.77 |

**August 22, 2012**

**Major Market Variables**

| | Close | Change % | | | Prior | | |
|---|---|---|---|---|---|---|---|
| | | Week | QTD | YTD | Week | Quarter | Year |
| Dow Jones Ind | 13,172.76 | (0.2) | 2.3 | 7.8 | 13,194.56 | 12,871.39 | 12,217.56 |
| S&P 500 | 1,413.80 | 0.8 | 3.7 | 12.4 | 1,402.14 | 1,363.98 | 1,257.60 |
| S&P Financial | 204.17 | 1.4 | 2.9 | 16.5 | 201.33 | 198.44 | 175.23 |
| S&P Insurance | 190.32 | 1.3 | 4.5 | 11.8 | 187.91 | 182.21 | 170.17 |
| US Dollar $ | | Change % | | | Prior | | |
| / Euro | $1.25 | 1.7 | (0.6) | (3.4) | $1.23 | $1.26 | $1.30 |
| / Crude Oil bbl | 97.33 | 3.8 | 16.4 | (1.5) | 93.81 | 83.62 | 98.83 |
| / Gold oz | 1,637.40 | 1.5 | 2.4 | 4.5 | 1,613.90 | 1,598.90 | 1,566.80 |
| Treasury Ylds % | % | Change bp | | | % | % | % |
| 1 Year | 0.19 | 0.01 | (0.02) | 0.08 | 0.18 | 0.20 | 0.11 |
| 10 Year | 1.70 | (0.02) | 0.11 | (0.18) | 1.72 | 1.59 | 1.88 |
| 30 Year | 2.81 | 0.02 | 0.12 | (0.08) | 2.79 | 2.70 | 2.90 |
| Corp Credit Spreads -bp | | Change % | | | Prior | | |
| CDX.IG | 74.41 | (0.6) | (11.4) | (34.6) | 74.85 | 83.99 | 113.83 |

**August 22, 2012**
**Major Insurer Bond Yields**

| | Company | Coupon | Maturity | Current | Price Change | Yield | Spread B.P. | Spread Change |
|---|---|---|---|---|---|---|---|---|
| Life | Aflac | 8.500% | 5/15/2019 | $132.09 | $0.30 | 3.16% | 195 | (7) |
| | Ameriprise | 5.300% | 3/15/2020 | $115.28 | ($0.01) | 3.02% | 169 | 1 |
| | Genworth | 6.515% | 5/15/2018 | $100.37 | $1.74 | 6.44% | 546 | (36) |
| | Lincoln National | 8.750% | 7/15/2019 | $128.55 | ($0.02) | 3.95% | 276 | 3 |
| | MassMutual | 8.875% | 6/15/2039 | $149.18 | $2.32 | 5.38% | 268 | (11) |
| | MetLife | 4.750% | 2/15/2021 | $114.52 | $0.59 | 2.81% | 134 | (5) |
| | Mutual of Omaha | 6.800% | 6/15/2036 | $115.64 | ($0.87) | 5.60% | 312 | 7 |
| | New York Life | 6.750% | 11/15/2039 | $136.99 | ($0.36) | 4.40% | 167 | 2 |
| | Northwestern Mutual | 6.063% | 3/15/2040 | $126.91 | ($1.84) | 4.37% | 163 | 6 |
| | Pacific Life | 9.250% | 6/15/2039 | $133.40 | $0.81 | 6.58% | 390 | (5) |
| | Principal | 6.050% | 10/15/2036 | $117.48 | $1.78 | 4.82% | 226 | (12) |
| | Prudential | 4.500% | 11/15/2020 | $108.67 | $0.22 | 3.29% | 186 | 3 |
| | TIAA | 6.850% | 12/15/2039 | $135.85 | ($2.84) | 4.54% | 183 | 13 |
| P&C | ACE INA | 5.900% | 6/15/2019 | $123.75 | ($1.03) | 2.13% | 95 | 13 |
| | Allstate | 7.450% | 5/15/2019 | $130.00 | ($0.26) | 2.56% | 140 | 3 |
| | American Financial | 9.875% | 6/15/2019 | $126.93 | ($0.08) | 5.13% | 390 | 1 |
| | Berkshire Hathaway | 5.400% | 5/15/2018 | $120.22 | $0.27 | 1.68% | 73 | (1) |
| | Travelers | 3.900% | 11/15/2020 | $111.50 | ($0.25) | 2.35% | 90 | 5 |
| | XL Group | 6.250% | 5/15/2027 | $110.24 | ($0.13) | 5.24% | 322 | 7 |
| Other | AON | 5.000% | 9/15/2020 | $113.43 | ($0.12) | 3.11% | 168 | 4 |
| | AIG | 5.850% | 1/15/2018 | $114.30 | $1.59 | 2.96% | 210 | (27) |
| | Fidelity National | 7.875% | 7/15/2020 | $114.08 | $0.71 | 1.75% | 82 | (9) |
| | Hartford | 5.500% | 3/15/2020 | $108.41 | $0.88 | 4.19% | 288 | (11) |
| | Marsh | 9.250% | 4/15/2019 | $133.79 | ($0.22) | 3.50% | 235 | 4 |
| | Nationwide | 9.375% | 8/15/1939 | $134.90 | ($1.23) | 6.59% | 388 | 6 |
| Health | Aetna | 3.950% | 9/15/2020 | $108.36 | ($1.90) | 2.78% | 137 | 25 |
| | CIGNA | 5.125% | 6/15/2020 | $112.91 | ($0.47) | 3.24% | 187 | 4 |
| | United Healthcare | 3.875% | 10/15/2020 | $109.80 | $0.83 | 2.53% | 113 | (4) |
| | Wellpoint | 4.350% | 8/15/2020 | $109.26 | ($0.34) | 3.03% | 164 | 5 |

Questions and comments are always welcomed. Please contact Ed Toy, (212) 386-1974, etoy@naic.org

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 – 2018 National Association of Insurance Commissioners. All rights reserved.