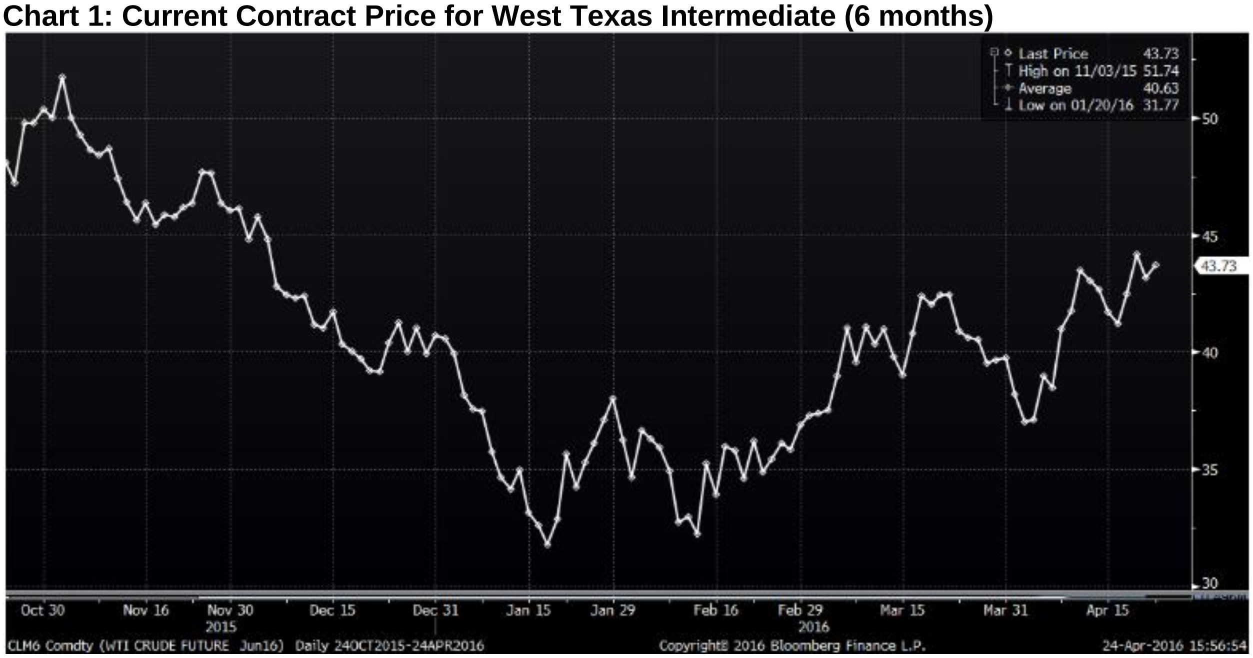
The HOT SPOT

U.S. Insurance Industry's YE 2015 Exposure to the Energy Sector: Warrants Continued Monitoring, But No Cause for Immediate Concern (04/26/2016)

At the close of markets on April 22, the price per barrel of West Texas Intermediate crude oil closed at $43.73. This represents a significant improvement from the environment for oil just two months ago, when the contract price traded in the area of $25/barrel, and almost dropped to $20/barrel. Nonetheless, concerns for the energy sector continue. Current prices are still substantially below where they were two years prior, and few market participants expect any substantial improvement in the near term. Bank exposures to weaker drilling companies have gained much attention. These concerns were emphasized in April when Peabody Energy, one of the nation's largest coal producers, filed for Chapter 11 protection.

Chart 1: Current Contract Price for West Texas Intermediate (6 months)



Reflecting the shifting fortunes of oil prices (as shown in Chart 1), stock prices for energy companies have been equally volatile, falling almost 37% from April 2015 to late January 2016. They have since recovered almost 30%. The U.S. insurance industry's total common stock exposure to the energy sector was $18.3 billion as of year-end 2015, with the bulk ($15.5 billion) in P/C portfolios. The industry also had about $167.5 billion (81.3%) of aggregate bond exposure to the energy sector with life companies at year-end 2015, followed by $28.9 billion (14.0%) in bonds with P/C companies.

The U.S. insurance industry's exposure to the energy sector is not insignificant, but it does not warrant major concern at this time. The bulk of the industry's energy bond exposure (90%) was investment grade, with another 8% in the double-B rating category. A total of $206 billion in energy sector bonds (year-end 2015) was modestly lower than the previously reported $226 billion at the end of 2013, as indicated in a Capital Markets Bureau Special Report published

Feb. 27, 2015, titled, "The Current Oil Shock: Modest Impact on Insurance Industry Investment Portfolios." Roughly 66% of the year-end 2015 exposure was in bonds with maturities of 10 years or less (see Table 1). Exposure to countries whose economies are impacted by volatility in oil prices (i.e., oil-producing countries) has also declined from $169 billion in 2013 to $167 billion in 2014 and $152.4 billion in 2015. In addition, excluding Canada (which had the largest exposure at $33 billion), the largest year-end 2015 investment in an oil-producing country was Mexico at $14.3 billion.

Table 1: NAIC Designations for Energy Sector Bonds by Maturity

NAIC Desig	< 1 yr	1 - 5 yrs	6 - 10 yrs	11 - 20 yrs	>20 yrs	Total
1	4,326	22,092	18,985	9,692	12,787	67,883
2	9,165	31,282	32,918	14,063	29,923	117,351
3	945	6,552	5,132	1,801	1,677	16,107
4	77	1,983	1,503	53	37	3,653
5	125	460	392	-	47	1,024
6	2	49	7	-	5	63
Total	14,640	62,418	58,937	25,609	44,476	206,080
NAIC Desig	**< 1 yr**	**1 - 5 yrs**	**6 - 10 yrs**	**11 - 20 yrs**	**>20 yrs**	**Total**
1	2.1%	10.7%	9.2%	4.7%	6.2%	32.9%
2	4.4%	15.2%	16.0%	6.8%	14.5%	56.9%
3	0.5%	3.2%	2.5%	0.9%	0.8%	7.8%
4	0.0%	1.0%	0.7%	0.0%	0.0%	1.8%
5	0.1%	0.2%	0.2%	0.0%	0.0%	0.5%
6	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	7.1%	30.3%	28.6%	12.4%	21.6%	100.0%

As shown in Table 1, with almost 10% of the U.S. insurance industry's bond exposure to the energy sector below investment grade, and more than 20% with maturities of more than 20 years, market values will potentially be volatile and warrant continued attention by state insurance regulators. Focusing specifically on below investment grade bonds, the total par value for the industry was $22.8 billion, with a book/ adjusted carrying value (BACV) of $20.8 billion and a reported fair value of $17.2 billion at year-end 2015.

The Capital Markets Bureau will continue to monitor market trends in the energy (and related) sector and report as deemed appropriate.