The HOT SPOT

U.S. Insurance Industry Exposure to Ukraine and Former USSR Countries is Minimal, Mitigating Concern Over Political Uncertainty (3/5/14)

The current crisis in the Ukraine, particularly the recent intervention by Russian militia in Crimea, has triggered volatility in global financial markets, including stock losses in the U.S., Europe and Asia. U.S. Treasuries, however, have rallied because of investors' flight-to-quality instinct. While the Russian economy has been struggling, it could benefit from the current turmoil in the form of higher prices for oil and gas, two of its main exports.

Recently, the Russian ruble has dropped to a record low against the dollar and the euro, and Russian stocks have decreased by 10% since the beginning of the year. In addition, the yield on the 10-year Ukrainian U.S. dollar-denominated bond has been extremely volatile, ranging from approximately 9.0% to more than 11.0% in February 2014, closing on March 4 at 9.5%. This equates to prices ranging from $80 to $91, with the current price at $88.50.

According to JPMorgan Asset Management, the Ukraine desperately needs financial support — a situation that existed prior to the current turmoil. While the Ukraine's current interim government has been negotiating with the International Monetary Fund (IMF) about a bailout agreement, its foreign reserves have dropped to record lows along with its currency, the hryvina. That said, the possibility of a Ukrainian sovereign default cannot be ruled out. And the market price of insuring against Ukrainian default has increased 300 basis points since the summer of 2013.

As of year-end 2012, the U.S. insurance industry had a modest exposure of $94 million in Ukrainian bonds, of which 84% was in the form of government bonds. There were no Ukrainian equity investments. Taking a broader view, exposure to all of the former Union of Soviet Socialist Republics (USSR) totaled $1.6 billion in book/adjusted carrying value (BACV). The majority of former USSR exposure was with Russia at $1.1 billion, the majority of which (72%) was also sovereign debt.

Ukrainian U.S. dollar-denominated long-term sovereign debt is rated CCC/Caa2/CCC by Standard & Poor's, Moody's Investors Service and Fitch Ratings, respectively. Russian U.S. dollar-denominated long-term sovereign debt is rated BBB/Baa1/BBB by the three aforementioned nationally recognized statistical rating organizations. Other former USSR exposures included an aggregate of $410 million with Georgia, Kazakhstan, Latvia, Lithuania and Slovenia. While this exposure is small, the situation bears closer monitoring by regulators until a resolution is reached. Further volatility is expected, as is economic and financial damage if there is a continued standoff between the Ukraine and Russia.

The NAIC Capital Markets Bureau will continue to monitor events within this region and report as deemed appropriate regarding any potential impacts to the U.S. insurance industry's investments.