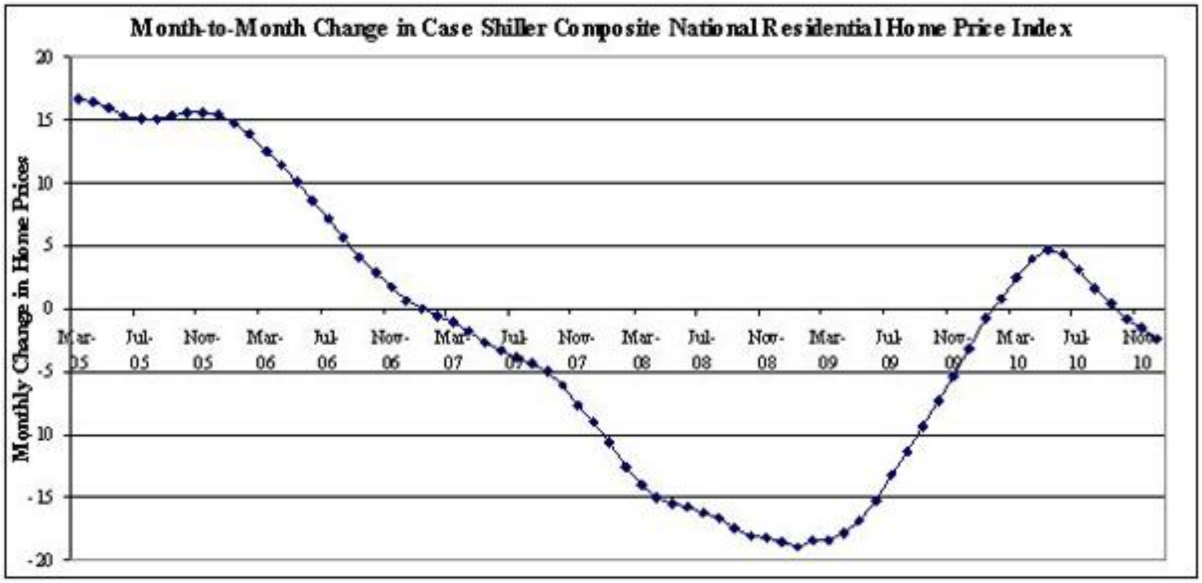
The **NAIC's Capital Markets Bureau** monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of US insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the **index**

Continuing Concerns for the Housing Market and Residential Mortgage-Backed Securities

Roughly 54 million of the approximately 80 million homes in the United States are financed through residential mortgages. These loans represent $10.6 trillion in debt, compared to $17.35 trillion in U.S. housing values. The housing market continues to be depressed in an improving economy. The unemployment rate stands at 8.8%, which suggests that the ability to make full and timely mortgage payments is still a struggle for many homeowners. As a result, foreclosures have increased and could still be on the rise, as home prices continue to slide. Additionally, as borrowers experience severe losses of equity in their homes that coincide with declining values, it has been suggested that some borrowers are choosing to not make their mortgage payments, even though they are able to pay. These defaults have been referred to as "strategic defaults." Whatever the reason, eventually, these defaulted payments will negatively impact the pools of residential mortgages (in terms of income) that collateralize residential mortgage-backed securities (RMBS). As a result, investors in these securities could experience a certain level of loss, as well as depressed market values.

Residential prices continue to decline

The national median sales price of existing homes (that is, existing single-family, townhomes, condominiums and co-ops, as opposed to newly constructed homes) decreased 5.2% in February 2011 from a year earlier, according to National Association of Realtors. This also represents a 10% decrease from the national median existing-home price from January 2011, which was more than expected. Home prices have been on a declining trend since August 2010 according to S&P/Case-Shiller Home Price Indices, after a brief period of stability. The S&P Case-Shiller Home Price Index for 20 large cities (see table below) has dropped 31.8% from its peak in 2006. While housing prices moved up somewhat in early 2009 due in part to the federal tax credit for homebuyers, once it expired, prices began lagging.



Month-to-Month Change in Case Shiller Composite National Residential Home Price Index
Monthly Change in Home Prices
20
15
10
5
0
-5
-10
-15
-20
Mar-05
Jul-05
Nov-05
Mar-06
Jul-06
Nov-06
Mar-07
Jul-07
Nov-07
Mar-08
Jul-08
Nov-08
Mar-09
Jul-09
Nov-09
Mar-10
Jul-10
Nov-10

Bloomberg Table

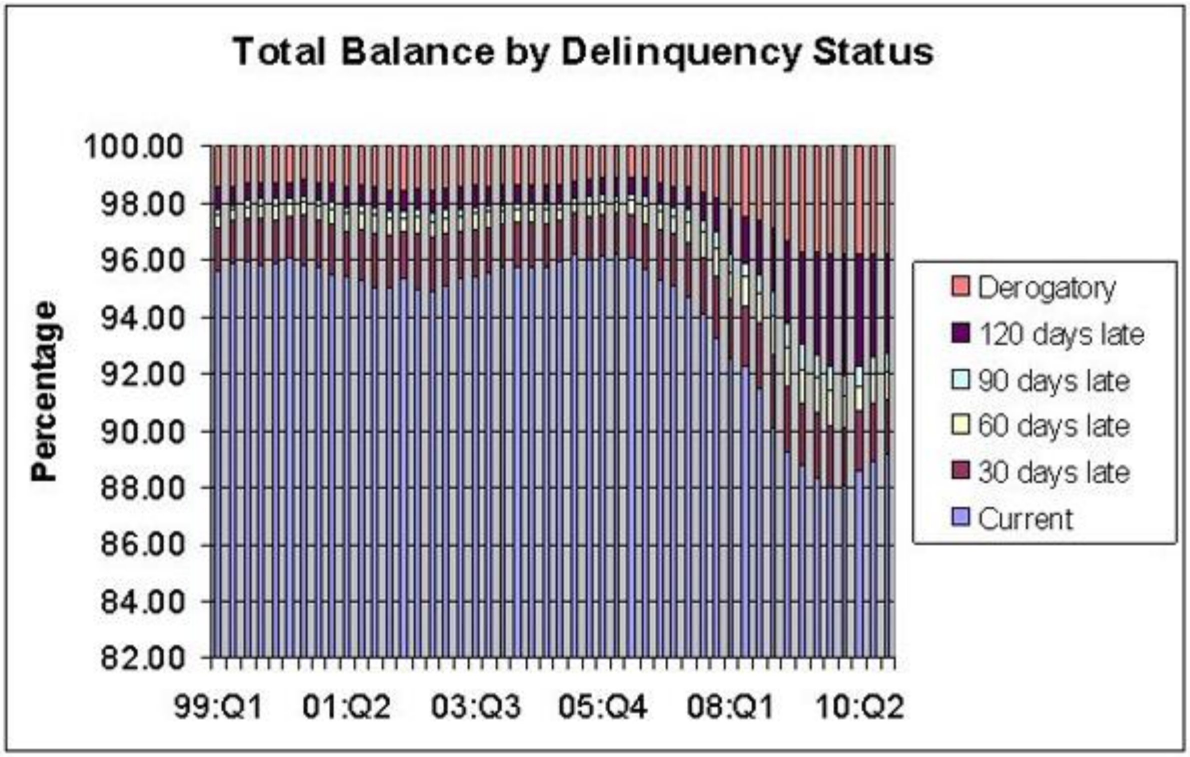
	Current MoM%	Previous MoM%	3-Mth Annual%	YoY% Change	Index Level
US Composite-20	-1.04%	-0.98%	-11.50%	-3.06%	140.86
Washington DC	0.10%	-0.20%	-2.82%	3.58%	183.75
San Diego	-1.22%	-0.69%	-7.20%	0.05%	157.03
Boston	-0.30%	-0.16%	-5.75%	-0.61%	152.07
San Francisco	-1.95%	-0.92%	-14.85%	-1.67%	133.37
Los Angeles	-0.65%	-1.32%	-9.24%	-1.79%	169.88
Denver	-1.10%	-0.74%	-11.62%	-2.28%	122.73
Dallas	-0.52%	-0.19%	-6.84%	-2.75%	114.07
New York	-0.88%	-0.97%	-11.51%	-2.97%	166.30
Cleveland	-0.85%	0.18%	-10.42%	-3.80%	99.36
Las Vegas	-0.25%	-1.10%	-6.72%	-4.42%	99.23
Miami	-1.26%	-0.49%	-7.37%	-4.73%	141.30
Charlotte	-1.11%	-0.62%	-8.87%	-4.83%	111.50
Seattle	-2.37%	-2.03%	-19.89%	-6.67%	135.41
Atlanta	-0.44%	-0.79%	-13.61%	-6.96%	99.59
Tampa	-1.04%	-2.70%	-17.67%	-6.99%	128.52

	Current MoM%	Previous MoM%	3-Mth Annual%	YoY% Change	Index Level
Chicago	-1.76%	-1.43%	-19.63%	-7.46%	115.78
Minneapolis	-3.43%	-1.55%	-24.62%	-7.62%	113.21
Portland	-1.76%	-1.21%	-16.73%	-7.80%	135.80
Detroit	-1.71%	-1.37%	-17.34%	-8.10%	66.02
Phoenix	-1.51%	-1.67%	-15.70%	-9.14%	101.54

The U.S. Department of Commerce also has reported that new home sales have decreased by 17%, to a record low, from January to February 2011.

Delinquencies and strategic defaults

Approximately 10.8% of residential mortgage loans outstanding were in some form of delinquency as of the fourth quarter of 2010, according to data from the Federal Reserve Bank of New York. As shown in the chart below, the total balance of delinquent mortgage loans had been on the rise over the past few years, particularly those 120 or more days past due.



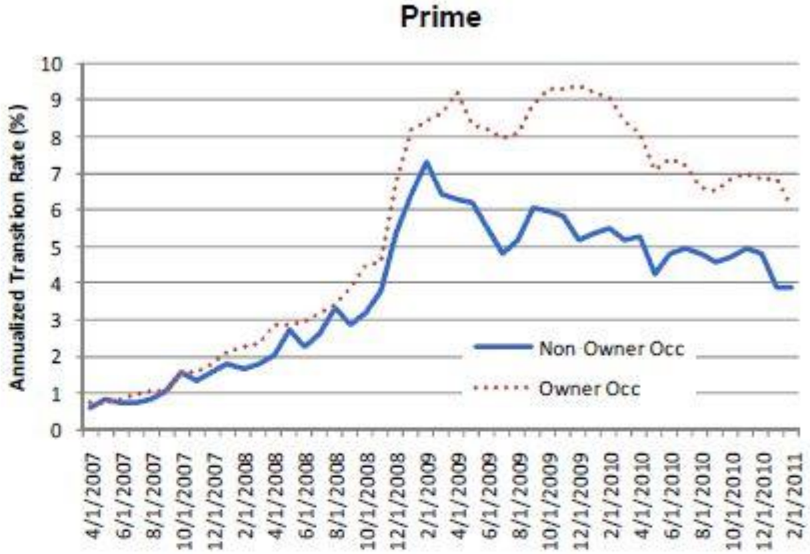
Source: Federal Reserve Bank of New York Consumer Credit Panel; "Derogatory" indicates more than 120 days past due.

Delinquencies and defaults are not necessarily correlated to the unemployment rate
A defining characteristic of the current housing crisis is the apparent widespread willingness of homeowners to strategically default. As mentioned above, a strategic default is defined as when a borrower stops making payments on the mortgage loan, despite having the means to continue to do so. In general, a homeowner deliberately ceases making mortgage payments because the equity investment in the house has disappeared and is unlikely to be recovered. That is, the debt outstanding on the house is substantially more than the value of the house itself. With a sharp rise and subsequent fall in home prices over the past few years, many homeowners found that they had lost all of the equity value in their homes.
The chart below compares trends in home price appreciation and unemployment rates. There does not appear to be a strong correlation between the two statistics. In fact, when home prices first began to fall in 2007, unemployment was about half of what it is today.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Home Price Appreciation*	6.3%	7.5%	7.6%	10.7%	11.5%	2.7%	(4.1%)	(10.3%)	(3.7%)	(3.1%)
Unemployment Rate**	4.7%	5.8%	6.0%	5.5%	5.1%	4.6%	4.6%	5.8%	9.3%	9.6%

***Source: FNMA 10-K filed with the U.S. Securities and Exchange Commission (SEC) Feb. 24, 2011.**
****Based on the average national unemployment rate for each month reported in the labor force statistics current population survey, U.S. Bureau of Labor Statistics.**

An additional statistic that confirms the prevalence of strategic defaults focuses on the increase in defaults among prime borrowers. Prime borrowers are considered the most credit-worthy, as indicated by a Fair Isaac Corporation (FICO) score greater than 720. Defaults among prime borrowers occurred well before 2009 when the unemployment rate was (relatively) unchanged, but after home prices had started to fall.



The table below includes data from CoreLogic, a provider of financial, property and consumer data, and shows the relationship between the rate of transition to non-payment for prime and subprime mortgages, given a range of unemployment rates and a spectrum of combined loan-to-value (CLTV) ratios. CLTVs include both first- and second-lien mortgage loans. At a CLTV of 100% or more, the homeowner's equity no longer exists, and so the outstanding mortgage loan balance is effectively larger than the home is worth. A CLTV ratio that is at or below 80% means that the homeowner retains a significant equity stake in the value of the home.

Annualized Transition Rates as a Function of Unemployment and CLTV

	PRIME			
Unemployment Rate 3Mo Ago (%)	CLTV <=80	CLTV 81-100	CLTV 101-120	CLTV >120
<=8.0	2.6	4.98	6.31	9.56
8.1-10.0	2.74	5.93	8.81	16.85
10.1-12.0	2.19	6.05	9.91	16.16
>12.0	2.76	6.46	9.18	15.43

	SUBPRIME			
Unemployment Rate 3Mo Ago (%)	CLTV <=80	CLTV 81-100	CLTV 101-120	CLTV >120
<=8.0	11.7	19.65	24.09	25.46
8.1-10.0	12.44	20.3	25.93	30.67
10.1-12.0	9.39	17.54	23.14	31.09
>12.0	9.05	15.17	19.73	31.04

Source: CoreLogic, Amherst Securities Group.

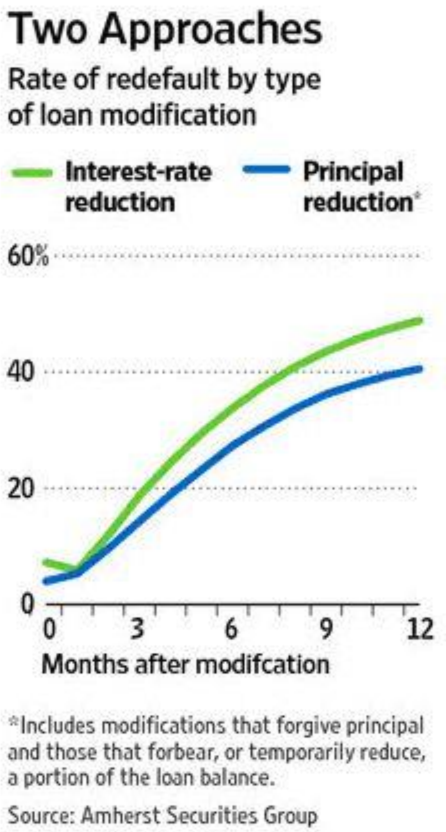
Unsurprisingly, the lowest transition rates to delinquency exist when there is a significant amount of equity in the home (i.e., CLTV <=80%) for prime and subprime borrowers. Prime borrowers also show little change in the transition rate to delinquency (ranging between 2.6%

and 2.8%) when they retain significant home equity, despite the range of unemployment rates. In comparison, when CLTV is at or equal to 80%, subprime borrowers' transition rates to delinquency are between 3 and 4.5 times higher than that of prime borrowers. Generally, subprime borrowers' transition rates to delinquency range between 2 to 4 times that of prime borrowers across the respective CLTV and unemployment spectrums. Oddly, the transition rate to delinquency tends to decrease for subprime borrowers when the unemployment increases over 10% (except in the case of no home equity value, or when CLTV is above 120%), suggesting that factors other than unemployment could be contributing to their transition to delinquency at that point.

Rising foreclosures

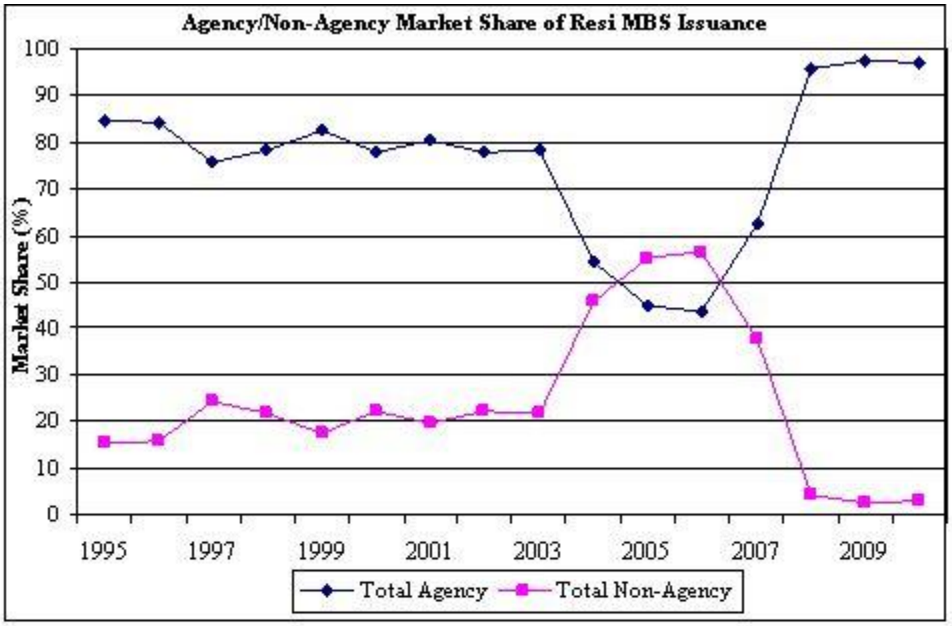
There has been an increase in the number of houses on the market due in part to foreclosure inventory, putting additional pressure on home prices in the coming months. A further decline in housing prices causes potential homebuyers to wait on the sidelines, thereby hurting construction and homebuilding industries. According to RealtyTrac Inc., a housing data seller, foreclosure filings could increase by 20% in 2011. Though foreclosures decreased to a three-year low in February 2011, it was primarily because lenders, facing legal scrutiny, "struggled to process a backlog of defaults and put new systems in place for home seizures," as stated by RealtyTrac Inc. Over the past year, Move Inc., a real estate website, indicated that inventory of unsold homes has increased by 13%.

In an attempt to curtail the building foreclosure backlog, U.S. banks, despite some resistance, are being encouraged by state attorneys general to implement loan modifications that reduce mortgage loan principal balances for those in jeopardy of foreclosure. Such modifications are viewed as an alternative to reducing the interest rate and extending the life of the loans. For some borrowers, principal reduction is viewed as a means to providing a better long-term return. Some servicers, however, contend that reducing loan balances might not be effective. One mortgage servicer indicated that 17% of its borrowers who received a principal reduction were delinquent on their mortgage payments six months later, whereas 20% of its borrowers that received a reduction in monthly payments were delinquent again after six months.



RMBS: Agency-backed and private-label

RMBS are pools of residential mortgage loans that could include some or all of different types of fixed and/or floating rate loans, such as prime, subprime, Alt-A and Option ARMs (adjustable rate mortgages). Institutional investors, including insurance companies, have historically been enthusiastic buyers of RMBS, due in part to the long-term cash flows they provide, which are useful for offsetting long-term liabilities. As of year-end 2010, insurance companies owned approximately $130 billion in non-agency RMBS (about 3% of total industry investments), with 85% of that exposure held by life insurance companies.



Source: Inside MBS & ABS, CoreLogic and Amherst Securities

As the financial crisis emerged, private-label (or non-agency) RMBS issuance dropped substantially, and any existing transactions experienced extreme losses in market value. As a result, new issuance has been minimal, if nonexistent. Nevertheless, in recent months, there has been a slight increase in demand for RMBS backed by subprime mortgages, due in part to investor willingness to take on the additional risk for a higher yield.

In summary, home prices continue on a declining trend, while a backlog of foreclosures persists. The recent dramatic decline in home equity values has caused some borrowers to intentionally default on their mortgage loans, even though they have the financial means to make payments. For subprime borrowers, the unemployment rate has a stronger correlation to non-payment. This is less apparent for prime borrowers.

Inevitably the rise in foreclosures and delinquencies will negatively impact cash flows for RMBS. Consequently, the ability of the RMBS issuer to make full and timely principal and interest payments to investors could also be negatively impacted.

April 1, 2011

Major Insurer Share Prices

		Close	Change % Week	Change % QTD	Change % YTD	Prior Week	Prior Quarter	Prior Year
Life	Aflac	$53.45	1.5	1.3	(5.3)	$52.65	$52.78	$56.43
	Ameriprise	62.43	2.4	2.2	8.5	60.97	61.08	57.55
	Genworth	13.51	3.4	0.4	2.8	13.07	13.46	13.14
	Lincoln	30.47	0.5	1.4	9.6	30.32	30.04	27.81
	MetLife	45.31	0.5	1.3	2.0	45.07	44.73	44.44
	Principal	31.71	(0.6)	(1.3)	(2.6)	31.90	32.11	32.56
	Protective	26.90	2.3	1.3	1.0	26.30	26.55	26.64
	Prudential	62.45	2.4	1.4	6.4	60.96	61.58	58.71
	UNUM	26.54	1.3	1.1	9.6	26.19	26.25	24.22
PC	ACE	$65.83	5.6	1.7	5.8	$62.32	$64.70	$62.25
	Axis Capital	35.42	6.5	1.4	(1.3)	33.26	34.92	35.88
	Allstate	31.45	0.2	(1.0)	(1.3)	31.40	31.78	31.88
	Arch Capital	100.31	4.5	1.1	13.9	95.95	99.19	88.05
	Cincinnati	32.97	1.6	0.5	4.0	32.46	32.79	31.69
	Chubb	61.42	1.9	0.2	3.0	60.26	61.31	59.64
	Everest Re	90.40	8.9	2.5	6.6	82.98	88.18	84.82
	Progressive	21.20	1.6	0.3	6.7	20.86	21.13	19.87
	Travelers	59.65	1.1	0.3	7.1	58.98	59.48	55.71
	WR Berkley	32.86	7.4	2.0	20.0	30.60	32.21	27.38
	XL	24.75	7.0	0.6	13.4	23.13	24.60	21.82
Other	AON	$53.71	2.7	1.4	16.7	$52.29	$52.96	$46.01
	AIG	34.96	(4.3)	(0.5)	(27.6)	36.54	35.14	48.27
	Assurant	38.37	(2.9)	(0.4)	(0.4)	39.51	38.51	38.52
	Fidelity National	14.41	4.7	2.0	5.3	13.76	14.13	13.68
	Hartford	27.65	3.7	2.7	4.4	26.66	26.93	26.49
	Marsh	30.00	0.7	0.6	9.7	29.80	29.81	27.34
Health	Aetna	$37.68	2.6	0.7	23.5	$36.73	$37.43	$30.51
	Cigna	44.54	4.5	0.6	21.5	42.62	44.28	36.66
	Humana	69.98	5.9	0.1	27.8	66.07	69.94	54.74
	United	45.65	4.3	1.0	26.4	43.75	45.20	36.11
	WellPoint	70.64	1.9	1.2	24.2	69.35	69.79	56.86
Monoline	Assured	$14.99	1.7	0.6	(15.3)	$14.74	$14.90	$17.70
	MBIA	10.00	(4.0)	(0.4)	(16.6)	10.42	10.04	11.99
	MGIC	9.36	6.9	5.2	(8.2)	8.75	8.89	10.19
	PMI	2.69	(2.9)	(0.4)	(18.5)	2.77	2.70	3.30
	Radian	6.83	1.4	0.3	(15.4)	6.74	6.81	8.07
	XL Capital	24.75	7.0	0.6	13.4	23.13	24.60	21.82

April 1, 2011

Major Market Variables

		Close	Change % Week	Change % QTD	Change % YTD	Prior Week	Prior Quarter	Prior Year
Dow Jones Ind		12,376.72	1.3	0.5	6.9	12,220.59	12,319.73	11,577.51
S&P 500		1,332.41	1.4	0.5	5.9	1,313.80	1,325.83	1,257.64
S&P Financial		222.48	1.1	0.8	3.6	220.06	220.71	214.77
S&P Insurance		196.21	0.6	0.6	4.2	195.10	194.96	188.22
US Dollar $			**Change %**			**Prior**		
	/ Euro	$1.42	1.1	0.5	6.3	$1.41	$1.42	$1.34
	/ Crude Oil bbl	108.09	2.4	1.3	17.2	105.56	106.72	92.22
	/ Gold oz	1,427.70	(0.1)	(0.8)	0.5	1,429.00	1,438.90	1,420.78
Treasury Ylds %		**%**	**Change**			**%**	**%**	**%**
	1 Year	0.24	(0.03)	(0.05)	(0.04)	0.27	0.28	0.27
	10 Year	3.45	0.00	(0.03)	0.15	3.44	3.47	3.30
	30 Year	4.49	(0.02)	(0.02)	0.15	4.50	4.51	4.34
Corp Credit Spreads -bp			**Change %**			**Prior**		
	CDX.IG	83.81	0.9	0.0	(1.4)	83.03	83.81	85.00

April 1, 2011
Major Insurer Bond Yields

	Company	Coupon	Maturity	Price Current	Price Change	Yield	Spread B.P.	Spread Change
Life	Aflac	8.500%	5/15/2019	$121.00	($0.06)	5.28%	211	(2)
	Ameriprise	5.300%	3/15/2020	$106.17	$0.01	4.45%	110	(2)
	Genworth	6.515%	5/15/2018	$100.10	$0.17	6.50%	349	(7)
	Lincoln National	8.750%	7/15/2019	$126.16	$0.18	4.86%	165	(4)
	MassMutual	8.875%	6/15/2039	$136.45	($0.05)	6.14%	164	1
	MetLife	4.750%	2/15/2021	$100.30	($0.26)	4.71%	122	4
	Mutual of Omaha	6.800%	6/15/2036	$95.87	$0.16	7.16%	284	0
	New York Life	6.750%	11/15/2039	$114.76	$0.11	5.70%	118	(1)
	NLV Financial	7.500%	8/15/2033	$115.76	($0.64)	6.19%	202	6
	Northwestern Mutual	6.063%	3/15/2040	$105.86	$0.65	5.65%	111	(4)
	Pacific Life	9.250%	6/15/2039	$132.03	$0.00	6.70%	222	2
	Principal	6.050%	10/15/2036	$103.82	($0.11)	5.76%	145	8
	Prudential	4.500%	11/15/2020	$98.08	$0.01	4.75%	131	1
	TIAA	6.850%	12/15/2039	$113.37	$0.25	5.88%	135	(1)
P&C	ACE INA	5.900%	6/15/2019	$111.14	($0.04)	4.27%	107	(3)
	Allstate	7.450%	5/15/2019	$118.93	$0.15	4.62%	144	(6)
	American Financial	9.875%	6/15/2019	$122.46	($0.23)	6.32%	313	3
	Berkshire Hathaway	5.400%	5/15/2018	$110.35	$0.04	3.73%	75	(4)
	Travelers	3.900%	11/15/2020	$94.98	($0.22)	4.55%	112	4
	XL Group	6.250%	5/15/2027	$98.86	$0.09	6.36%	253	10
Other	AON	5.000%	9/15/2020	$101.51	($0.11)	4.80%	139	2
	AIG	5.850%	1/15/2018	$103.98	($0.11)	5.15%	224	(2)
	Fidelity National	7.875%	7/15/2020	$109.75	($0.06)	6.46%	316	(4)
	Hartford	5.500%	3/15/2020	$102.12	($0.10)	5.20%	188	(1)
	Marsh	9.250%	4/15/2019	$126.01	($0.29)	5.24%	202	(1)
	Nationwide	9.375%	8/15/1939	$123.76	$1.11	7.37%	291	(7)
Health	Aetna	3.950%	9/15/2020	$96.64	($0.14)	4.39%	97	0
	CIGNA	5.125%	6/15/2020	$104.46	($0.25)	4.53%	114	1
	United Healthcare	3.875%	10/15/2020	$95.62	($0.63)	4.44%	102	8
	Wellpoint	4.350%	8/15/2020	$99.73	($0.38)	4.38%	100	4

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