

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](#)

Foreign Currency Exposure of U.S. Insurance Company Investments

While the majority of U.S. insurance company investments are issued by companies domiciled in the United States and U.S. dollar-denominated (USD), there is a relatively small portion of securities that are denominated in foreign currencies and/or issued outside of the United States. As of year-end 2010, and in USD terms, foreign currency exposure represented approximately \$138 billion, or almost 3% of total industry exposure. The majority of all foreign currency exposure was held by life insurance companies, and about 40% of total foreign currency exposure was hedged risk.

Insurance Company Exposure to Foreign Investments

The following table shows the insurance company foreign currency exposure as of year-end 2010 in a variety of ways:

\$ billion

A. Securities issued by non-U.S. entities and denominated in foreign currencies (excluding Canada)	\$89.3*
B. Securities issued by U.S. entities and denominated in Canadian dollars	\$23.8
C. Securities issued by Canadian entities denominated in foreign currencies, not Canadian dollars	\$2.5
D. Securities issued by Canadian entities denominated in Canadian dollars	\$0.3
E. Securities issued by U.S. entities but denominated in foreign currencies (other than Canadian dollars)	\$21.7

*Nets out any

USD-denominated exposure that might have been included as "foreign currency"; that is, securities issued by a country other than the United States, but denominated in USD.

In terms of country exposure, the largest four countries that issued securities with foreign currency exposure — and relative to the categories listed in the table above — included:

\$ billion

	A	B	C	D	E	Total
Japan			\$42.4	\$0.06		\$42.5
Canada		\$22.0	\$0.09	\$2.2	\$0.23	\$24.5
United Kingdom		\$9.4	\$0.06			\$9.5
Australia		\$0.06	\$8.0			\$8.1

Foreign currency in this case includes the currency of the issuing country and could also include currencies of other countries (except for USD). Canadian exposure includes mostly securities

denominated in Canadian dollars; however, it does include about \$2 billion in securities denominated in other foreign currencies.

With regard to the actual currencies, the largest four exposures as of year-end 2010 were as listed in the table below. The largest, approximately 40% of foreign currency exposure, was in Japanese yen.

\$ billion

JPY – Japanese yen	\$67.1
EUR – Euro	\$22.7
CAD – Canadian dollar	\$22.5
AUD – Australian dollar	\$ 8.8

Status of Key Currencies

The key currencies — euro, British pound, Chinese yuan, Japanese yen and Canadian dollar — have been trading mixed against the USD. In general, worldwide political and economic events influence the movement of foreign currencies. This includes the fluctuation of prices on raw materials and commodities, as well as unemployment rates, sovereign debt levels, economic growth and interest rate changes.

A few of the major currencies have been affected by fluctuating oil prices and the status of eurozone economic issues, in particular, the bailout of Greece and Ireland. Although the value of the euro had gained almost 9% against the USD so far this year, as the European Central Bank (ECB) has begun raising interest rates, it declined due, in part, to concerns regarding the status of Greece's financial distress and long-term sovereign debt rating downgrade by Standard & Poor's from BB- to B. While a strong euro wards off inflation, it also jeopardizes economic growth, especially for eurozone countries in the midst of crisis (such as Portugal and Ireland) that rely on exports. Expectations are that the ECB is unlikely to aggressively increase rates in the near term.

A strong Japanese yen benefits economic growth, given that the country relies heavily on international trade. A weaker yen, however, makes the country's products more competitive abroad. The value of the yen also tends to move in the opposite direction of commodity prices; that is, the yen strengthens as commodity prices (most recently oil) decrease. This is likely because investors tend to become risk averse as commodities fall, which benefits not only the yen, but also the USD.

China is the largest holder of U.S. Treasuries and, as such, it is concerned about the U.S. debt ceiling. The Chinese yuan has appreciated 5% against the USD since May 2010, reducing the value of its Treasury holdings as the yuan rises and USD falls. Insurance company exposure to the Chinese yuan, however, was relatively small, at approximately \$600 million, or less than 1% of total foreign currency exposure.

A recent decline in the Australian dollar was halted as the country realized a larger trade surplus than economists expected, due in part to an increase in exports of iron ore and coal. The Canadian dollar has been on the rise, with gains in global equities believed to be encouraging a demand for this currency.

Benchmark Currency Rates – as of (mid-day) May 13, 2011

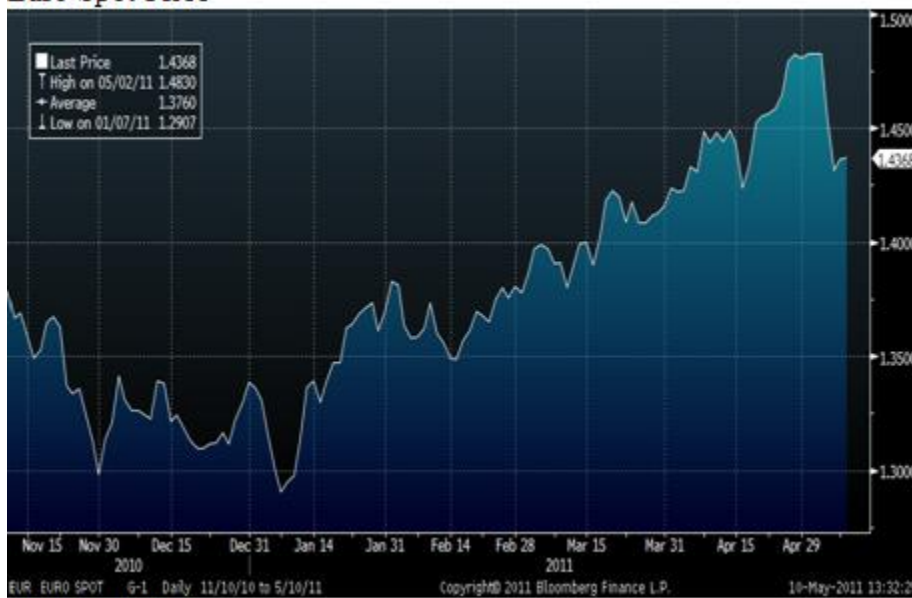
CURRENCY	VALUE	CHANGE	% CHANGE (from day prior)
EUR-USD	1.4111	-0.0135	-0.9469%
GBP-USD	1.6194	-0.0097	-0.5966%
USD-JPY	\$0.7305	-0.2075	-0.2564%
AUD-USD	1.0568	-0.0110	-1.0339%
USD-CAD	0.9697	0.0070	0.7251%
USD-CHF	0.8915	0.0074	0.8381%

Source: Bloomberg.com

The euro had been increasing in value relative to the USD, but decreased in late April and leveled off due, in part, to reports of new financial aid for Greece being arranged by the

International Monetary Fund (IMF). A cheaper euro relative to other currencies makes the 17-nation currency more affordable, and perhaps might assist with attracting investments toward the “PIIGS” countries within the eurozone (Portugal, Ireland, Italy, Greece and Spain) that are currently struggling financially. One way for these countries to balance budgets would be to devalue their respective currencies, but the fact that these countries are tied to the euro has been a hindrance. This has led to some speculation that they might withdraw from the common currency. Euro-denominated bonds represent approximately 13.6% of insurance company foreign currency investments.

Euro Spot Price



Source: Bloomberg

Canadian Dollar Spot Price



Source: Bloomberg

The Japanese yen took a deep dive as a result of the devastating earthquake and tsunami in March 2011, but then recovered, due in part to the Bank of Japan infusing capital into the Japanese financial system to bolster liquidity.

Japanese Yen Spot Price



Source: Bloomberg

Insurance Company Foreign Investments

As of year-end 2010, total foreign investments by all U.S. insurance companies was \$574 billion, including USD-denominated, 93% of which was in bond exposure. Foreign common and preferred stock exposure was much smaller, at \$37.6 billion and \$3.1 billion, respectively. Overall, about 80% of the total represented life insurance company investments. Foreign currency exposure is about a quarter of this total amount.

The top 10 foreign country exposures as of year-end 2010 are listed in the table below. Note that this excludes Canada (which amounted to approximately \$110 billion of total foreign exposure). In addition, the total amount of foreign investments might include some structured finance securities and foreign subsidiaries of U.S.-domiciled companies.

\$ billion

United Kingdom	\$89.6
Australia	\$48.2
Japan	\$46.4
Netherlands	\$39.7
Cayman Islands	\$37.7
France	\$23.2
Luxembourg	\$20.9
Bermuda	\$19.9
Germany	\$13.3
Ireland	\$10.7

Six out of the 10 foreign countries are members of the eurozone. In particular, exposure to Ireland, as one of the financially challenged members, is less than 1% of total foreign exposure,

and the United Kingdom (UK) represents 15% of foreign exposure. While the global economy is generally on a path to recovery, many countries continue to face some degree of financial strain — some more so than others. Mitigating concern over any foreign exposure is that the majority of insurance company investments are in the larger, more developed economies with supportive infrastructures. According to the World Bank, the UK's 2010 gross domestic product (GDP) was \$2.17 trillion, and it was the sixth-largest economy in the world. In an effort to emerge from the current financial crisis, the Bank of England has kept its main interest rate at a record low. The economic growth forecast for the UK has been reduced by the IMF, and it is also one of the slowest growing economies of the G7, with the exception of Japan, according to a report by the Organisation for Economic Co-operation and Development (OECD). Despite signs of recovery, continued appropriate monetary policy and structural reform will be necessary for the UK to fully recover.

Japan's GDP was \$5 trillion and represented the third-largest economy in the world. After the devastating earthquake and tsunami in March 2011, Japan's disaster damage has, so far, amounted to 25 trillion yen (\$310 billion). While the Bank of Japan has provided capital to sustain liquidity in its financial system, appropriate monetary policy going forward, along with reconstruction efforts, will assist its recovery, including as it relates to exports and supply-chain disruptions.

Australia, with a GDP of \$924.8 billion, has been one of the more resilient countries during the global economic crisis, according to the OECD. Unlike many countries, Australia has had strong job growth, evidenced by a jobless rate of 4.9% as of April 2011, according to the Australian Bureau of Statistics. According to the OECD, Australia has maintained "years of sound policies [that] left ample room for monetary and fiscal policy to act rapidly and forcefully when the crisis struck."

Risks to Investing in Foreign Currencies

Volatility clearly exists across the different currencies, with the movement in value dependent, in part, on the state of domestic and global economic progress and political events. According to a BNP Paribas currency strategist, "commodity markets are in the driver's seat for currency markets," suggesting that the recent fluctuations in oil prices have affected not only USD strength but other currencies, as well. Risks to investing in foreign currencies can be hedged to mitigate risks not only related to volatility, but also for any currency mismatches as it relates to liabilities.

Because currency volatility can impact the value of investments, prudent due diligence in relation to foreign currency-denominated securities should include an analysis of a country's growth expectations, debt levels and monetary policy by the respective central banks, among other factors. With regard to existing foreign currency exposure, concern over the volatility of currency investments in nations that are experiencing financial and economic distress, and, perhaps political turmoil, is mitigated by the relatively small percentage of exposure of these currencies within the insurance industry's overall portfolio of investments.

May 6, 2011

Major Insurer Share Prices

		Close	Change %			Prior		
			Week	QTD	YTD	Week	Quarter	Year
Life	Aflac	\$55.12	(1.9)	4.4	(2.3)	\$56.19	\$52.78	\$56.43
	Ameriprise	61.20	(1.4)	0.2	6.3	62.06	61.08	57.55
	Genworth	11.50	(5.7)	(14.6)	(12.5)	12.19	13.46	13.14
	Lincoln	29.88	(4.3)	(0.5)	7.4	31.23	30.04	27.81
	MetLife	44.80	(4.3)	0.2	0.8	46.79	44.73	44.44
	Principal	31.43	(6.9)	(2.1)	(3.5)	33.75	32.11	32.56
	Protective	24.55	(8.8)	(7.5)	(7.8)	26.91	26.55	26.64
	Prudential	63.70	0.4	3.4	8.5	63.42	61.58	58.71
	UNUM	26.23	(1.0)	(0.1)	8.3	26.48	26.25	24.22
PC	ACE	\$67.26	0.0	4.0	8.0	\$67.25	\$64.70	\$62.25
	Axis Capital	34.39	(2.7)	(1.5)	(4.2)	35.36	34.92	35.88
	Allstate	33.41	(1.3)	5.1	4.8	33.84	31.78	31.88
	Arch Capital	101.78	(2.1)	2.6	15.6	104.00	99.19	88.05
	Cincinnati	30.96	(2.3)	(5.6)	(2.3)	31.68	32.79	31.69
	Chubb	65.44	0.4	6.7	9.7	65.19	61.31	59.64
	Everest Re	90.00	(1.2)	2.1	6.1	91.12	88.18	84.82
	Progressive	21.69	(1.1)	2.7	9.2	21.94	21.13	19.87
	Travelers	63.39	0.2	6.6	13.8	63.28	59.48	55.71
	WR Berkley	32.05	(1.7)	(0.5)	17.1	32.61	32.21	27.38
	XL	23.45	(4.0)	(4.7)	7.5	24.42	24.60	21.82
	Other	AON	\$52.56	0.7	(0.8)	14.2	\$52.17	\$52.96
AIG		30.76	(1.3)	(12.5)	(36.3)	31.15	35.14	48.27
Assurant		38.83	(2.2)	0.8	0.8	39.70	38.51	38.52
Fidelity National		15.33	(0.7)	8.5	12.1	15.44	14.13	13.68
Hartford		27.49	(5.1)	2.1	3.8	28.97	26.93	26.49
Marsh		29.74	(1.8)	(0.3)	8.8	30.28	29.81	27.34
Health	Aetna	\$41.89	1.2	11.9	37.3	\$41.38	\$37.43	\$30.51
	Cigna	46.87	0.1	5.8	27.9	46.83	44.28	36.66
	Humana	76.99	1.1	10.1	40.6	76.12	69.94	54.74
	United	50.10	1.8	10.8	38.7	49.23	45.20	36.11
	WellPoint	77.98	1.5	11.7	37.1	76.79	69.79	56.86
Monoline	Assured	\$16.72	(1.6)	12.2	(5.5)	\$17.00	\$14.90	\$17.70
	MBIA	10.06	(2.6)	0.1	(16.1)	10.32	10.04	11.99
	MGIC	8.37	(3.3)	(5.8)	(17.9)	8.66	8.89	10.19
	PMI	1.83	(15.3)	(32.2)	(44.5)	2.16	2.70	3.30
	Radian	5.59	(5.7)	(17.9)	(30.7)	5.93	6.81	8.07
	XL Capital	23.45	(4.0)	(4.7)	7.5	24.42	24.60	21.82

May 6, 2011

Major Market Variables

		Close	Change %			Prior		
			Week	QTD	YTD	Week	Quarter	Year
Dow Jones Ind		12,638.74	(1.3)	2.6	9.2	12,810.54	12,319.73	11,577.51
S&P 500		1,340.20	(1.7)	1.1	6.6	1,363.61	1,325.83	1,257.64
S&P Financial		216.69	(1.7)	(1.8)	0.9	220.49	220.71	214.77
S&P Insurance		194.27	(2.5)	(0.4)	3.2	199.30	194.96	188.22
US Dollar \$			Change %			Prior		
/ Euro		\$1.44	(3.1)	1.4	7.2	\$1.48	\$1.42	\$1.34
/ Crude Oil bbl		97.86	(14.1)	(8.3)	6.1	113.93	106.72	92.22
/ Gold oz		1,490.80	(4.2)	3.6	4.9	1,556.40	1,438.90	1,420.78
Treasury Ylds %		%	Change			%	%	%
1 Year		0.17	(0.03)	(0.12)	(0.10)	0.19	0.28	0.27
10 Year		3.16	(0.14)	(0.32)	(0.14)	3.29	3.47	3.30
30 Year		4.29	(0.11)	(0.22)	(0.05)	4.40	4.51	4.34
Corp Credit Spreads -bp			Change %			Prior		
CDXIG		77.99	3.8	(6.9)	(8.2)	75.13	83.81	85.00

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Major Insurer Bond Yields

Company	Coupon	Maturity	Price			Spread		
			Current	Change	Yield	B.P.	Change	
Life	Aflac	8.500%	5/15/2019	\$124.56	\$1.18	4.77%	195	(4)
	Ameriprise	5.300%	3/15/2020	\$109.25	\$0.67	4.04%	106	2
	Genworth	6.515%	5/15/2018	\$102.32	\$0.43	6.10%	348	5
	Lincoln National	8.750%	7/15/2019	\$129.74	\$0.68	4.37%	151	0
	MassMutual	8.875%	6/15/2039	\$142.03	\$1.15	5.82%	154	4
	MetLife	4.750%	2/15/2021	\$103.29	\$1.04	4.33%	115	(1)
	Mutual of Omaha	6.800%	6/15/2036	\$105.72	\$0.88	6.34%	226	4
	New York Life	6.750%	11/15/2039	\$118.05	\$1.28	5.49%	119	2
	NLV Financial	7.500%	8/15/2033	\$117.69	\$0.78	6.04%	212	5
	Northwestern Mutual	6.063%	3/15/2040	\$109.50	\$1.35	5.41%	110	2
	Pacific Life	9.250%	6/15/2039	\$136.01	\$1.12	6.46%	221	4
	Principal	6.050%	10/15/2036	\$107.56	\$1.60	5.49%	137	3
	Prudential	4.500%	11/15/2020	\$101.16	\$0.90	4.35%	121	0
	TIAA	6.850%	12/15/2039	\$117.90	\$1.32	5.59%	131	2
P&C	ACE INA	5.900%	6/15/2019	\$113.72	\$0.96	3.91%	107	(0)
	Allstate	7.450%	5/15/2019	\$121.82	\$0.74	4.21%	141	2
	American Financial	9.875%	6/15/2019	\$126.60	\$0.73	5.72%	287	1
	Berkshire Hathaway	5.400%	5/15/2018	\$112.26	\$0.66	3.42%	85	1
	Travelers	3.900%	11/15/2020	\$97.86	\$0.88	4.18%	104	(1)
	XL Group	6.250%	5/15/2027	\$102.37	\$0.87	6.02%	250	4
Other	AON	5.000%	9/15/2020	\$103.89	\$0.79	4.49%	134	(1)
	AIG	5.850%	1/15/2018	\$106.80	\$0.61	4.65%	215	(1)
	Fidelity National	7.875%	7/15/2020	\$111.50	\$0.06	6.21%	424	1
	Hartford	5.500%	3/15/2020	\$105.48	\$0.94	4.74%	173	(2)
	Marsh	9.250%	4/15/2019	\$130.83	\$1.88	4.57%	166	(22)
	Nationwide	9.375%	8/15/1939	\$128.90	\$1.71	7.01%	276	(2)
Health	Aetna	3.950%	9/15/2020	\$99.42	\$0.71	4.03%	92	4
	CIGNA	5.125%	6/15/2020	\$106.92	\$0.95	4.20%	112	(0)
	United Healthcare	3.875%	10/15/2020	\$98.35	\$0.97	4.09%	96	(1)
	Wellpoint	4.350%	8/15/2020	\$102.29	\$1.01	4.05%	96	(3)

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

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