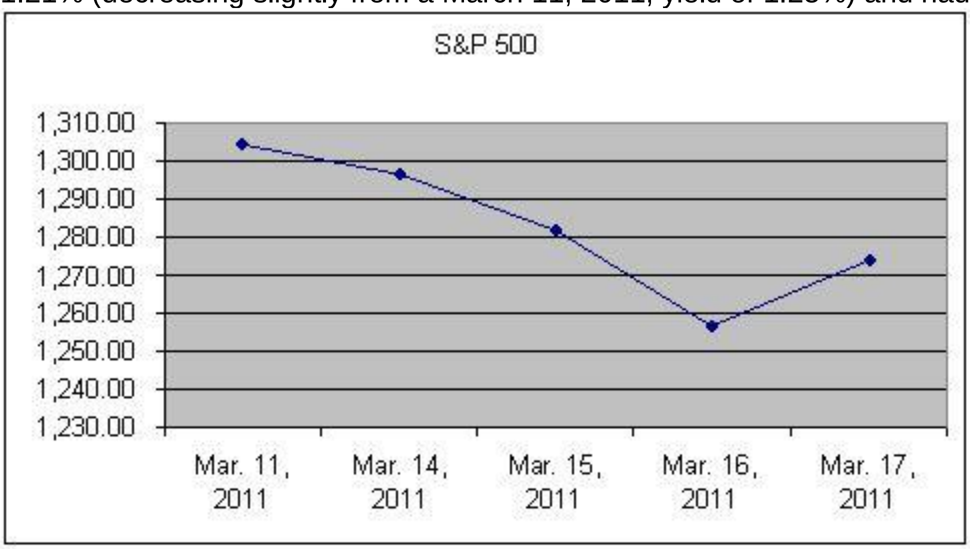
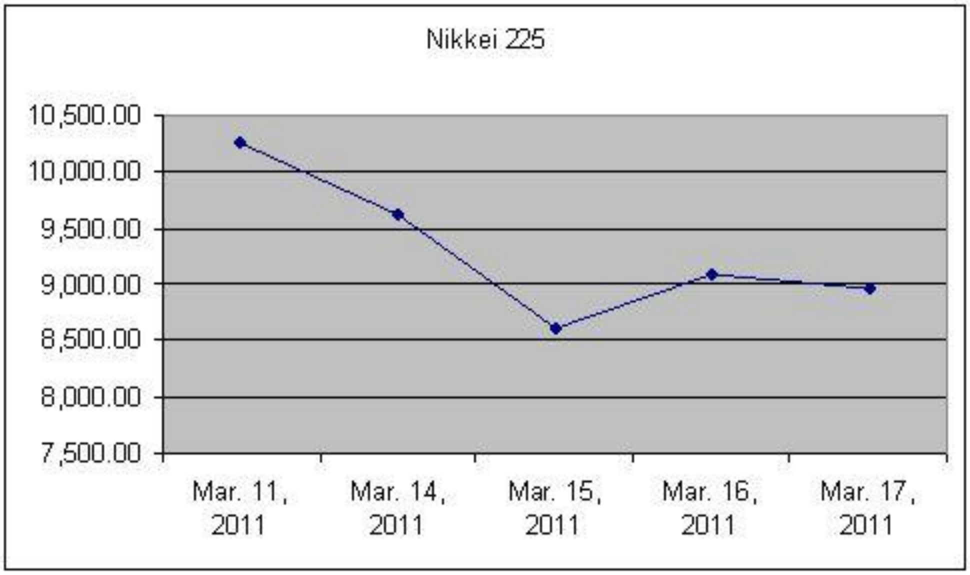
The **NAIC's Capital Markets Bureau** monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of US insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the **index**

Insurance Company Investments in Japan

Since the earthquake and tsunami occurred in Japan just over one week ago, and with subsequent nuclear power plant damage and radiation leaks, financial markets worldwide have been impacted. While the Bank of Japan has infused capital into the Japanese financial system to bolster liquidity, Japan's trading partners and overseas customers are uncertain about potential "supply-chain" disruptions with Japanese corporations. Many ports and docks have been destroyed, railroad transport has been disrupted and, in the severely affected areas — especially those areas that have experienced problems with their nuclear facilities — employees have fled.

The resulting volatility in the financial markets has extended worldwide. In the United States, some transactions in the fixed-income market have been put on hold, including a few high-yield bond offerings. U.S. equity markets, as measured by the S&P 500, were up 1.3% as of March 17, 2011, to 1,273.13 from the day prior. On March 11, 2011, the Nikkei 225 index closed at 10,254.43, but dropped to 8,962.7 as of March 17, 2011, despite a short-term rise due in part to the Japanese government's liquidity infusion. With the Bank of Japan's efforts, the yield on the 10-year Japanese government bond remained relatively unchanged from a few days prior at 1.21% (decreasing slightly from a March 11, 2011, yield of 1.25%) and had a price of 100.8.





As Japanese insurers and financial firms sell liquid assets to generate cash for rebuilding efforts, demand for the yen is also on the rise. The dollar was at 79.07 yen as of March 17, 2011, a 0.6% decrease from the day prior. This was a welcome sign, as the value of the yen had been on the rise despite the central bank's efforts, likely due to Japanese institutions and households bringing money home from investments abroad. In an attempt to keep the value of the yen down, thereby making Japan's exports less expensive, Japan's Finance Ministry has sold yen through the Bank of Japan. After a meeting of the G-7 countries, they also have agreed to cooperate in making efforts to assist with minimizing the yen's volatility.

U.S. Insurance Company Exposure

U.S. insurance company exposure to Japanese-domiciled securities was $46.4 billion as of year-end 2010. Almost all of this exposure was in bonds, with 55% of the bond exposure ($24.6 billion) representing Japanese national government bonds. The remaining bond exposure included $12.6 billion in Japanese corporate bonds (27% of bond exposure) and $7.4 billion (16% of bond exposure) in other government issues, such as with prefectures, which are similar in concept to U.S. states. Almost all of this exposure was held across a small number of U.S.-domiciled insurance companies with substantial business in Japan.

Given Japan's liquid government debt market, and that it is the world's third-largest economy, exposure to its national bonds will likely not be jeopardized in terms of ability to pay debt service. With regard to other government debt, such as that of the prefectures, it is possible that Japan's central government also will assist financially with respect to the debt of regional and local governments severely affected by the disaster. Standard & Poor's research states that Japan's "current system supports the credit quality of municipalities, [but] it does not ensure timeliness of debt payments. In addition, it lacks a legal framework that allows the central government to take prompt corrective action before fiscal reconstruction is undertaken."

Corporate Bond Exposure

Greater uncertainty lies with insurance company exposure to Japanese corporate bonds. Some issuers might benefit from being part of U.S., international or even nationally diversified entities. Others, however, might be materially negatively impacted because of their specific industry sector. For example, the Japanese insurance industry is expected to incur losses depending on the types of coverage provided and reinsurance programs. Recent estimates suggest insured losses of $15 billion to $35 billion, which do not yet include losses resulting from the tsunami. According to Moody's, additional industries that will likely be negatively affected include power utility companies, regional banks operating in the three prefectures most affected and the transportation industry (particularly railroad).

On average, as of year-end 2010, the market value of insurance companies' total exposure to Japanese-domiciled bonds was 103.5% of par. This included Japanese national government bonds, political subdivisions and agencies. For corporate bond exposure only, the market value was slightly less, at 102.8% of par, as of year-end 2010. As of March 17, 2011, the market value for approximately 80% of the same year-end 2010 corporate bond portfolio (that is, for those corporate bonds whose prices were available), increased to 105.3% of par.

The largest three corporate bond concentrations as of year-end 2010 included Tokyo Electric Power at $808.8 million (book/adjusted carrying value), followed by Bank of Tokyo Mitsubishi ($632.0 million) and Sumitomo Trust and Bank ($629.7 million). Altogether, they represent approximately 16% of the corporate bond exposure. Given the size and diversity of the two aforementioned banks, exposure within the corporate bond portfolio might not significantly be at risk. However, exposure to power companies should be monitored carefully, as it is an industry that could be negatively impacted by the dual disaster. While some of Tokyo Electric Power Company's facilities have been severely damaged, Japanese government officials have taken charge of the Tokyo Electric Power Company in an effort to control the nuclear crisis. The Japanese government also has amassed a team to help restore power to Japan, even amid the threat of radiation exposure.

Small Equity Exposure

Insurance companies had exposure to approximately $1.7 billion in Japanese common stocks, which represented 3.7% of total investments, as of year-end 2010. The common stock portfolio was relatively diversified, with the largest holding, Toyota Motor Corp., representing $75.3 million of the common stock exposure, or approximately 4%, followed by $70.5 million in Daiwa Securities Group and $44.2 million in Canon Inc.

March 18, 2011
Major Insurer Share Prices

		Close	Change % Week	QTD	YTD	Prior Week	Quarter	Year
Life	Aflac	$50.65	(8.8)	(10.2)	(10.2)	$55.55	$56.43	$56.43
	Ameriprise	61.12	(1.7)	6.2	6.2	62.18	57.55	57.55
	Genworth	12.73	(2.1)	(3.1)	(3.1)	13.00	13.14	13.14
	Lincoln	29.56	(2.4)	6.3	6.3	30.28	27.81	27.81
	MetLife	43.98	(4.1)	(1.0)	(1.0)	45.85	44.44	44.44
	Principal	31.75	(1.8)	(2.5)	(2.5)	32.33	32.56	32.56
	Protective	25.75	(5.3)	(3.3)	(3.3)	27.18	26.64	26.64
	Prudential	60.65	(3.9)	3.3	3.3	63.10	58.71	58.71
	UNUM	25.68	(2.4)	6.0	6.0	26.32	24.22	24.22
PC	ACE	$60.86	(0.9)	(2.2)	(2.2)	$61.39	$62.25	$62.25
	Axis Capital	32.59	(3.6)	(9.2)	(9.2)	33.82	35.88	35.88
	Allstate	31.13	(2.7)	(2.4)	(2.4)	31.99	31.88	31.88
	Arch Capital	90.97	0.5	3.3	3.3	90.54	88.05	88.05
	Cincinnati	32.60	(1.5)	2.9	2.9	33.08	31.69	31.69
	Chubb	58.13	(1.6)	(2.5)	(2.5)	59.06	59.64	59.64
	Everest Re	81.79	(2.1)	(3.6)	(3.6)	83.52	84.82	84.82
	Progressive	20.67	(0.9)	4.0	4.0	20.85	19.87	19.87
	Travelers	58.16	(1.2)	4.4	4.4	58.88	55.71	55.71
	WR Berkley	30.13	(0.4)	10.0	10.0	30.26	27.38	27.38
	XL	21.95	(1.2)	0.6	0.6	22.22	21.82	21.82
Other	AON	$51.98	1.4	13.0	13.0	$51.25	$46.01	$46.01
	AIG	35.51	(4.9)	(26.4)	(26.4)	37.35	48.27	48.27
	Assurant	39.08	2.4	1.5	1.5	38.18	38.52	38.52
	Fidelity National	13.74	(1.4)	0.4	0.4	13.93	13.68	13.68
	Hartford	25.51	(7.6)	(3.7)	(3.7)	27.60	26.49	26.49
	Marsh	29.20	(3.5)	6.8	6.8	30.27	27.34	27.34
Health	Aetna	$35.14	(3.7)	15.2	15.2	$36.50	$30.51	$30.51
	Cigna	41.56	(4.6)	13.4	13.4	43.57	36.66	36.66
	Humana	64.94	0.8	18.6	18.6	64.45	54.74	54.74
	United	42.57	(2.3)	17.9	17.9	43.59	36.11	36.11
	WellPoint	66.68	(1.9)	17.3	17.3	67.98	56.86	56.86
Monoline	Assured	$14.46	1.4	(18.3)	(18.3)	$14.26	$17.70	$17.70
	MBIA	10.06	(2.0)	(16.1)	(16.1)	10.27	11.99	11.99
	MGIC	8.62	0.5	(15.4)	(15.4)	8.58	10.19	10.19
	PMI	2.73	(4.2)	(17.3)	(17.3)	2.85	3.30	3.30
	Radian	6.69	(4.4)	(17.1)	(17.1)	7.00	8.07	8.07
	XL Capital	21.95	(1.2)	0.6	0.6	22.22	21.82	21.82

March 18, 2011
Major Market Variables

		Close	Change % Week	QTD	YTD	Prior Week	Quarter	Year
Dow Jones Ind		11,858.52	(1.5)	2.4	2.4	12,044.40	11,577.51	11,577.51
S&P 500		1,279.21	(1.9)	1.7	1.7	1,304.28	1,257.64	1,257.64
S&P Financial		218.96	(1.6)	2.0	2.0	222.56	214.77	214.77
S&P Insurance		191.05	(2.6)	1.5	1.5	196.24	188.22	188.22
US Dollar $			Change %			Prior		
	/ Euro	$1.42	1.9	5.9	5.9	$1.39	$1.34	$1.34
	/ Crude Oil bbl	101.45	0.3	10.0	10.0	101.16	92.22	92.22
	/ Gold oz	1,419.00	(0.2)	(0.1)	(0.1)	1,421.80	1,420.78	1,420.78
Treasury Ylds %		%	Change			%	%	%
	1 Year	0.22	(0.01)	(0.05)	(0.05)	0.23	0.27	0.27
	10 Year	3.27	(0.14)	(0.03)	(0.03)	3.41	3.30	3.30
	30 Year	4.42	(0.13)	0.08	0.08	4.55	4.34	4.34
Corp Credit Spreads -bp			Change %			Prior		
	CDX.IG	89.54	4.0	5.3	5.3	86.08	85.00	85.00
	CDX.XO	144	(11.9)	(24.9)	(24.9)	163.5	191.67	191.67

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