Capital Markets Special Report

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

U.S. Insurer Bank Loan Exposure as of Year-End 2018

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Executive Summary

- Reporting bank loans as a separate line item is new for U.S. insurers' annual statements as of year-end 2018.
  - The NAIC *Statement of Statutory Accounting Principles (SSAP) No. 26R—Bonds* is applicable to bank loans reported in Schedule D Part 1.
  - Bank loans that qualify as cash equivalents or short-term assets are reported in Schedule E Part 2 or Schedule DA, respectively.
- U.S. insurer exposure to bank loans was $53.7 billion in book/adjusted carrying value (BACV) as of year-end 2018.
  - The exposure was 1% of total cash and invested assets and 3% of total capital and surplus.
  - The exposure represented 2.3% of total U.S. bank loans outstanding as of February 2019, according to St. Louis Federal Reserve data.
- Liquidity may become an issue for some U.S. insurers, particularly for small insurers where these assets may be a significant percentage of total capital and surplus.

As of year-end 2018, U.S. insurers reported bank loans issued directly or acquired through a participation, syndication or assignment as a separate line item in the investment schedules. SSAP No. 26R defines bank loans as a security representing a creditor relationship, with a fixed schedule of at least one future payment, and it applies to bank loans reported in Schedule D Part 1. However, if a bank loan qualifies as cash equivalent or a short-term asset, it is reported in Schedule E Part 2 or Schedule DA, respectively; and it follows guidance pursuant to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*.

Leveraged bank loans are loans made by a group of lenders to companies whose credit quality is typically rated below investment grade. Broadly syndicated loans (BSLs) are the largest portion of the leveraged bank loan market; they are syndicated by originating banks to investors. The NAIC Capital

Markets Bureau published a broad discussion and definition of bank loans in a primer titled "Leveraged Bank Loans" in November 2018. This special report analyzes U.S. insurer exposure to bank loans as of year-end 2018.

As of year-end 2018, U.S. insurer exposure to bank loans was reported to be $53.7 billion in BACV, which was 1% of total cash and invested assets and 3% of total capital and surplus. Bank loans are reported either as loans issued (by the insurer directly) or loans acquired in a market transaction. Loans issued directly by an insurer may be deemed riskier than loans acquired, due to a lack of transparency in origination. As shown in Table 1, the majority of bank loans comprised acquired loans at 93% of the total, and life companies reported 74% of total bank loan exposure.

Table 1: U.S. Insurer Bank Loan Exposure as of Year-End 2018 (BACV, $Mil.)

Loan Classification	Life	P/C	Health	Fraternal	Title	Total	Pct of Total
Loans Acquired	37,045	10,898	1,460	504	209	50,117	93%
Loans Issued	2,720	827	0	-	-	3,547	7%
Total	**39,765**	**11,725**	**1,460**	**504**	**209**	**53,664**	**100%**
Pct of Total	74%	22%	3%	1%	0%	100%	

An insignificant portion (less than 1%) of U.S. insurers' bank loan exposure was reported as short-term in Schedule DA ($216 million) and as cash equivalents in Schedule E Part 2 ($15 million).

Large insurers, or those with at least $10 billion of cash and invested assets, held 85% of the BACV of bank loan exposure reported in Schedule D Part 1, or $45.7 billion. Small insurers, those with cash and invested assets of less than $500 million, held about 1% of the exposure ($507 million) reported in Schedule D Part 1.

According to Standard and Poor's (S&P) Leveraged Commentary and Data, U.S. leveraged loan new issuance was $609 billion in 2018, down from $650 billion in 2017. There is an estimated $2.3 trillion in outstanding bank loans according to the St. Louis Federal Reserve, which means U.S. insurer exposure was about 2.3% of outstanding bank loans at year-end 2018.

NAIC Designation of Bank Loans

Only 22% of bank loans reported in Schedule D Part 1 were investment grade as of year-end 2018 based on NAIC 1 or NAIC 2 designations. Almost 80% were deemed non-investment grade, with the largest concentration (41%) carrying NAIC 4 designations (see Table 2). The relatively high concentration of investment grade bank loan exposure by U.S. insurers, unlike the S&P/Loan Syndications and Trading Association (LSTA) Index (an index of senior secured, floating rate leveraged loans compiled by S&P and the LSTA) which is comprised of non-investment grade loans, reflects the historical composition of credit quality of U.S. insurer fixed income exposure.

Table 2: NAIC Designation of U.S. Insurer Bank Loan Exposure from Schedule D Part 1 as of Year-End 2018 (BACV, $Mil.)

NAIC Designation	Life	P/C	Health	Fraternal	Title	Total	Pct of Total
1	3,706	48	3	-	-	3,757	7%
2	6,802	1,043	101	33	17	7,996	15%
3	8,479	3,200	456	245	105	12,485	23%
4	14,713	6,302	856	219	66	22,156	41%
5	5,793	1,044	37	6	17	6,897	13%
6	103	16	8	-	1	129	0%
N/A	-	11	0	-	-	12	0%

Life companies reported higher exposure to bank loans designated NAIC 1 or NAIC 2 for a total of 27%, whereas other insurer types trended toward investing in higher yielding bank loans, with investment grade exposure at 9% or less of total bank loan exposure.

In terms of capital structure position, about 93% of bank loans reported in Schedule D Part 1 were reported as senior loans; senior secured loans were 59% of the senior bank loan exposure, while senior unsecured loans accounted for 34%. Subordinated loan exposure was about 1% of bank loans. The maturity distribution was tilted towards the short end, with 51% of reported bank loans having maturities of five years or less as of year-end 2018; 45% were reported to have maturities between five years and 10 years. Long maturities of greater than 10 years accounted for 4% of U.S. insurer bank loan exposure.

Notable Bank Loan Exposure Among U.S. Insurers

In BACV terms, U.S. insurers with the largest 10 exposures accounted for 53% of the industry's total bank loan exposure, with the largest accounting for 11%. U.S. insurers reported exposure to 3,359 unique borrowers. The most widely held was First Data Corporation, a provider of commerce-enabled technology and solutions for merchants, financial institutions and card issuers globally; ($310 million) followed by Vistra Energy, a U.S. retailer of electric and electrical services ($248 million). Table 3 is a list of the 10 most widely held bank loans reported by U.S. insurers as of year-end 2018.

Table 3: 10 Most Widely Held Bank Loans as of Year-End 2018 (BACV, $Mil.)

Company	BACV
First Data Corporation	310
Vistra Energy	248
SS&C Technologies Inc	244
Level 3 Financing, Inc.	232
Las Vegas Sands, LLC/Venetian Casino Resort, LLC	223
Scientific Games Inc.	215
DaVita Inc. (DaVita HealthCare Partners Inc.)	210
Valeant (Bausch Health)	204
Transdigm Inc.	196
Caesars Entertainment Op Co Inc	189
Total	**2,271**
Pct of Total Bank Loans	4%

Small insurers (those with total cash and invested assets of up to $500 million) accounted for 16 of the 216 insurers reporting bank loan exposure.

Summary

Year-end 2018 was the first year that U.S. insurers were required to report bank loans as a separate line item in their annual statement filings. Bank loans were less than 1% of total cash and invested assets for U.S. insurers at year-end 2018; and based on NAIC designations, bank loans primarily represented a source of yield pick-up (and diversification) more so than the "traditional" investments (such as corporate bonds). This is a positive trend, given that the market for bank loans can be volatile, and it is relatively unseasoned.

While bank loan issuance has experienced steady growth in recent years, bank loans are still considered to be illiquid relative to other fixed income securities. The risk is greatest especially for those insurers where bank loans may be a significant percentage of total capital and surplus.

The Capital Markets Bureau will continue to monitor bank loan exposure trends within the insurance industry and report on any developments as deemed appropriate.

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