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The NAIC Capital Markets Bureau monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. Previously published NAIC Capital Markets Bureau Special Reports are available via its web page and the NAIC archives (for reports published prior to 2016).

U.S. Insurance Industry's Exposure to Commercial Mortgage-Backed Securities Totals Almost $300 Billion at Year-End 2022

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Executive Summary

- U.S. insurance companies reported $293 billion in commercial mortgage-backed securities (CMBS) at year-end 2022, an increase of 5.6% compared to year-end 2021.
- CMBS represented 29.9% of the U.S. insurance industry's total commercial real estate (CRE) exposure and 2.7% of the industry's total cash and invested assets.
- Private-label CMBS accounted for approximately three-quarters of U.S. insurers' CMBS exposure at year-end 2022, with agency CMBS accounting for the remainder.
- The credit quality of the CMBS portfolio has weakened modestly over time, with CMBS investments carrying an NAIC 1 Designation, declining to 94% from 97% of total exposure at year-end 2022 and year-end 2019, respectively.
- CMBS new issuance in the U.S. has been hard hit by two headwinds; i.e., uncertainty in the office sector amid the shift to a hybrid work environment and high interest rates.

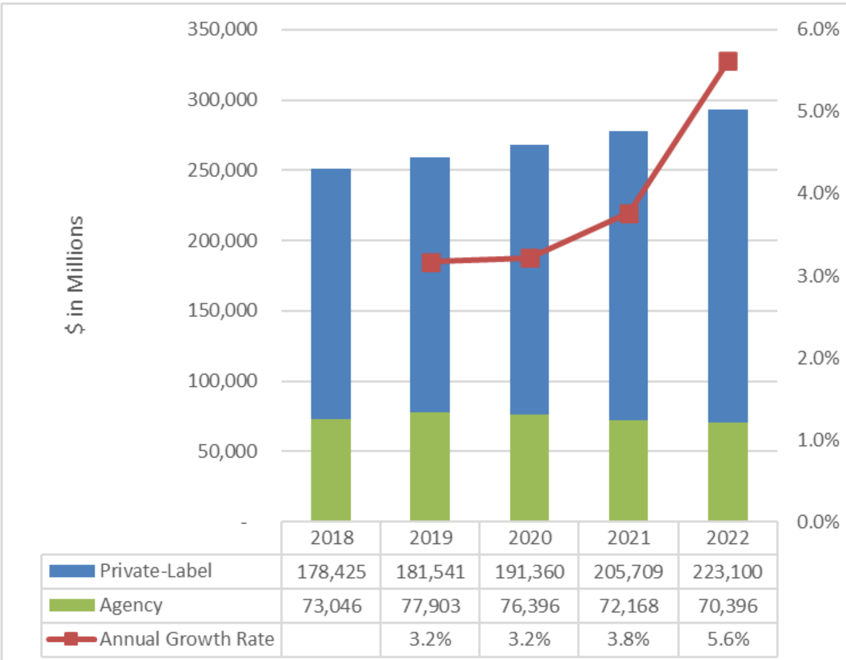
The U.S. insurance industry is exposed to commercial real estate (CRE) through various investments, including commercial mortgage-backed securities (CMBS), direct commercial mortgage loans (CMLs), owned real estate, and unsecured bonds issued by real estate investment trusts (REITs). Historically, CMBS has accounted for the second largest CRE exposure, following CMLs, for the overall insurance industry. As of year-end 2022, CMBS reported by U.S. insurance companies totaled $293 billion or 29.9% of the industry's total CRE exposure[1] and 2.7% of the industry's total cash and invested assets.

From 2018 through 2022, total U.S. insurer investments in CMBS have grown steadily on an absolute dollar basis, with private-label CMBS driving the growth for the most part. Total CMBS exposure increased by 5.6% on a year-over-year (YOY) basis in 2022, with private-label CMBS growing by 8.5% and agency CMBS declining by 2.5% (Refer to Chart 1). The YOY growth rate for total CMBS in 2022 was the

[1] NAIC Capital Markets Bureau Special Report, "U.S. Insurance Industry's Mortgage Loan Exposure Rises at Year-End 2022 as Commercial Real Estate Trends Deteriorate," August 2023, p. 3.

largest increase since 2018, while agency CMBS have experienced exposure declines over the last three years.

Chart 1: U.S. Insurance Industry Private-Label CMBS and Agency CMBS, Year-End 2018–2022



Note: Includes affiliated and unaffiliated investments.

Private-label CMBS accounted for approximately three-quarters of U.S. insurers' CMBS exposure at year-end 2022, with agency CMBS accounting for the remainder. The distribution by CMBS type has been relatively consistent over the past several years.

Similar to previous years, life and property/casualty (P/C) companies accounted for the majority of the industry's CMBS investments. Life companies held the largest share, or 70.1%, of the industry's CMBS in 2022, while P/C companies owned 25.7%. Health and title companies together represented approximately 4% of the industry's CMBS exposure. Note that life, P/C, and health companies invested proportionately more in private-label CMBS, while title companies invested more in agency CMBS.

Table 1: Total U.S. Insurance Industry CMBS by Type, Year-End 2022 (BACV$ in Millions)

CMBS Type	Life	P/C	Health	Title	Total	% of Total
Private-Label	164,700	48,188	10,199	13	223,100	76.0%
Agency	41,148	27,331	1,839	79	70,396	24.0%
Total	**205,849**	**75,518**	**12,038**	**92**	**293,497**	**100.0%**
% of Total	70.1%	25.7%	4.1%	0.0%	100.0%	

Note: Numbers in the table have been rounded.

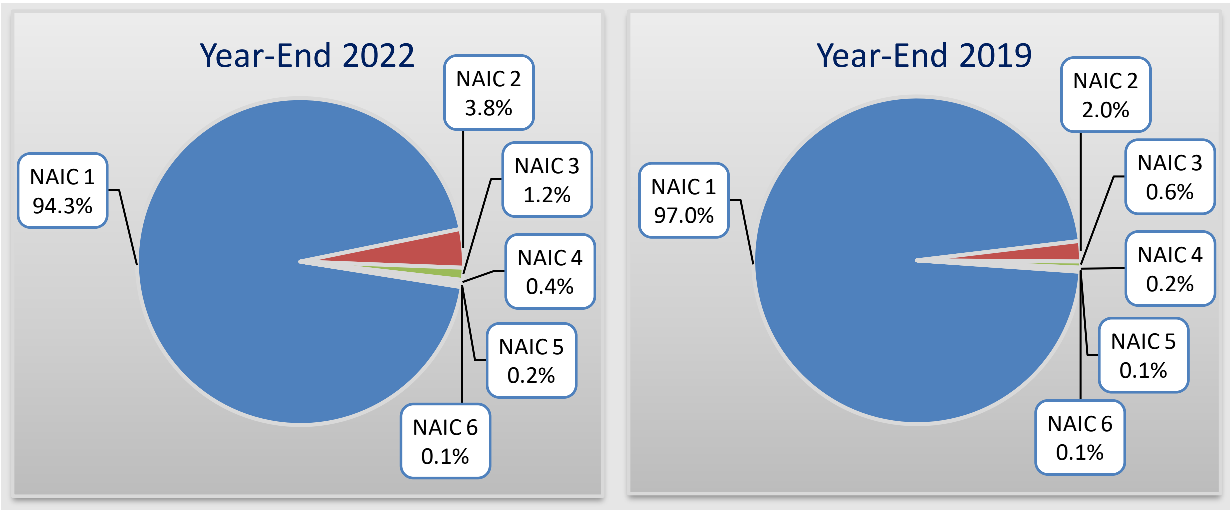
While it accounted for the second largest CRE exposure for life insurance companies, CMBS represented P/C companies' largest CRE exposure.

Commercial Mortgage-Backed Securities Portfolio Credit Quality Weakens Over Time

The U.S. insurance industry's CMBS investments are often in the most senior triple-A rated tranches, which are typically structured with considerable credit enhancement. At year-end 2022, approximately 94% of U.S. insurers' CMBS investments carried an NAIC 1 Designation, which is unchanged from the previous year. Together with investments carrying an NAIC 2 Designation, approximately 98% of CMBS exposure was considered investment grade or high credit quality.

However, over a longer time period, the credit quality of the CMBS portfolio has deteriorated modestly (Refer to Chart 2 and Chart 3). Compared to year-end 2019, CMBS investments carrying an NAIC 1 Designation declined to 94% from 97% of total exposure, while investments carrying an NAIC 2 Designation increased to nearly 4% from 2%. In addition, CMBS with an NAIC 3 Designation and lower accounted for 2% of the year-end 2022 CMBS portfolio compared to 1% at year-end 2019.

Chart 2 and Chart 3: Reported Credit Quality of the U.S. Insurance Industry's CMBS Portfolio at Year-End 2022 (Left) and Year-End 2019 (Right)

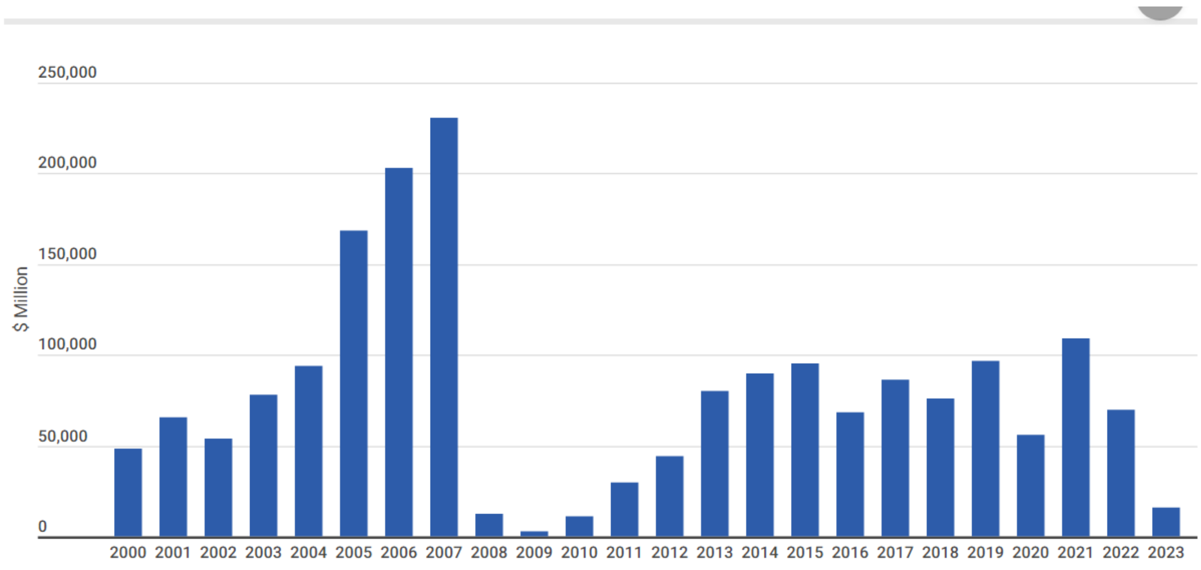


U.S. Commercial Mortgage-Backed Securities Market and New Issuance Trends

The CRE sector faces significant headwinds. The hybrid work environment became more widely adopted during the COVID-19 pandemic and remains a more common work model. This has led to significant occupancy concerns within the office sector, which can ultimately pressure CMBS fundamentals and valuations. In addition, high interest rates have created a new challenge for existing commercial mortgages that are due for refinancing, as well as the financing of new projects. For additional details related to CRE market trends, please refer to the NAIC Capital Markets Bureau special report, "U.S. Insurance Industry's Mortgage Loan Exposure Rises at Year-End 2022 as Commercial Real Estate Trends Deteriorate," which was published in August 2023.

CMBS new issuance in the U.S. has been hard hit by these headwinds. Based on Trepp data, private-label CMBS issuance totaled $16.5 billion in the first half of 2023, a significant decline from approximately $50 billion during the same period in 2022 (Refer to Chart 4). Private-label CMBS issuance in 2022 totaled $70 billion, a 36% decrease from $109 billion in 2021.

Chart 4: U.S. Private-Label CMBS Issuance, 2000–June 2023



Source: Trepp.

S&P Global Ratings (S&P) believes CMBS issuance will remain subdued for the remainder of 2023 amid the recent rise in long-term interest rates. S&P estimates that private-label CMBS issuance will end the year in the $30- to $40-billion range, a decline from its initial forecast of $60 billion. [2]

The NAIC Capital Markets Bureau will continue to monitor trends in the U.S. insurance industry's CMBS investments and report as deemed appropriate.

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

[2] S&P Global Ratings, U.S. CMBS Update Q2 2023: The Market Continues to Adjust While Offices Drive Credit Concerns, July 14, 2023.