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U.S. Insurer Exposure to Bank Loans Increased by 17.5% at Year-End 2019

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Executive Summary

- U.S. insurers' exposure to bank loans totaled \$63 billion in book/adjusted carrying value (BACV) as of year-end 2019, representing a 17.5% increase from approximately \$54 billion at year-end 2018.
- The majority of the industry's bank loan exposure, or 93%, was unaffiliated, and 80% of the total exposure was held by life companies at year-end 2019. Large life companies, or those with more than \$10 billion in assets under management, accounted for 87% of total bank loan exposure.
- The composition of leveraged loans rated B and below reached an all-time high in April 2020. About 36% of U.S. insurers' bank loan exposure carried NAIC 4 designations (comparable to the nationally recognized statistical ratings organizations (NRSROs) single B ratings category).
- Leveraged loan new issuance so far in 2020 was \$149 billion as of early May. Total leveraged loans outstanding were about \$1.2 trillion at year-end 2019.

U.S. Insurer Exposure

As of year-end 2019, U.S. insurers had approximately \$63 billion in BACV exposure to bank loans, as reported in the annual statement filings. This represents a 17.5% increase in total bank loan exposure for the U.S. insurance industry year-over-year (YOY), as year-end 2018 exposure was approximately \$54 billion. At year-end 2019, the majority, or 76.1%, was held by life companies, followed by about 21.2% with property/casualty (P/C) companies

(see Table 1). While total bank loan exposure includes those reported in Schedule D Part 1, Schedule DA Part 1, and Schedule E Part 2, 99.6% of the exposure was reported in Schedule D Part 1. Note that beginning with the year-end 2019 annual statement filings, fraternal companies' reported data is now combined with that of life companies' reported data.

Table 1: U.S. Insurer Exposure to Bank Loans – Year-End 2019 (\$BACV)

Loan Type	Life	P/C	Health	Title	Total	% of Total
Affiliated Bank Loans Acquired	80,245,362	300,000,000			380,245,362	0.6%
Affiliated Bank Loans Issued	3,927,567,208				3,927,567,208	6.2%
Unaffiliated Bank Loans Acquired	39,023,118,867	12,804,727,104	1,610,645,032	145,433,245	53,583,924,248	85.0%
Unaffiliated Bank Loans Issued	4,894,763,470	226,876,759	1,042,614		5,122,682,843	8.1%
Total	47,925,694,907	13,331,603,863	1,611,687,646	145,433,245	63,014,419,661	100.0%
% of Total	76.1%	21.2%	2.6%	0.2%	100.0%	

Table 1 also shows that unaffiliated bank loans accounted for the majority, or about 93%, of the U.S. insurance industry's bank loan exposure; 85% were acquired in market transactions as opposed to being issued directly by the reporting entity. The *Statement of Statutory Accounting Principles (SSAP) No. 26R—Bonds* defines bank loans as “fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired by a reporting entity through an assignment, participation or syndication.”

Table 2 shows that large insurers, or U.S. insurance companies with more than \$10 billion in assets under management, accounted for the majority, or 87.1%, of the industry's exposure to bank loans at year-end 2019. Companies with between \$1 billion and up to \$10 billion in assets under management accounted for 11.4%.

Table 2: Bank Loan Exposure by Industry Type and Assets Under Management (\$BACV), Year-End 2019

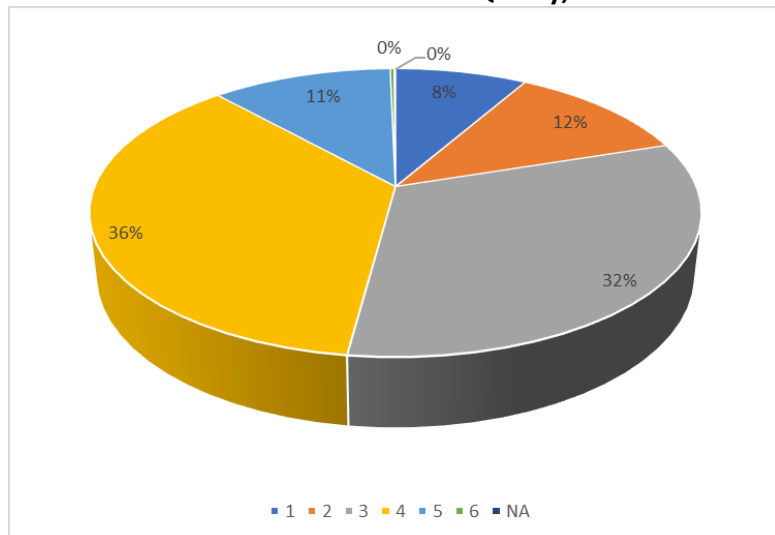
Assets Under Management	Life	P/C	Health	Title	Total	% of Total
Greater Than \$10B	46,758,182,115	7,780,192,329	335,673,254		54,874,047,698	87.1%
Between \$5.0B and \$10.0B	714,618,580	2,597,002,666	113,003,510		3,424,624,756	5.4%
Between \$2.5B and \$5.0B	220,926,138	1,361,243,874	301,045,578	77,511,346	1,960,726,936	3.1%
Between \$1.0B and \$2.5B	207,351,673	1,029,463,183	532,408,582	56,466,661	1,825,690,099	2.9%
Between \$500MM and \$1.0B	23,638,802	348,906,816	311,143,252	11,455,238	695,144,108	1.1%
Between \$250MM and \$500MM	728,524	166,298,085	17,024,431		184,051,040	0.3%
Less Than \$250MM	249,075	48,496,910	1,389,039		50,135,024	0.1%
Total	47,925,694,907	13,331,603,863	1,611,687,646	145,433,245	63,014,419,661	100.0%
% of Total	76.1%	21.2%	2.6%	0.2%	100.0%	

The top 10 insurance companies with bank loan exposure accounted for almost 60% of the total exposure as of year-end 2019, all of which were large life companies.

In terms of credit quality, as of year-end 2019, 68% carried NAIC 3 and NAIC 4 designations at year-end 2019 (a slight increase from 64% at year-end 2018), which is comparable to the BB and B-rating categories, respectively, as assigned by the NRSROs. In particular, bank loans carrying NAIC 4 designations, which is comparable to the

single B-rating category, accounted for about 36% of the industry’s total bank loan exposure. However, bank loans carrying NAIC 5 designations—i.e., in the CCC category—decreased to 11% in 2019 from 13% of bank loan exposure in 2018.

Chart 5: U.S. Insurer Bank Loan Credit Quality, Year-End 2019



Bank loans that were senior in terms of capital structure accounted for 89% of the U.S. insurance industry’s bank loan exposure as of year-end 2019, according to reported annual statement filings, which was a decrease from 93% as of year-end 2018. Senior secured loans were 58% of total senior loans, which is relatively consistent with year-end 2018. Senior unsecured loans were 42% of senior loans in 2019, compared to 34% in 2018. This in part is a function of the market’s bank loan inventory.

In terms of maturity, similar to year-end 2018, 96% of U.S. insurer bank loans were scheduled to mature in 10 years or less at year-end 2019. About 77% were scheduled to mature in five years or less, compared to about 70% of the bank loans making up the S&P/LSTA Leveraged Loan Index (S&P/LSTA Index).

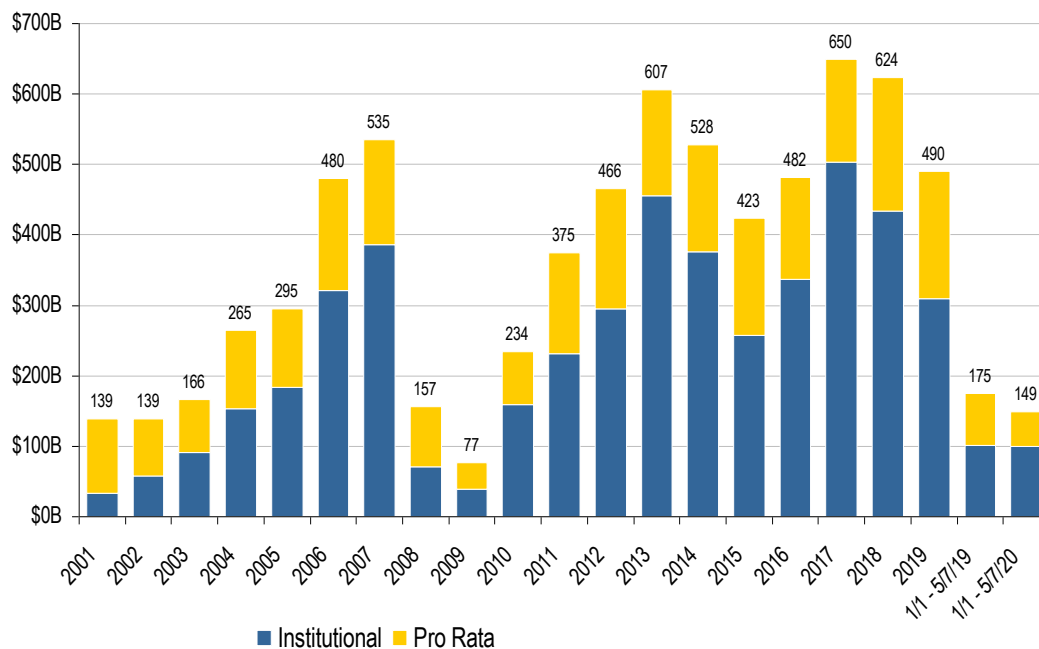
Leveraged Bank Loan Market Trends

By definition, leveraged bank loans are lent to companies with high-yield credit quality (rated below investment grade) by a group of lenders. Within a company’s capital structure, leveraged bank loans rank the highest in terms of payment priority, and they are considered senior secured credit. Leveraged bank loans comprise institutional loans—i.e., broadly syndicated term loans invested in by institutional investors—and pro rata loans, which include a revolving credit facility and a term loan, that are typically invested in by banks. According to Refinitiv LPC, the leveraged bank loan market was about \$1.2 trillion as of December 2019. YOY in March 2020, the market has grown by 6%. The volume of new issuance of leveraged loans so far in 2020 was \$149 billion as of early May 2020, including both pro rata and institutional loans (see Chart 1). For the full year of 2019, total new issuance volume was about \$490 billion. However, leveraged loan volume has been declining since 2017. Leveraged bank loans are floating rate instruments, so the decline in volume may have reflected increasing

interest rates, as the Federal Reserve had increased the federal funds rate seven times altogether in 2017 and 2018, perhaps making financing via bank loans less attractive than other alternatives.

FitchRatings research cites that as of March 2020, collateralized loan obligations (CLOs) were the second largest holders of leveraged bank loans, second to banks.¹ CLOs hold about \$700 billion of the leveraged bank loan market.

Chart 1 - Annual New-Issue Loan Volume (\$bil)



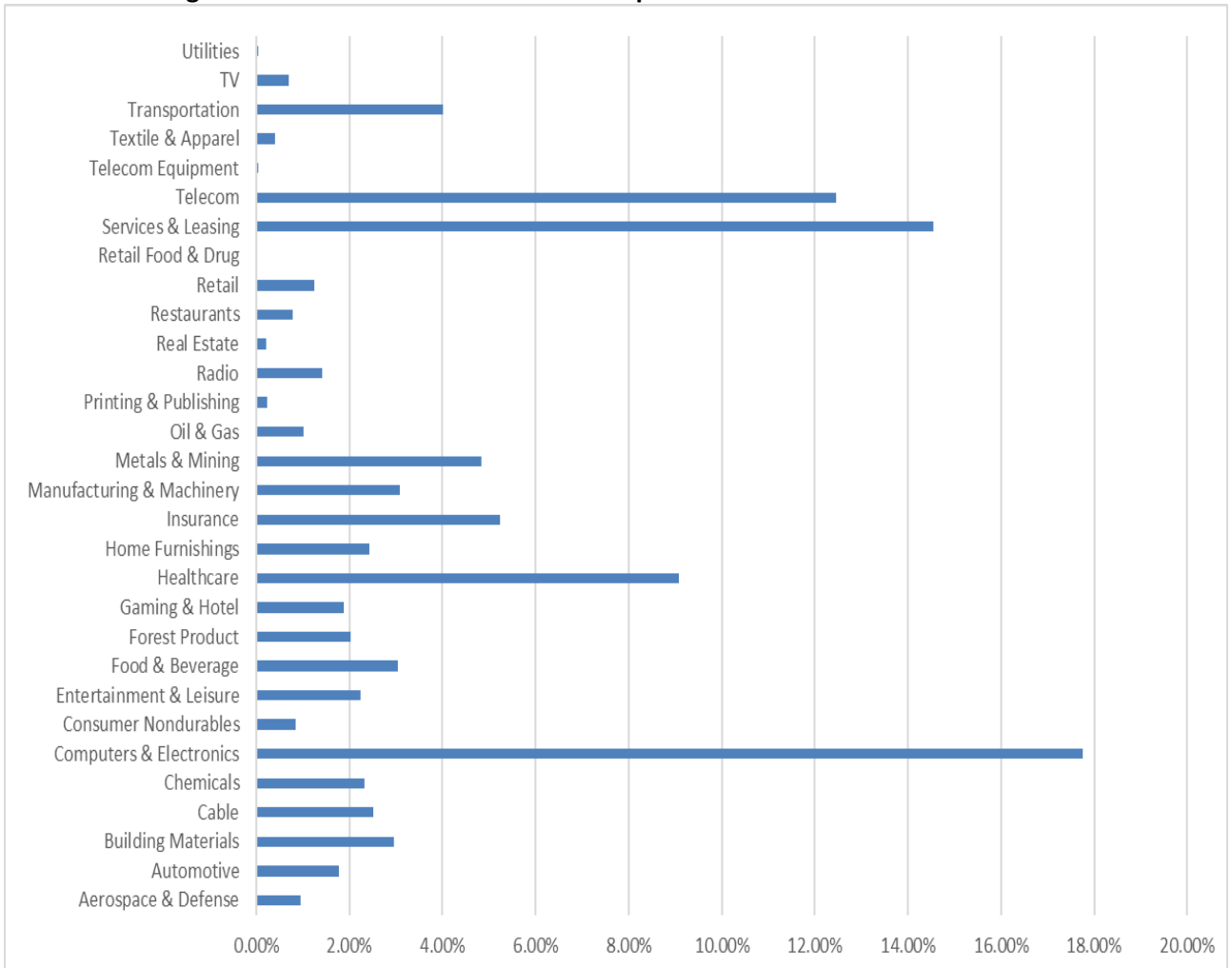
Source: S&P LCD, *LoanStats Weekly*, May 7, 2020

Industry Breakdown of Leveraged Loans

With regard to the composition of industries represented in the leveraged loan market, computers and electronics were the largest at almost 18% of total volume in April 2020 as shown in Chart 2, according to S&P Global data. The second and third largest industries were service and leasing at 14.5% and telecommunications at 12.4%, respectively.

¹ FitchRatings, *Fitch Leveraged Loans & CLOs in Financial Institutions – Update*, March 2020.

Chart 2 - Leveraged Loan Industries Breakdown as of April 2020

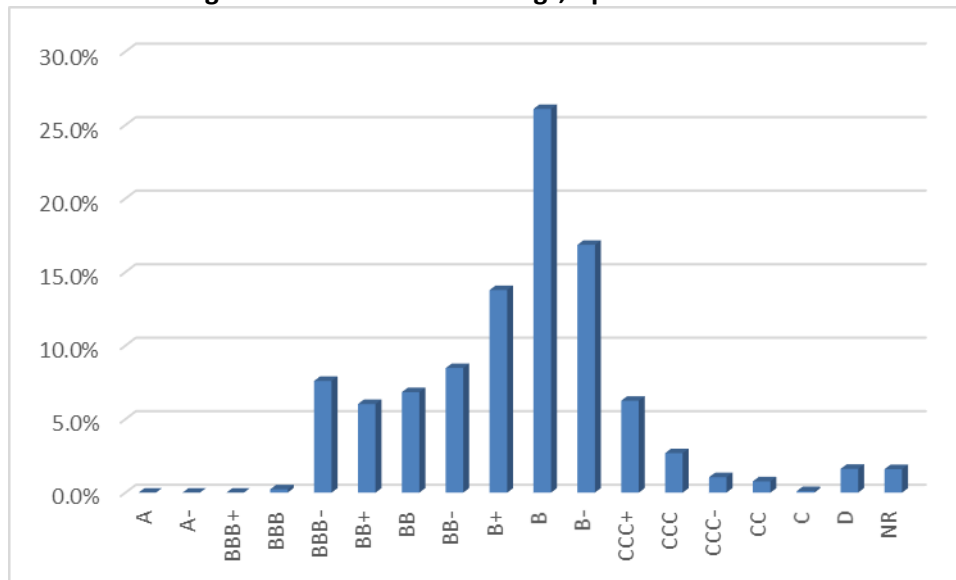


Source: S&P Global LCD

Increase In B-Rated Leveraged Loans

There was an increase in downgrades to corporate credits since year-end 2019, as the COVID-19 pandemic has affected the revenues of certain industries more than others, such as those in the retail, restaurant and leisure sectors. Loans rated B and lower totaled 55.4% of total leveraged loans (based on par) as of April 30 according to the S&P/LSTA Index (see Chart 3), compared to 46.9% a year prior and 50% at year-end 2019. In comparison, about 48% of U.S. insurer bank loan exposure at year-end 2019 was rated B and lower based on NAIC designations—slightly lower than the market, indicating perhaps marginally better credit quality.

Chart 3 – Leveraged Bank Loan Credit Ratings, April 2020.



Source: S&P/LSTA Leveraged Loan 100 Index

S&P Global Ratings research indicates that it lowered ratings on 114 leveraged loans in March 2020 such that the composition of leveraged loans rated B and below reached an all-time high.² To that end, loans rated CCC+ and below in April 2020 were 12.5%, compared to 8.1% in February 2020.

Further, as of early May, more than 400 of the approximately 1,500 obligors held in U.S. broadly syndicated loan CLOs had either been downgraded, placed on CreditWatch negative, or both, representing about 27% of total U.S. CLO collateral.³ These rating actions are due to the credit impact of COVID-19, as well as oil price volatility.

Leveraged Loan Default Rate Comparatively Lower

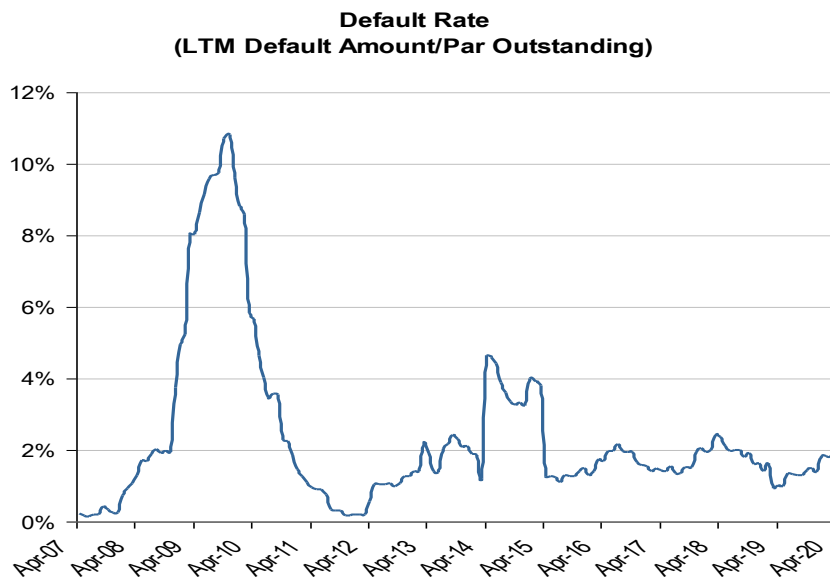
The last-12-month (LTM) U.S. leveraged loan default rate for outstanding leveraged loans (based on the dollar amount of defaults) was 2.3% as of April 2020, or \$27.1 billion, according to S&P LCD, compared to a peak of 10.8% in November 2009 (see Chart 5) and 1% in April 2019. The default rate is comparatively lower than that experienced after the financial crisis due, in part, to a preceding benign credit environment. However, this could change if the economic impact of the COVID-19 pandemic continues to negatively affect certain industries. Notwithstanding, according to S&P Global research, there were 11 defaulted loan issuers in April 2020, the most in a one-month period since 2009.⁴

² S&P Global, *Amid Record Leveraged Loan Downgrades, B- Debt Swells, CCC Loans Test CLO Limits*, April 2020.

³ S&P Global, *U.S. CLO Exposure to Negative Corporate Ratings Actions (As Of May 3, 2020)*, May 2020.

⁴ S&P Global, *In Grim Sign, U.S. Leveraged Loan Defaults Set Record in April*, May 2020.

Chart 5 – LTM Default Rate of Leveraged Bank Loans, Based on Par Outstanding



Source: S&P/LSTA Index LoanStats Monthly, April 2020.

Year-to-date (YTD), the oil and gas industry accounted for the largest defaults at \$6 billion, or 30.5% of the total defaulted loan volume, followed by telecommunications and then business equipment and services. See the Appendix for a graph of the industry composition of leveraged loan defaults as of April 30 based on the S&P/LSTA Index.

More background on leveraged bank loans can be found in the NAIC Capital Market Bureau’s primer on [Leveraged Bank Loans](#) published in November 2018.

Conclusion

U.S. insurers’ exposure to bank loans increased by 17.5% from year-end 2018 to year-end 2019, to approximately \$64 billion in BACV. This is perhaps due to the increase in interest rates by the Federal Reserve during 2017 and 2018. As bank loans are floating rate investments, an increase in interest rates means a higher yield for bank loans, making them relatively more attractive investments. YTD through May 2020, leveraged loan new issuance increased by \$149 billion according to S&P Global. Bank loans have been experiencing a decline in credit quality due to downgrades of corporate issuer ratings, particularly to those in industries most affected by the COVID-19 pandemic, with B-rated bank loans making up the majority of outstanding leveraged loans as of the end of April 2020. While a large proportion of U.S. insurer bank loan exposure is within the single-B ratings category, lending some comfort, the majority are in senior loans, atop the capital structure of a company’s debt burden. U.S. insurer investments in bank loans are also predominantly with large life companies, or those whose

assets under management exceed \$10 billion, and they are about 1% of the industry's total cash and invested assets.

The NAIC Capital Markets Bureau will continue to monitor trends with CLOs and leveraged bank loans and report, as appropriate.

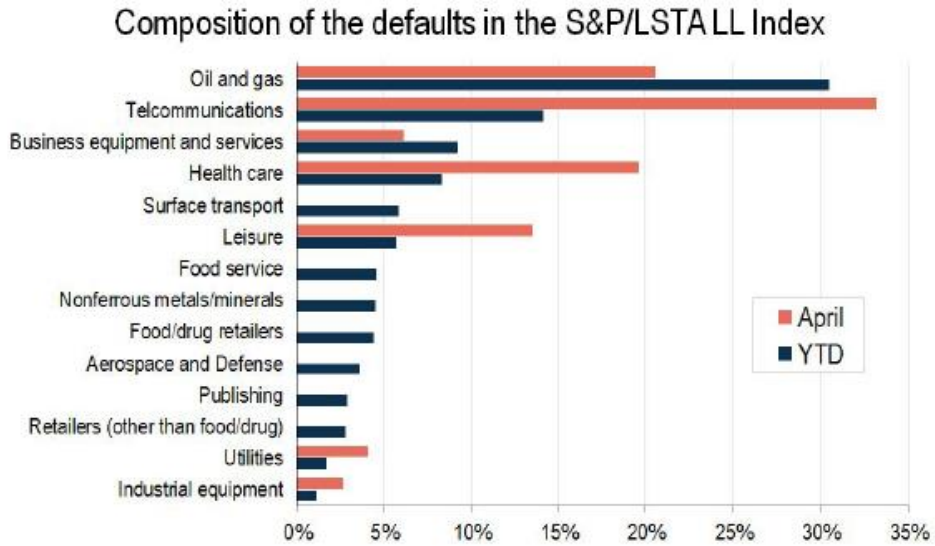
Useful Links:

[NAIC Capital Markets Primer – Leveraged Bank Loans, November 2018](#)

[NAIC Capital Markets Primer—Collateralized Loan Obligations, July 2018](#)

[NAIC Capital Markets Special Report - The Rise in the U.S. Insurance Industry's Exposure to Collateralized Loan Obligations as of Year-End 2019](#)

Appendix:



Data through April 30, 2020

Source: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index