40% of life insurers' bank loans below investment grade: AM Best

By Editorial Staff *Thu, Sep 12, 2019*

'The benefit of floating interest rates on bank loans, which somewhat protects insurers from rapidly rising interest rates, is further diminished in a continued low interest rate environment,' the rating agency's report said.

About three-quarters of the $40.6 billion in bank loans owned by the U.S. life/annuity companies are rated below investment grade, according to a new AM Best report.

The Best's Special Report, titled, "Bank Loans: Low Credit Quality, But Manageable Exposure," notes that bank loans are not yet widely held throughout the industry.

Bank loan holdings totaled over $54 billion in par value for the insurance industry as of year-end 2018. Life/annuity insurers own nearly three-quarters, at 74%, with property/casualty and health insurers owning 23% and 3%, respectively.

More than 90% of bank loans in the property/casualty and health segments are below investment grade, but they are concentrated primarily with the largest holders, who generally have a strong expertise in this asset class.

Most insurers that own bank loans below investment grade have exposure of less than 10% of capital and surplus. In the life/annuity segment, the top 10 bank loan holders owned 79% of the total bank loans as of year-end 2018.

Most of these companies are large, with over $7 billion in capital and surplus, and bank loans make up just a small percentage of their bond portfolios, typically less than 4%.

Insurers use bank loans primarily for diversification, as well as for gaining floating rate exposure and additional yield. Returns from loans have been generally high due to the lower credit quality and illiquidity.

Additionally, the overwhelming majority of these loans are senior debt, indicating that nearly all of these loans are in a favorable position for repayment in the event of a default.

"However, with even marginal borrowers able to access loans in a strong economy, the risk of loan defaults will rise as the economy turns," said Jason Hopper, an associate director on AM Best's industry research and analytics team.

The report adds that the benefit of floating interest rates on bank loans, which somewhat protects insurers from rapidly rising interest rates, is further diminished in a continued low interest rate environment.