# Insurers' Debt Remains Attractive To Investors During COVID-19 Uncertainty

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## Key Takeaways

- Despite higher credit spreads during 2020, the flight to quality has meant that insurers across the globe have retained good market access at favorable coupon rates and should be able to redeem or refinance the $140 billion (20% of total outstanding debt) coming up for call or maturity by Dec. 31, 2021.
- Insurance bonds remain attractive to investors, providing diversification, relatively favorable yields, and high security--with an average issuer credit rating in the 'A' category.
- We believe much of the issuance to date has been opportunistic. With some taking advantage of favorable market conditions instead of repairing weakened balance sheets.

Investors are particularly sensitive to credit quality when the economic environment is uncertain, which should advantage insurers' issuances. This is due to the relatively strong credit quality of insurers, which shines when compared with nonfinancial corporate sectors. S&P Global Ratings expects the sector to tap the debt market and refinance, as needed, its upcoming redemptions in line with investor expectations. In the hybrid space, we see the risk of non-call as very remote, particularly given that the potential financial savings from a non-call (even on a pretax basis) are relatively modest. Despite higher credit spreads triggered by the pandemic-induced recession and market jitters, insurers are still accessing the debt capital markets at favorable coupon rates. We estimate that about $140 billion (or 20% of total outstanding debt) of debt is coming for call or maturity by Dec. 31, 2021.

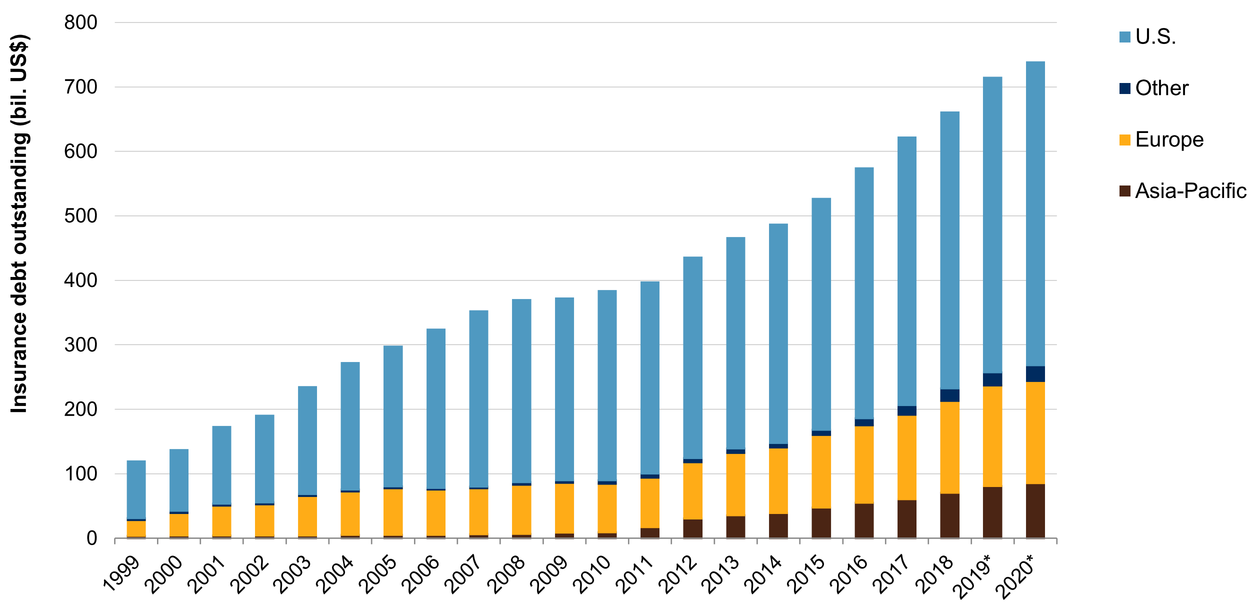
We recognize that some investors are cautious of potential losses to lockdown-related claims on the property/casualty (P/C) side and the capital market volatility hitting both life and P/C companies. In general we expect pandemic-related claims or investment losses to be more of an earnings event than a capital event. This is the reason that rating actions across the insurance sector have been limited this year. Some insurers could increase their use of debt at attractive rates to boost solvency ratios or for growth opportunities, particularly on the P/C side, where insurance pricing looks attractive.

## Debt Outstanding Is Steadily Climbing

Since the global financial crisis, lower funding costs from the low interest rates, as well as perhaps investors' tolerance for higher debt loads, has spurred the increased issuance of debt in global capital markets. Insurers' debt outstanding has also increased steadily, almost doubling in the past 10 years (chart 1). But that increase in insurers' debt has been broadly in line with their increase in capital and therefore financial leverage (20%-30%) remains supportive of our ratings. Although some subsectors (like the publicly traded U.S. health insurers) have seen higher financial leverage over the past decade, most insurance sectors globally have not seen a meaningful increase in leverage. However, in the main, insurers, particularly mutuals, don't rely heavily on debt compared with corporates, particularly bearing in mind that only a small portion of insurers are active in the debt markets.

Chart 1

**Insurers' Debt Has Doubled Over The Past Decade**




*2019 data is as of June 1, 2019; 2020 data is as of June 1, 2020.

Source: S&P Global Ratings, Bloomberg, Thomson Financial.

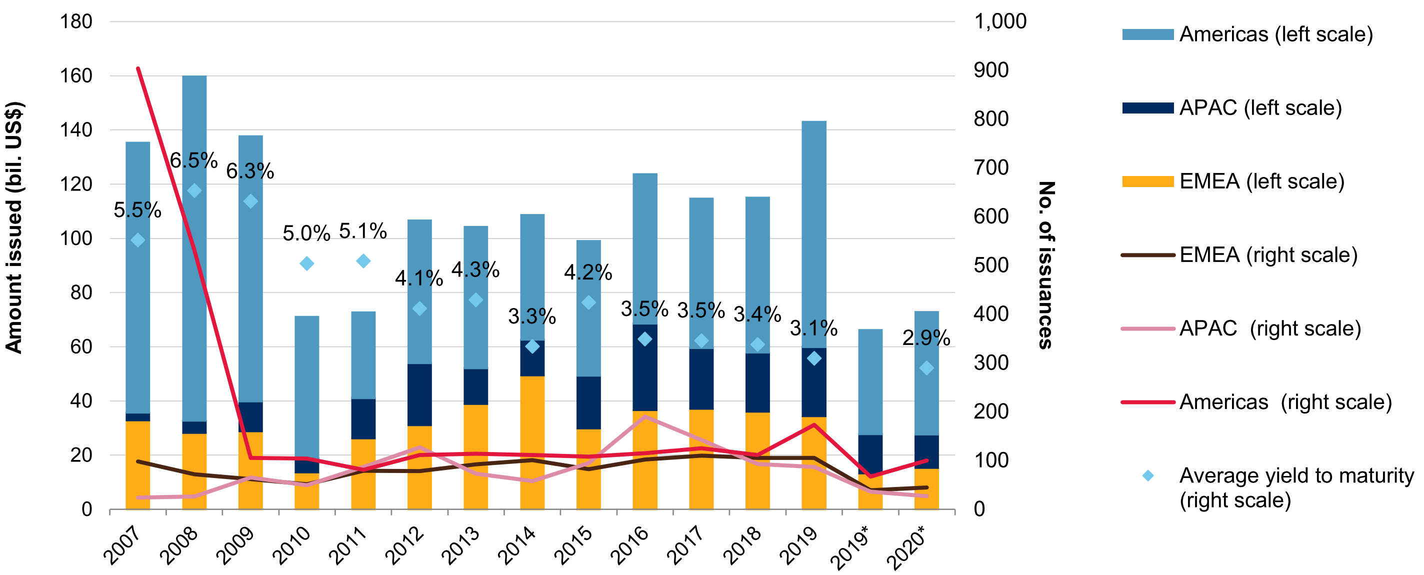


## Good Access To Debt Capital Markets Due To Strong Credit Quality

Many insurers that are active in the debt market accessed the capital markets in the first half of this year, and we expect this will continue. With about $73 billion of new debt globally, the sector issued slightly more than in the same period of 2019 (chart 2). This issuance volume has been particularly noticeable given the slowdown in market appetite in early 2020 and despite the doubling of insurance credit spreads during March 2020, which have since declined. Overall, credit spreads are well below the levels we saw during the global financial crisis, and more favorable than those seen across many other sectors (chart 3).

Chart 2

### Insurers Retain Good Access To Debt Markets Despite COVID-19-Related Capital Markets Volatility

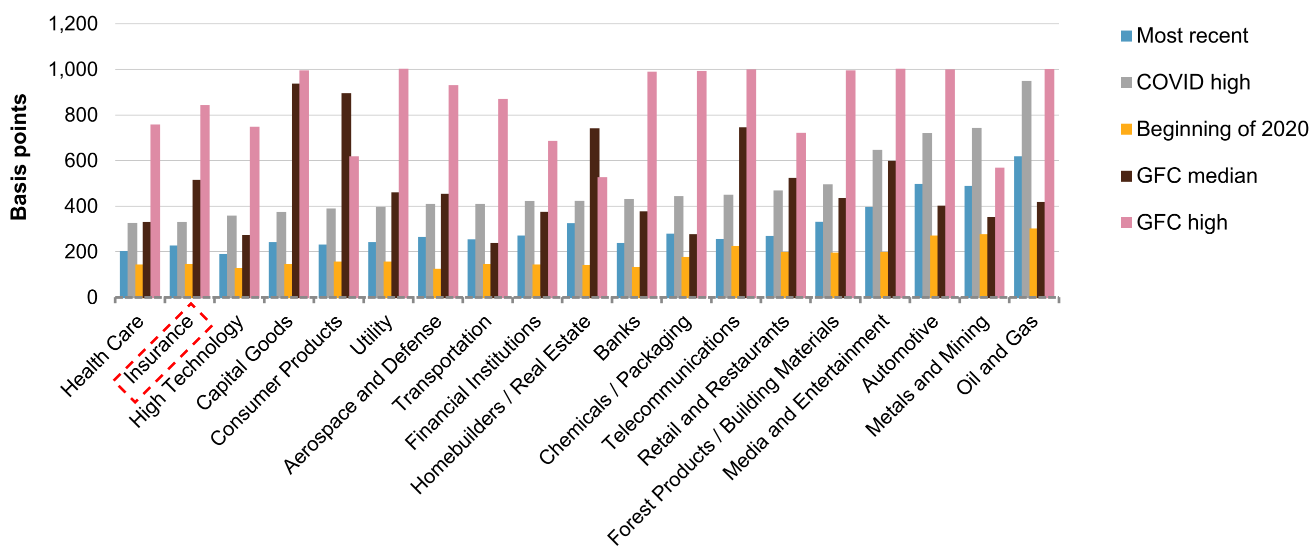



*2019 --Data to June 1, 2019 (yield to maturity not relevant for this period); *2020 --Data to June 1, 2020. Data as of June 1, 2020. Spike in Americas issuances in 2007 primarily due to Talcott Resolution Life Insurance Co.

Source: S&P Global Ratings; Bloomberg; Thomson Financial.

Chart 3

### Insurance Spreads Are Favorable Compared With Many Other Sectors And Well Below Global Financial Crisis Levels




*Data as of June 1, 2020. GFC--Global financial crisis. Source: S&P Global Ratings.

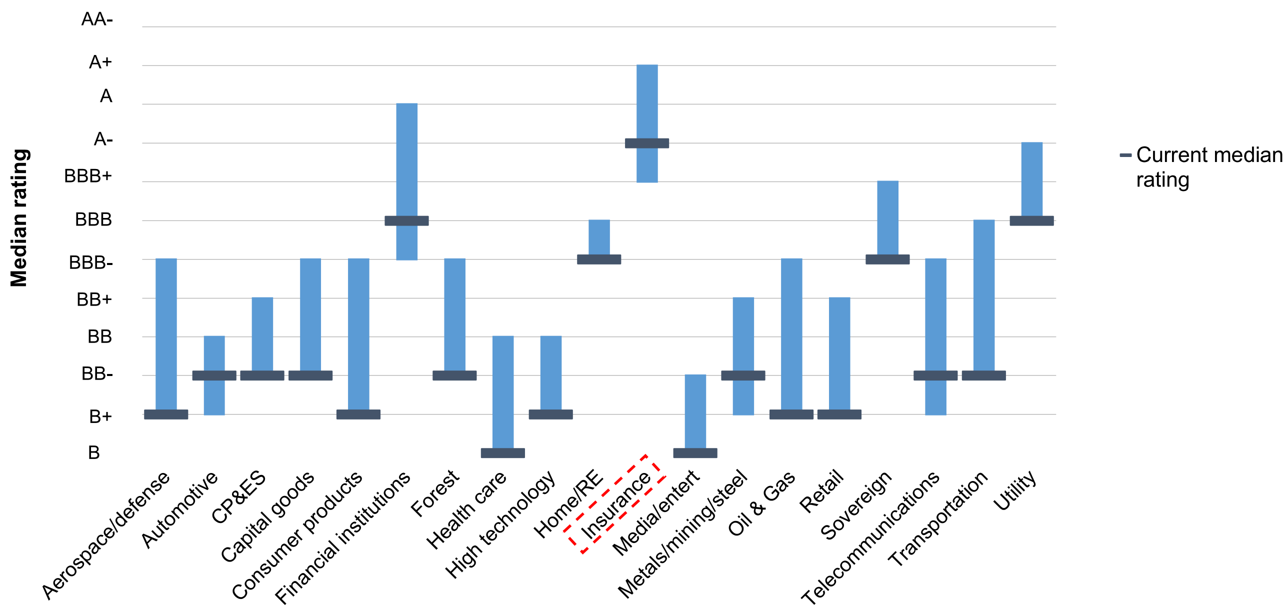


On average, insurers have been able to issue senior debt and hybrids at low coupon rates so far in 2020. This is despite uncertainty around COVID-19-related claims, with some industry loss estimates exceeding $100 billion. There is also uncertainty relating to the upcoming hurricane season, notably for those with material exposure to North America, as well as the claims inflation (also known as social inflation) for the U.S. casualty lines.

The stronger credit quality of insurers is particularly evident when compared with nonfinancial corporate sectors (chart 4). Furthermore, there is a limited number of insurance companies with debt ratings at the 'BBB-' level (table 1). However, insurers don't appear to be reaping the benefits of their credit strength when it comes to the coupons they pay for their debt, as they have historically paid more than corporate issuers (chart 5.) Although the gap has reduced, and is virtually nonexistent since 2018, investors still demand a relatively higher premium for investing in insurers when considering their stronger credit quality. This could be due to a number of factors, including insurers' complex and capital-intensive business models. Nevertheless, we continue to see strong demand for insurance debt in 2020, with most new issuances substantially oversubscribed.

Chart 4

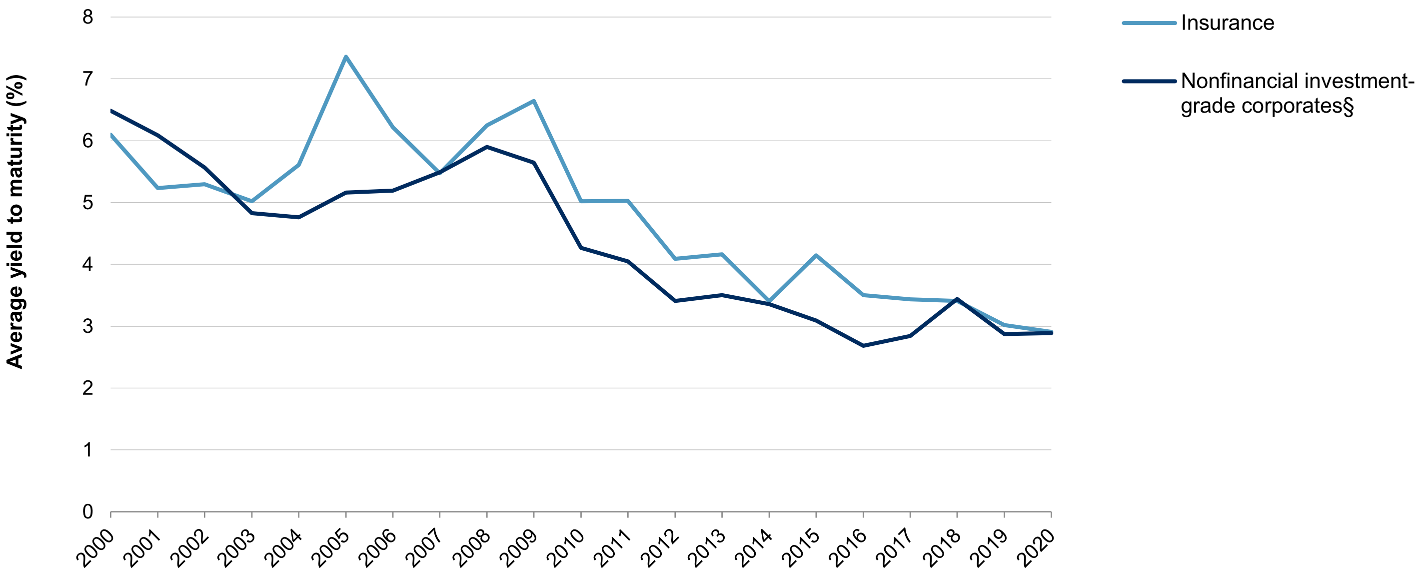
**Insurers' Credit Quality Is Typically Higher Than Corporates'**




Data as of April 30, 2020. Ranges computed from 2000-2020. CP&ES-- Chemicals, packaging, and environmental services. Source: S&P Global Ratings.

Chart 5

**Insurers' Yields Are Much Closer To NonFinancial Investment-Grade Corporates' In Recent Years, Despite Stronger Ratings**




Data as of June 1, 2020. §Investment grade corporate ratings data based on issuer credit rating. Source: S&P Global Ratings; Thomson Financial.



## Refinancing Risk Remains Low For the Sector

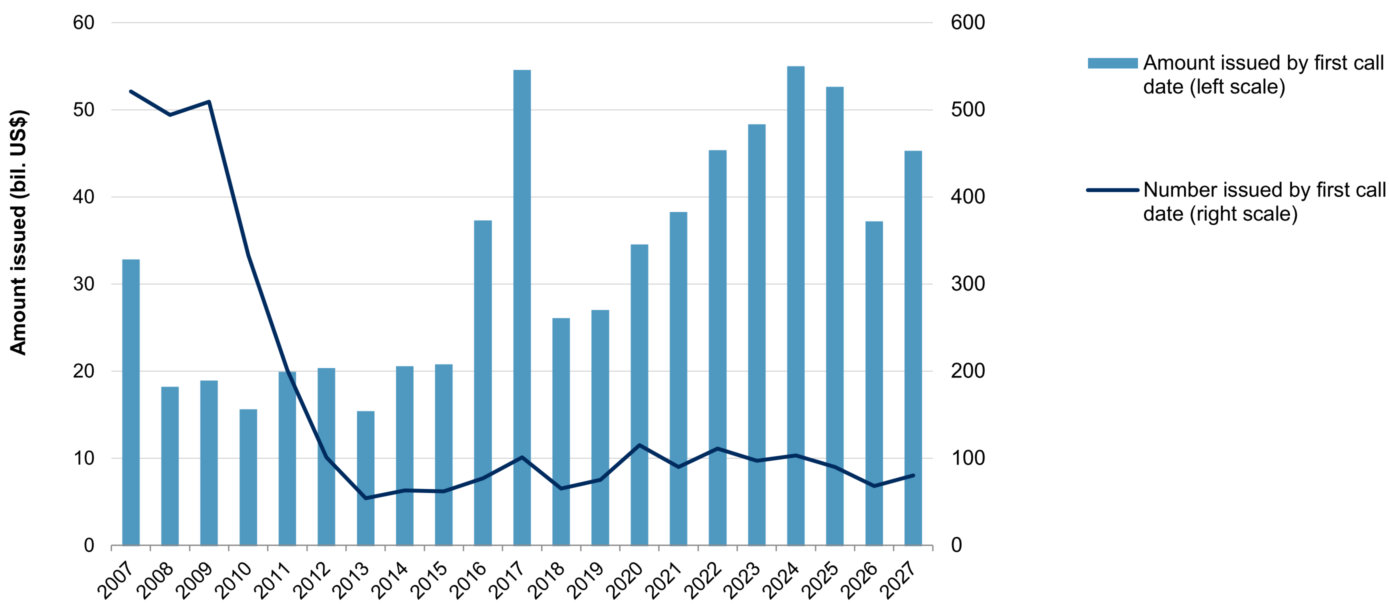
We expect that the sector will not face high hurdles in refinancing upcoming calls and maturities. Following the redemption of about $25 billion of debt between January and May 2020, the sector is set to refinance nearly $140 billion by the end of 2021 ($52 billion between June and December 2020, including about $23 billion of hybrids with upcoming call dates during this period). Half of this is due to hybrids reaching call dates (chart 6) and the remainder is debt coming to maturity. We recognize some insurers have already pre-financed upcoming calls or maturities.

In debt markets where financing conditions are less favorable, insurers may choose to wait for refinancing and access the market when market conditions are better. Delay in refinancing or in new issuances that were planned could cause a temporary drop in their risk-based capital (measured using our capital model) or regulatory solvency ratios below the required levels to support our ratings. In general, this would not adversely affect our ratings, provided capital adequacy was restored to the expected level over our projection period which is up to three years.

Based on our rated universe, insurers, including those that chose to wait for refinancing, have sufficient levels of capital in general and strong liquidity on average. As such they are able to manage capital within their targeted range, which is also comfortably above the levels required by regulators and supportive of their ratings when measured using our capital model. At the same time, we do not see liquidity constraints, given that insurers tend to have highly liquid investment portfolios.

Chart 6

**Insurers Are Well Placed To Refinance Upcoming Callable Debt**




Callable debt only. For example, callable debt issued in 2007 with first call date in 2017 is captured in 2017. Data as of June 1, 2020. Spike in Americas issuances in 2007 primarily due to Talcott Resolution Life Insurance Co.
Source: S&P Global Ratings; Bloomberg.


## Well-Positioned To Meet Investor Expectations

We note that roughly half of the above mentioned $140 billion that is expected to be refinanced before the end of 2021 is comprised of hybrids with an optional call date during the period (chart 6). While insurers, notably those based in Europe, the Middle East, and Africa, have typically called (and replaced) hybrid instruments sold to institutional investors on their first call date, they have no obligation to do so. If financing conditions do deteriorate significantly before the call date, it may make more economic sense for the insurer not to call the bond at the first call date. In the event a hybrid instrument is not called on an optional call date, this would not be a default under our criteria (for more details, see "What Are The Potential Credit Implications For A European Insurer Not Exercising A Call On A Hybrid?" published on March 16, 2017, on RatingsDirect).

The short-term economic benefits of not calling a hybrid security may not necessarily outweigh the potential consequences for the creditworthiness of the insurer. Such actions could lead to a loss of goodwill from hybrid investors, particularly if the hybrid price falls in the secondary market. Furthermore, the general investor community, policyholders, or other stakeholders may assume that the company is in financial difficulty and this could adversely affect its business and financial profiles.

## Insurers May Opportunistically Raise More Debt

Insurers entered this crisis with strong capital and liquidity and were largely able to absorb the market losses experienced to date. We believe much of the issuance to date has been opportunistic, with some taking advantage of favorable market conditions instead of repairing weakened balance sheets, while keeping in mind uncertainty around future market conditions.

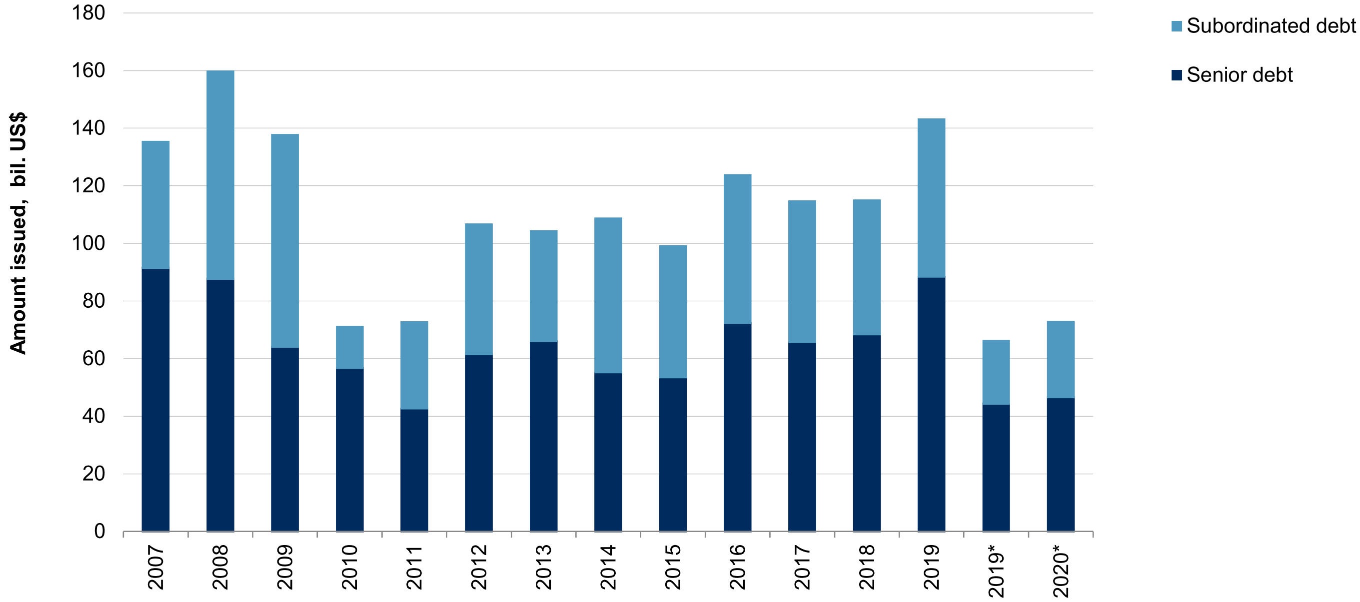
Because of cheaper financing, we could see more insurers boosting their use of debt, including hybrid capital, over 2020-2021, to enhance capital adequacy to targeted levels. So far during 2020, a few issuances were driven by declines in solvency ratios coming from market volatility and additional reserves being set aside for COVID-19-related claims, notably on the non-life side. Some insurers issued debt and hybrids to take advantage of future organic and inorganic growth opportunities. For example, on the P/C reinsurance side the sector is seeing more favourable pricing conditions, with material premium rate rises in loss-affected lines and hardening premium rates in many other lines. We have also seen various insurers raise equity for the same reasons. In the U.S. life insurance sector we expect block acquisitions to provide inorganic growth opportunities for some players. While in the U.S. health insurance side, the increased vertical integration will continue to be a key M&A trend that will require capital investments.

When considering the level of issuances, we do not expect to see a permanent material increase in financial leverage or a decrease in fixed-charge coverage. Financial leverage (financial obligations to reported equity and financial obligations) is typically 20%-30% and fixed charge coverage is generally well above 4x, which is supportive of ratings.

We expect the type of debt issued will continue to follow recent trends with the bulk of debt in the U.S. dominated by senior instruments and hybrid issuances dominating other markets (see chart 7 for split by debt type). The debt type is driven by qualification for regulatory capital. The U.S. groups typically issue senior notes at the nonoperating holding company level and downstream to the operating entities to meet regulatory capital needs. Furthermore, at this time of volatility, investors are likely to have a higher appetite for less complex issuance such as senior notes without coupon deferral features to avoid exposure to nonpayment of coupons. Hence, the U.S. insurers have seen better demand for their paper than other regions where senior notes are not typically downstreamed as regulatory capital.

Chart 7

### Regulatory Capital Qualification Will Continue To Drive Debt Type




*2019 --Data to June 1, 2019; 2020--Data to June 1, 2020. Data as of June 1, 2020. Seinor debt includes first lien, second lien, secured, unsecured, senior unsecured. Subordinated debt includes preferred, subordinated, senior subordinated, junior subordinated. Source: S&P Global Ratings; Bloomberg.


Table 1

### A Limited Number Of Insurers Have Bonds Rated 'BBB-'

| Issuer Name | Region | Rating at issuer level* |
|---|---|---|
| AEGON N.V. | EMEA | A-/Stable |
| Allied World Assurance Company Holdings Ltd | EMEA | BBB-/Stable |
| Allstate Corp | Americas | A-/Stable |
| American Equity Investment Life Holding Co. | Americas | BBB-/Negative |
| American Financial Group Inc. | Americas | BBB+/Stable |
| AMP Ltd. | APAC | BBB+/Negative |
| Argo Group US Inc. | Americas | BBB-/Negative |
| ASR Nederland N.V. | EMEA | BBB+/Stable |
| Athene Holding Ltd. | Americas | BBB+/Stable |
| AXA Equitable Life Insurance Co. | Americas | BBB+/Stable |
| Brighthouse Financial | Americas | BBB+/Stable |
| Centene Corp. | Americas | BBB-/Stable |

Table 1

### A Limited Number Of Insurers Have Bonds Rated 'BBB-' (cont.)

| Issuer Name | Region | Rating at issuer level* |
|---|---|---|
| CNO Financial Group Inc. | Americas | BBB-/Stable |
| Fairfax Financial Holdings Ltd. | Americas | BBB-/Stable |
| Global Atlantic (Fin) Company | Americas | BBB-/Stable |
| Hartford Financial Services Group Inc. | Americas | BBB+/Stable |
| Hiscox Ltd. | EMEA | BBB+/Stable |
| La Mondiale | EMEA | A-/Positive |
| Liverpool Victoria Insurance Co. Ltd. | EMEA | BBB+/Stable |
| MetLife Inc. | Americas | A-/Stable |
| Nationwide Financial Services Inc. | Americas | BBB+/Stable |
| NN Group N.V. | EMEA | BBB+/Stable |
| Ohio National Financial Services Inc. | Americas | BBB-/Negative |
| ProAssurance Corp. | Americas | BBB-/Watch Neg |
| QBE Insurance Group Ltd. | APAC | A-/Stable |
| Voya Financial Inc. | Americas | BBB+/Stable |
| WR Berkley Reinsurance | Americas | BBB+/Stable |

*Data as of June 1, 2020. This list is not exhaustive. We have listed issuer credit ratings only. These issuers may also have bonds or preferred shares that are speculative grade. EMEA--Europe, Middle East, and Africa. APAC--Asia-Pacific. Source: S&P Global Ratings; Bloomberg.

## Related Research

- Refinancing Risk For North American Insurers Amid The COVID-19 Pandemic Remains Muted So Far, April 20, 2020
- What Are The Potential Credit Implications For A European Insurer Not Exercising A Call On A Hybrid? March 16, 2017

This report does not constitute a rating action.