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Spectrum Asset Management

Principal Asset Management[SM]

Insurers defensive vs. bank turmoil

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Despite the recent collapse of Credit Suisse (CS) and failures of several United States regional banks, we expect the fallout to be manageable for the defensive insurance sector.

Insurance liquidity is abundant. Unlike on demand and uninsured bank deposits, insurers generally have limited confidence-sensitive funding sources. Premiums and reserves that fund investments are broadly duration-matched and paid out for events including property loss and liability claims, or for protection needs such as life and disability losses. Cash may be withdrawn from certain savings-oriented products (e.g., cash value life insurance, some annuities) though doing so often results in penalties such as surrender charges, or the loss of valuable tax benefits and long-term income guarantees. As such, while insurers may have material unrealized accounting losses on their mostly high-grade fixed income investment portfolios due to the rapid rise in interest rates, they often are willing and able to hold these securities for the long-term, thus matching cash flows to pay customer claims.

Insurers also maintain substantial cash and highly liquid assets, as well as access to off balance sheet funding. For example, U.S. insurers can often pledge assets to the Federal Home Loan Banks (FHLB) rather than selling investments to raise cash. In Europe and the United Kingdom, under Solvency 2 regulation, insurers are required to hold capital and liquidity sufficient to cover rigorous capital & liquidity stresses. This strength was demonstrated by limited disruption to insurance owners of large pension annuities versus corporate pension managers forced to monetize losses during the U.K. liability-driven investment (LDI) crisis in late 2022.

Limited investment exposure to distressed names. Insurers generally disclosed relatively low exposure to Credit Suisse Additional Tier 1 (AT1), and debt and preferreds issued by Silicon Valley Bank and Signature Bank. Insurers hold highly diverse, mainly high-grade fixed income portfolios, thereby avoiding outsized industry or single name concentrations, while limiting onerous regulatory requirements on lower-rated bonds and equity securities.

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Insurance claims expected to be moderate. Legal liability associated with investor and other lawsuits against the failed banks could result in insured claims under directors & officers (D&O) and other liability classes of insurance. These risks are often broadly syndicated, play out over time through the legal process, and tend to be manageable in the context of diverse earnings and capital.

The fact that insurers are rarely required to realize investment losses due to 'customer runs' is a key reason why the industry has largely performed well through past cycles. We continue to view the fundamentals of both property and casualty (P&C) and life insurers as strong.

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