US insurance industry

Search for yield draws US life insurers to risky places

Bonds rated one notch above junk now comprise more than a third of holdings

AIG, like other insurance companies, holds huge investment books, mainly consisting of bonds © Bloomberg

Oliver Ralph in London 3 HOURS AGO

US life insurers have loaded up on risky investments since the financial crisis, according to research from Fitch Ratings, as their search for yield has drawn them into potentially treacherous places.

Insurance companies such as AIG and MetLife hold huge investment books, mainly consisting of bonds, to back the promises they make to their customers.

Over the past decade, they have increasingly moved into riskier assets, according to Fitch, as yields in safer categories have fallen under aggressive easing policies from the world's central banks. The shift could leave the insurers vulnerable to downgrades in their own ratings in a recession, as their capital could get eaten up by losses in their portfolios.

The rating agency examined the books of 42 large US life insurance companies. Before the crisis, A-rated bonds made up 69 per cent of the insurers' portfolios. By the third quarter of last year, that had slipped to 61 per cent. Meanwhile, holdings of triple-B

rated bonds, which are the last notch before junk, have increased from 25 per cent of the portfolios to 34 per cent.

"The stretch for yield is . . . to meet profitability objectives," said Mark Rouck, group credit officer for insurance at Fitch. "They could meet policyholder obligations with less yield than they are striving for. They can meet their obligations without moving down the credit spectrum."

The search for yield is not the only reason for the growing risk in insurers' portfolios: a wave of corporate downgrades has also made higher-rated bonds harder to come by.

Rich Sega, chief investment strategist at Conning, a $134bn-in-assets firm, said: "It used to be the case that 25 per cent of corporate bonds were BBB or below, but now that's 50 per cent. What you can buy now is just lower quality. Rating agencies have been a lot more conservative since the financial crisis."

Recommended

The Fitch research also found that insurers have increased their exposures to illiquid assets such as private placements, which are stocks or bonds sold directly to private investors, rather than as part of a public offering. Even so, Mr Rouck said he thought insurers would still have enough cash on hand to be able to meet their obligations to customers. "Insurers have a very strong liquidity position overall so there is not a significant risk," he said.

He added that there was a low risk of a "run", when customers all try to withdraw their money at once. "Life insurance typically has very significant constraints and there are penalties involved if customers redeem and put their contracts back to the insurance company. We don't see that as a big concern."

Conning's Mr Sega said the addition of newer asset classes had helped the insurers to diversify, making their overall portfolios safer, in theory. "If you look at corporate credit, it looks like credit quality is down but default risk in portfolios is not higher," he said.

"Portfolios are much more diversified than they used to be — there are a lot more structured products, munis, bank loans and high yielding equities, for example. Diversification is very powerful."