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Portfolio Composition of Insurance Companies

By Dimitris Karapiperis, SVO Research Analyst

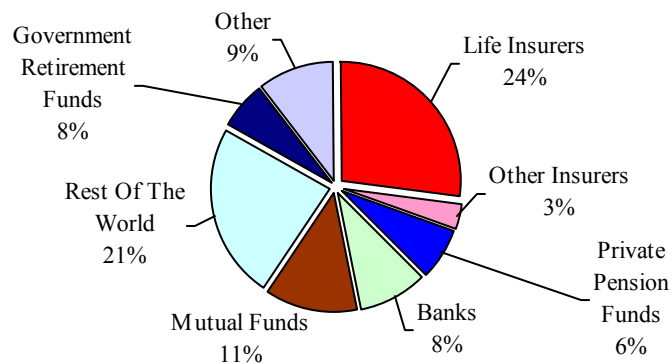
■ Introduction

As the current state of the insurance market and its companies has evolved, the role of the investment portfolio has taken on a heightened significance. Indeed, investment returns and gains have been responsible for a large portion of industry profitability for some years now, particularly within the property/casualty market.

Recent data from the Federal Reserve's Flow of Funds Accounts highlights the economic significance of the insurance industry's investment patterns. According to this data, insurers are the largest uniquely identified institutional investment sector in the bond market holding 27% of the total amounts outstanding in 2001. Life insurers are by far the largest with 24% while P&C insurers hold the remaining 3% (Figure 1).

Continued on page 3

Figure 1.
U.S. Investors of Corporate and Foreign Bonds 2001
(As a percentage of total amounts outstanding)



Source: Federal Reserve Board, Flow of Funds Accounts of the United States (Z.1).

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Web Address:

www.naic.org/1svo/index.htm

From the Director

Chris Evangel, SVO Managing Director

As the world continues to move towards increased globalization on many fronts, these events require us to bring various elements together in order to increase our common understanding of each other. For this issue's discussion, I want to offer a narrow observation on how two seemingly similar parties approach a certain aspect of the business down cycles. What appears interesting to this observer is the way we may take for granted as believing a common approach exists. In particular, when one assumes two parties are similar, but approach these economic challenges differently.

As with anything, one can never fully understand one's position without sometimes taking themselves away from their frame of reference. Things that may appear seemingly similar are quite often very different. Even when one undertakes such a venture, we tend to interpret the new perspective from their point of view, despite our best efforts to rid ourselves of biases. Nevertheless, this exercise may still lend some value in perhaps better understanding of why we differ.

One may expect to believe that the economic systems between the way our western European partners and us functioned fairly similar. This observation observed on a recent overseas visit and reading an English language newspaper when a western European resident commented "you [in the States] lack "compassion" in your business practices." They were referring to an article on the downsizing of a particular company. The question I posed was it not the expectation that as businesses engage in efforts to recalibrate their operations, make adjustments to meet market conditions, and/or closes unprofitable lines, the result can often be accompanied by announcement of layoffs.

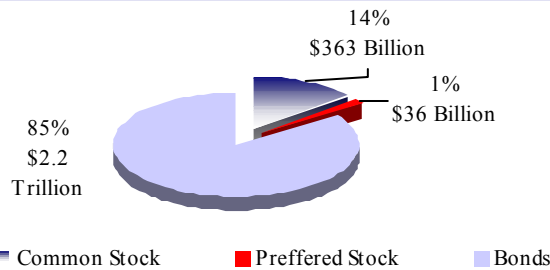
After a lengthy discussion and realizing each felt strongly about our "free" enterprise systems, I turned to this same newspaper containing a front page article showing a

baseball fan being tackled by security guards as the fan entered the field of play to punch a player. Seeing this article, my European friend stated, matter-of-factly, "what do you Americans expect when you don't separate fans from the field of play...we don't have *that* problem here." I paused and admitted he was right. However, I recalled my experience attending a football (soccer) match there and the fans' seating areas were fenced off from the playing field, while security personnel routinely escorted on and off the field the referees. When I asked if they thought the fencing was a bit over done, they thought I lost my mind in not understanding the consequences if such measures were not undertaken. From my perspective, I could not understand why this arrangement was acceptable and considered normal. I recall that the clamor of the baseball fan's action were still news worthy several weeks after the occurrence with much discussion of the *breakdown* of civility here.

Which brings me back to how we approach downsizing. This past fall, several articles appeared showing protests among workers in western European countries in response to layoff announcements or adjustments to their compensation. In some cases, these protests resulted in sympathy strikes and government action was contemplated. What a difference a continent makes. As a participant in the securities business here in New York City, I am still waiting to see the first protester from the nearly 67,000 job cuts announced since the start of 2001 in just the securities industry alone. In fact, I recall seeing limited other signs of protests stemming from the nearly two million jobs lost during this current recession. Are we also more accepting of the lost businesses and place more faith in the ability that another opportunity will arise? I do not know why we react differently. It seems as we continue to globize our approaches, remedies may be less consistent than we might anticipate, particularly when it involves those we believe already share a common understanding. As our global partners increasing involve even greater perspectives, I am forever reminded these different perspectives may require more patience in our dealing in the global economy.

Portfolio Composition of Insurance Companies (Continued)

Figure 2. Total Portfolio Composition Year-End 2001



Source: National Association of Insurance Commissioners.

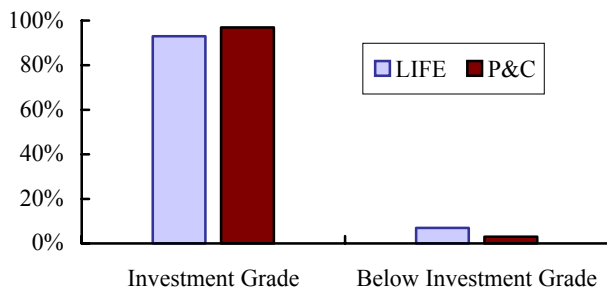
General Portfolio Composition

Figure 2 provides a picture of the composition of the aggregate insurance industry's investment portfolio at year-end 2001. The general composition of U.S. insurers' investment portfolios has been stable for the last several years with the largest allocation in long-term bonds, at \$2.2 trillion, or 85%, of total schedule D investments (long-term bonds, preferred and common stocks). For the same period, preferred stocks totaled \$363 billion or 14% of total Schedule D investments, while common stock investment at a reported \$36 billion was only 1% of Schedule D investments.

Within these general allocations, small changes are continuously made to adjust to changing market conditions and to realize investment objectives. Insurers' vast majority of investment is in investment grade (lower default risk) securities, as described in Figure 3.

In 2001, life insurance companies held 93% of their portfolio in investment grade securities with the remaining 7% in speculative grade securities. This is down from 95% in 1997 as life insurers rebalanced their portfolios' risk/return profiles.

Figure 3. Bond Portfolio of Credit Quality for Life and Property/Casualty Insurers, Year-End 2001



Source: National Association of Insurance Commissioners.

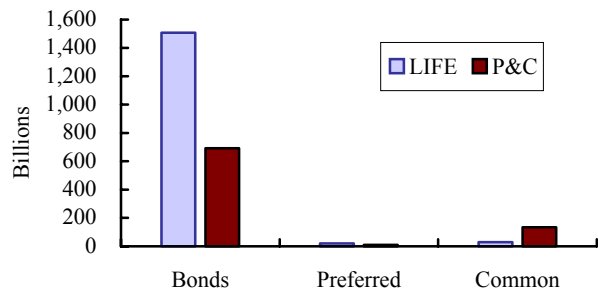
For property/casualty insurers, the distribution has been even more stable. In 2001 property/casualty insurers reported holdings of investment grade bonds equaling 97% of their total holdings (3% in speculative grade). In 1997, investment grade bonds were 98% of their total holdings, a compositional change of only 1% during the 1997-2001 period.

The recent market losses from exposure to Enron's collapse, Kmart's bankruptcy and Argentina's default illustrate now—amid the debate over "aggressive" accounting practices and record debt defaults—better than ever the importance of the continued high credit quality of insurers' bond portfolios.

Life insurance companies' exhibited marginal increases in speculative-grade bond holdings over the most recent reporting period. However, life insurers, as opposed to their property/casualty counterparts, did not alter their traditionally conservative investment approach to exploit the booming stock markets from 1995-1999. Stocks remained a minor investment for life companies during that period and remain so today, accounting for only 3% of total unaffiliated investments. This figure is up from about 2% in 1995, but this increase could also be a reflection of the appreciation of existing holdings than a net increase in new investment.

For property/casualty insurers, investment returns were the only positive contributor to net income in the last six to seven years. Investment income, as a percentage of net premiums, increased from about 15% in 1985 to approximately 18% in 1999 and 2000. The main determining factor for this increase was the bull market in the latter half of the 1990s. Property/casualty insurers increased their common stock holdings peaking at a little over 22% of total unaffiliated investments in 1999. In 2001, this percentage was reduced, as a result of the continuously deteriorating performance of the equity markets, to a still significant 16% or \$134 billion (see Figure 4).

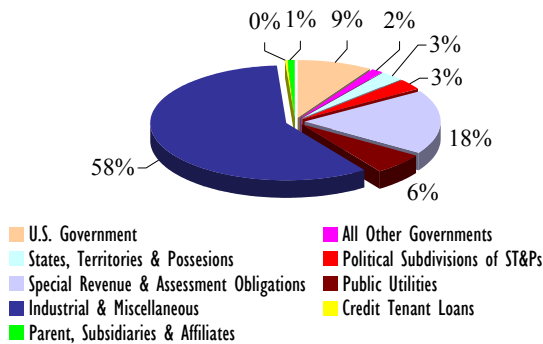
Figure 4. Composition of Insurers' Unaffiliated Investments Year-End 2001



Source: National Association of Insurance Commissioners.

Portfolio Composition of Insurance Companies (Continued)

Figure 5. U.S. Insurers Bond Portfolio Composition Year-End 2001

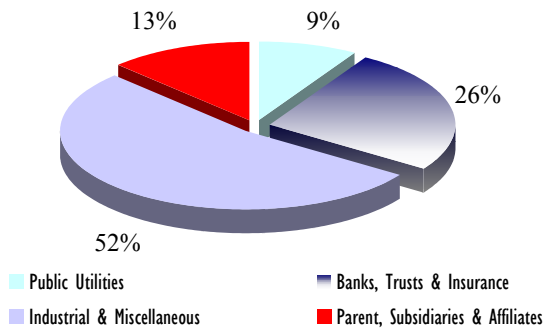


Source: National Association of Insurance Commissioners.

■ Bond, Preferred and Common Stock Portfolios

The 2001 bond portfolio of all U.S. insurers (both life and property/casualty) consists mainly (58% of total bond portfolio) of corporate (industrial and miscellaneous) bonds that total about \$1.3 trillion. The remaining 42 percent is divided among Government agencies' and authorities' obligations that comprise 18% (\$400 billion), U.S. government securities that are about 9% (\$196 billion), public utilities' bonds that are about 6% (\$136 billion), states' securities that total \$61 billion (3%), states' political subdivisions' securities that add up to another 3% (\$63 billion), all other governments' bonds that total \$35 billion (2%) and affiliates' securities that are only \$18 billion (1%) (see Figure 5).

Figure 6. Preferred Stock Portfolio Composition Year-End 2001



Source: National Association of Insurance Commissioners.

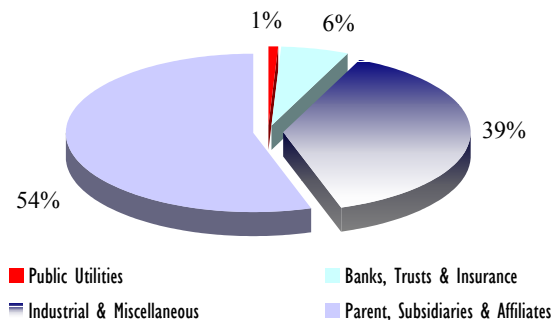
In the considerably smaller (when compared to bonds) preferred stock portfolio of all U.S. insurers, industrial & miscellaneous represent over half (52% or \$19 billion) of the total. Banks, trusts and insurance stocks are second with 26% (\$9 billion) while affiliates' and public utilities' preferred stocks represent the remaining shares of 13% (\$4 billion) and 9% (\$3 billion) respectively (see Figure 6).

With respect to common stock portfolios, the stock of parent companies and affiliates comprise 54% or \$199 billion while industrial & miscellaneous stocks are a significant 39% or \$140 billion (property/casualty insurers hold by far the largest share with \$114 billion). Common stock of banks, trusts & insurance is 6% of the total (\$21 billion). Lastly, public utilities' common stock represents just 1% (\$3 billion) of the total common stock portfolio of U.S. insurers (see Figure 7).

■ Conclusion

Recent developments in domestic and global financial markets illustrate the risks and uncertainties that directly impact any insurance company's ability to successfully integrate diverse investment and business goals. The stability of the composition of insurers' (aggregate) investment portfolio points to the conservative investment approach, shared by most insurance companies and the industry in general. The minimization of long-term financial risk, by maintaining a well-balanced portfolio of risks, can shelter the industry from increased volatility that could potentially generate widespread financial distress.

Figure 7. Common Stock Portfolio Composition Year-End 2001



Source: National Association of Insurance Commissioners.

Not-for-Profit Organizations: A Review

By Robert H. Stewart, CFA, SVO Credit Analyst

■ Introduction

Many insurers invest in not-for-profit organizations for humanitarian reasons. The insurers often have excellent motives for making these investments and recognize that the Securities Valuation Office (SVO) designates the majority (over 92% of the issuers' and 98% of the issues) of not-for-profits as below investment grade. For purposes of this review, Social Services (SIC Code 8300) is defined as a representative proxy of the not-for-profit industry. Currently the Social Services designation contains the following SVO designation percentages (Figure 1). The issuers are listed at the end of this article (Figure 2).

Figure 1.
Not-for-Profit Designations (SIC Code 8300)

NAIC Designation	# of Issuers	% of Issuers	# of Issues	% of Issues
1 Designation	1	7%	1	2%
2 Designation	0	0%	0	0%
3 Designation	4	26%	22	54%
4 Designation	8	53%	15	37%
5 Designation	1	7%	1	2%
6 Designation	1	7%	2	5%
TOTALS	15	100%	41	100%

Presently the SVO designates 41 issues in the not-for-profit category. These 41 issues are not the total number of not-for-profits designated by the SVO, but simply the total for the category. Due to the infrequent filing of this class of investments, the following is a brief review of several elements the SVO considers while assigning a NAIC designation.

■ Accounting

Typically, for-profit corporation financial information is prepared in accordance with Generally Accepted Accounting Principles (GAAP). In contrast, not-for-profits utilize Government Auditing Standards issued by the Comptroller of the United States. Another distinction is that the difference between assets and liabilities is called "net assets" rather than "net worth."

Net assets consist of two distinct categories, restricted net assets and unrestricted net assets. The restricted net assets are limited as to their usage, that is, funds from this

category may be limited for use in respect to meeting operating expenses or for paying for capital expenditures. Restrictions can also be time related; that is the proceeds are restricted for a particular purpose until a period of time elapses. The unrestricted net assets are exactly that; unrestricted (free of limits) for management to use as it chooses.

■ Balance Sheet

The SVO's credit analysis focuses on a conservatively managed not-for-profit balance sheet. Many well-established organizations maintain sizable investment funds and provide services from the interest generated on these funds and current donations. The SVO recognizes that a not-for-profit can invest all of its funds in investment grade issues, whether corporate bonds or government securities, which may result in spending less on current programs than expected and thereby reducing resources designed to meet their social mission. Conversely, a low income housing lender with 90% assets in low income housing with above normal default rates and substantial debt financing will not be rated as highly as a not-for-profit low income housing lender with limited debt, less lending concentration in high risk assets and more concentration in investment grade instruments.

Many of the not-for-profits show a "conservative" approach in their balance sheets, reflecting the philosophy, "to do good, we must do well first." Therefore, the SVO considers the sources of the organization's finances and how the cash flows are generated and maintained as very significant factors.

The SVO includes both categories in standard capitalization tests but looks closely at the restricted net assets and its constraints. If these assets represent a very large percentage of the total net assets, or are very restrictive in their usage, this may have a negative impact on the NAIC designation. Therefore, the SVO carefully evaluates the type of restrictions placed on net assets in determining the ultimate credit assessment.

As with any credit analysis, "rules of thumb" may not always apply. A restriction can also be considered positive; for example, a restriction that specifies paying only operating expenses allows the payment or reduction of expenses that would otherwise have been paid from revenues. This dedicated payment consequently increases the revenues available for debt service. This is important because not-for-profits, by their nature, do not have profitability as their first priority.

Not-for-Profit Organizations: A Review (Continued)

■ Financial Needs

Not-for-profit organizations can differ greatly in their capital and funding needs. For instance, most churches, low-income housing providers, and retirement home entities are capital intensive, reflective of their basic business operation. The capital intensity factor does not disqualify them from an investment grade designation, however, their financial needs are clearly greater than those not-for-profits whose focus is on providing personal services, such as family planning and drug counseling.

Conceivably, a retirement home with substantial net assets and a large endowment fund may produce investment quality results. In contrast, a drug counseling entity, with limited revenue and erratic levels of contributions may produce a credit rating determination below SVO investment grade standards.

■ Not-for-Profit Credit Standards

Not-for-profit investments are different from charity contributions. Contributions are gifts, whereas one expects investments to be repaid. A not-for-profit investment may, or may not, be structured to subsidize the not-for-profit with a low interest rate or other benevolent feature while maintaining the pay back provision. Notwithstanding their positive social purpose, not-for-profit investments require the same set of credit standards in credit analysis as a for-profit corporation.

■ Financial Results

The important thing in accessing all divergent entities is their financial result regardless of capital intensity, funding differences, social purpose and/or services they provide. For example, new organizations often have higher start up costs and fundraising expenses than more mature similar organizations. These charitable startups are not decidedly different from corporate startups with initial risks. In both cases, comparisons are made to well-established entities to determine where the entity fits along the designation scale.

■ Other Considerations

Further considerations include size, fundraising expenses and the experience of management. Not-for-profits with broad geographical scopes are less likely to be impacted by any regional recession. Not-for-profits with large total assets are more likely to have larger endowment funds. Not-for-profits with a large income stream are generally able to pay more and attract better management. All of these factors go into the credit analysis.

Lastly, in addition to the above, the following are broader items that are reviewed in performing the analysis:

Figure 2. Not-for Profit Issuers (SIC Code 8300)

Issuer	Total Investment (\$000)	% of Total	NAIC Designation
Delaware Valley Comm.	\$175	0.1%	N/A*
Assisted Living Concpnt	\$335	0.2%	N/A*
American Retirement Corp	\$620	0.4%	5
Local Initiatives Managed Assets	\$3,034	2.1%	3
Community Development	\$3,240	2.2%	4
The Low Income Housing Fund	\$3,624	2.5%	4
Enterprise Housing Partners 92	\$5,009	3.5%	N/A*
Crf-13, Llc	\$9,243	6.4%	4
Habitat For Humanity Intl	\$9,482	6.5%	3
Enterprise Foundation	\$9,713	6.7%	3
Enterprise Housing Ptnrs 1994 LP	\$11,029	7.6%	1
Sunrise Assisted Living Inc.	\$11,807	8.1%	4
Iasis Healthcare	\$34,225	23.6%	5
Local Initiatives Support Corp	\$43,404	29.9%	3
Total for SIC Code 8300	\$144,941	100%	

* N/A denotes Not Available. Source: National Association of Insurance Commissioners.

- Soundness of financial ratios. Examples are fixed charge coverage and capitalization.
- Transparency in contribution (if contributions represent a significant portion of revenues) and endowments (if endowments represent significant portion of assets and/or interest revenue).
- A clean audit certification.
- Comparison of various financial ratios with other similar organizations in the same sector.

■ Conclusion

Not-for-profits provide services are not necessarily designed to generate either cash flow or profits. However, the SVO's main responsibility is to evaluate not-for-profit's credit soundness rather than the social good provided by these entities.

The SVO uses a case-by-case approach. In order to analyze the credit worthiness of the organization, a standard set of financial ratios is used for comparison. The SVO adjusts the "benchmarks" prior to assigning an NAIC designation in order to affect the true nature of the underlying credit.

As in a for-profit entity, the final designation depends on the individual credit strength and soundness of finances to meet all "pay back provisions." While difficult to generalize, not-for-profits aim to "breakeven" and the effect on ratios typically places them in the below investment grade category.

Insurer Investment in European Sovereign Debt

By Dimitris Karapiperis, SVOResearch Analyst and Julius Vizner, SVO Associate Research Analyst

■ Five most held issues

U.S. life and property/casualty insurers held a total of five and a half billion dollars of European government bonds at the end of last year, according to 2001 annual statements filed with the NAIC.¹ While it is a large figure, compared to the \$2 trillion of bonds that insurers own overall, European sovereigns are only a quarter of 1% of the aggregate bond portfolio.² Also, most European countries are designated an NAIC 1, which is “assigned to obligations exhibiting the highest quality.”³ Given the small relative size and good credit quality of European government bonds, they do not seem to pose a threat to the overall solvency of the U.S. insurance industry.

The focus of this article, another installment in a continuing series on insurer investment in sovereign debt, is Europe. It is intended to aid NAIC members in their monitoring of the financial condition of their domiciliary

insurers by providing data on the industry’s aggregated investment portfolio. Regulators with questions about a specific state or company should contact the SVO Research Department.

■ Data

Aggregate exposures to European sovereign debt are shown in Figures 1-3, grouped by country. Figure 1 lists countries that are members of the European Union (EU) while Figures 2 and 3 (on the next page) those that are not currently in the EU. As the figures show, the four largest aggregate exposures are Italy, Greece, Poland, and Bulgaria.

The high dollar amount of Italian debt held by the U.S. insurance industry may be partly due to the rather large supply of Italian sovereign bonds in the international bond markets. According to some observers, Italy has been adept at attracting foreign capital by denominating the debt that it places in U.S. Dollars rather than Euros.

Figure 1. Insurers’ Investment in Europe



Source: National Association of Insurance Commissioners.

¹ Source: 2001 Annual Statements, Life and Property/Casualty Insurers, Schedule D.

² “Purposes and Procedures Manual of the Securities Valuation Office of the National Association of Insurance Commissioners”, NAIC, July 2001.

³ *ibid.*

Insurer Investment in European Sovereign Debt (Continued)

Figure 2. European Union

Country	NAIC Ratings	Fair Value Debt (in millions)
Italy	1	709.1
Greece	1	636.2
Germany	1	398.2
U.K.	1	312.5
Spain	1	279.3
Portugal	1	260.7
Austria	1	232.1
France	1	225.1
Finland	1	214.4
Belgium	1	124.1
Sweden	1	77.6
Netherlands	1	62.5
Denmark	1	34.5
Ireland	1	33.0

Source: National Association of Insurance Commissioners.

Figure 3. Rest of Europe

Country	NAIC Ratings	Fair Value Debt (in millions)
Poland	2	608.2
Bulgaria	4	447.9
Russia	4	334.7
Turkey	4	213.2
Croatia	2	93.3
Slovakia	2	37.7
Iceland	1	37.3
Hungary	1	31.1
Slovenia	1	27.9
Lithuania	3	3.7
Switzerland	1	2.7

Source: National Association of Insurance Commissioners.

Moreover, the appeal of these bonds is enhanced as investors benefit from the increased liquidity of holding on to bonds that are in large supply. Generally, as the market grows, the spread between the bid and ask price becomes smaller, making it less expensive for an investor to trade its position.

It should be noted that the presence of certain extraordinarily large positions in particular countries tend to somewhat skew the statistics shown. In the cases of Bulgaria, Greece and Poland, over half of the industry's holding in each country is the result of one single insurance company's position. Investment in these countries is not as widespread within the industry might appear at first glance. In each case, the sovereign debt positions are small components of the life insurers' overall portfolio with no position in excess of 15% while the average in the industry as a whole is about 1%.

■ Five most held issues

The five issues that the industry holds the most of are, in order of fair value held, restructured Polish and Bulgarian Brady bonds and bonds issued by Italy, Greece and Austria. Poland's issue has a coupon that increases in steps: it began accruing interest at the rate of 3.25% in 1994, increasing to its current rate of 6% and will be 7%

from October of this year through maturity in 2014.⁴ The Bulgarian issue accounts for half of total insurer investment in Bulgaria and has a floating coupon rate of U. S. dollar six-month LIBOR plus 81.25 basis points with a maturity date falling in 2011. The Italian bond, rated the equivalent of an NAIC 1, pays 6.875% until its maturity in 2023. The similarly rated but shorter-dated Greek bond pays 4.5% and matures in 2016. Out of the five issues described here, the Austrian bond is the only non-U.S. dollar denominated issue, having been placed in the Euro-yen market. It offers a coupon of 3.75% until maturity in 2009.

Due to the strengthening U.S. dollar last year, the industry reported a net unrealized foreign exchange loss of \$87.4 million during 2001. The recent addition of this column to Schedule D makes comparison figures for previous periods unavailable. Any impact that exchange rates might have on insurer positions is minimized by the fact that U.S. insurers tend to invest in the Eurodollar market where interest payments are made in U.S. Dollars. Also, an insurance company could hedge the exchange rate risk taken on by investing in non-U.S. dollar denominated assets by entering into a forward contract with a bank for delivery of

⁴Information about specific issues is from Bloomberg, L.P., with the exception of the Greek bond, which is listed on the NAIC's Q1-2002 Valuation of Securities CD-ROM.

Insurer Investment in European Sovereign Debt (Continued)

the foreign currency for a set rate at a specified future date, or via the use of other exchange rate derivatives. These positions would be reported in the various parts of schedule DB.

■ European Union

Predictably, the member countries of the European Union attract a significant portion of insurers' sovereign investment. EU-15 sovereigns enjoy very high credit ratings with eight countries being rated 'AAA', six falling into the 'AA+' or 'AA' categories, and only one being rated 'A'. The introduction of the euro as the EU's common currency transformed the different government bond markets into a more homogeneous European market. All outstanding and new debt is denominated in euros to create the second largest market after the US government bond market.

The EU members' creditworthiness is further supported by the economic stability promised by the Economic and Monetary Union (EMU), which is built on the principles of price stability and responsible fiscal management. The rules set by the Maastricht Treaty and The Stability and Growth Pact require all member states to keep their budget deficits and public debt within prescribed strict limits and to pursue the objective of a nearly balanced or in surplus budget by 2004. Recent events, with France refusing to balance its budget pending a recovery in economic growth (Italy, Germany and Portugal who are also running worryingly high public deficits have agreed to cut their cyclically adjusted shortfalls starting in 2003), have threatened the stability pact and could potentially undermine the euro's credibility.

Italy and Greece, the two nations in which insurers have most invested, are also two of the lowest rated European Union members with a credit rating of AA and A respectively. Sovereign debt analysts have noted that Italian debt offers relatively attractive spreads over its German or French equivalents.

Since the introduction of the euro, spreads have significantly narrowed between EU-member countries but a small gap still remains. Credit risk and liquidity risk are probably the two main sources of remaining risks in the EMU government debt markets. The treaty-mandated fiscal discipline, notwithstanding recent challenges, and the extremely high cost of default has made such occurrence a truly exceptional situation. However, EU countries have different sovereign ratings and financial markets still attach a risk premium to the associated default risk. Some EU

countries (e.g. Italy, Greece) still have to pay a premium to issue bonds, making financing marginally more expensive for them than other higher rated EU countries (e.g. Germany). This may at least partially explain the attractiveness of Italian and Greek issues with foreign investors. Even though both countries have dynamic and sound economies, disciplined by the strict rules of the EU's Maastricht Treaty for the monetary union, they still must offer better rates to compensate for the higher marginal risk.

■ Emerging Europe

The emerging European economies, composed of the central and eastern European countries and Turkey, have attracted international investors' attention for their improving economic performance and creditworthiness. The notable exception is Turkey which remains financially fragile and therefore still vulnerable to crisis.

After their largely successful transition to a market economy, most of the countries' attention is now centered on the accession to the European Union (i.e. adopting the set of laws and regulations that underpins the EU economic life). Their robust economic performance and the adoption of the rigorous EU requirements are the main reasons supporting their improving creditworthiness.

Anchoring their economic fates to developed Europe significantly lowers the credit risk for foreign investors. The highest rated emerging market is Slovenia, with Hungary and Poland being in second and third place, respectively. Out of the eight countries (nine with Turkey) from this region that are represented in insurance companies' bond portfolios, five are investment grade and all (except Croatia) are candidates for EU membership in the next expansion in 2004, and only three (four with Turkey) are non-investment grade but with their creditworthiness continuously improving over the period 2001-2002.

One of the higher rated non-investment grade countries that has experienced a number of favorable trends and developments is Russia. Russia's fast improving creditworthiness has helped attract the attention of investors. Russia, as of the end of 2001, was the sixth highest in insurers' aggregate investment in European sovereign debt.

The other side of the pendulum is Turkey, where a combination of weakening economic fundamentals and increasing uncertainty has increased doubts of the

Insurer Investment in European Sovereign Debt (Continued)

country's ability to stabilize and move towards disinflation and sustained economic growth. Furthermore, Turkey's adverse debt dynamics also raise doubts about sustainability with some analysts.

■ Conclusion

In the current distressed market cycle, the continuing expansion of the global financial market has helped broaden insurers' investment possibilities. This includes the European sovereign bond market. Therefore, it is important from a regulatory perspective to understand this market. This article summarized the insurance industry's exposure to the European sovereign bond market. The next installment of this series will summarize insurer sovereign investment in Asia.

Appendix

Maastricht Treaty: The Treaty on European Union as it is formally known, is the founding treaty of the EU and it was signed in 1992 in Maastricht, Holland. It provided for a single currency, common citizenship, common foreign and security policy and common labor policy. It also spelled out the conditions and criteria for the economic and monetary union.

EMU: The Economic and Monetary Union (EMU) was set as a goal in the Maastricht Treaty and it mandated the convergence and harmonization of the economic and monetary policies of the participating member states with a view to the introduction of the euro as the single and common currency. Twelve member states of the European Union belong to the eurozone, as the single currency area is more commonly known. Only Denmark, Sweden and the United Kingdom have not adopted the euro.

LIBOR: The London Interbank Offered Rate (LIBOR) is the interest at which banks borrow from other banks in the London interbank market. Many variable interest rates in the US are based on spreads of LIBOR.

Brady Bonds: Brady bonds are US dollar-denominated bonds issued by emerging countries, particularly those in Latin America, and collateralized by US treasury zero-coupon bonds. Many debtor countries issue Brady bonds under a debt reduction plan, to reduce their principal, interest and interest arrears.

Chronological List of SVO Research Reports

SVO RESEARCH NEWSLETTERS

Volume 1, Issue 1

- Provisional Exemptions Rules are Live
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