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S&P Global Ratings

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When The Cycle Turns

Investment Impairments Will Bend But Not Break U.S. Life Insurers' Financial Strength

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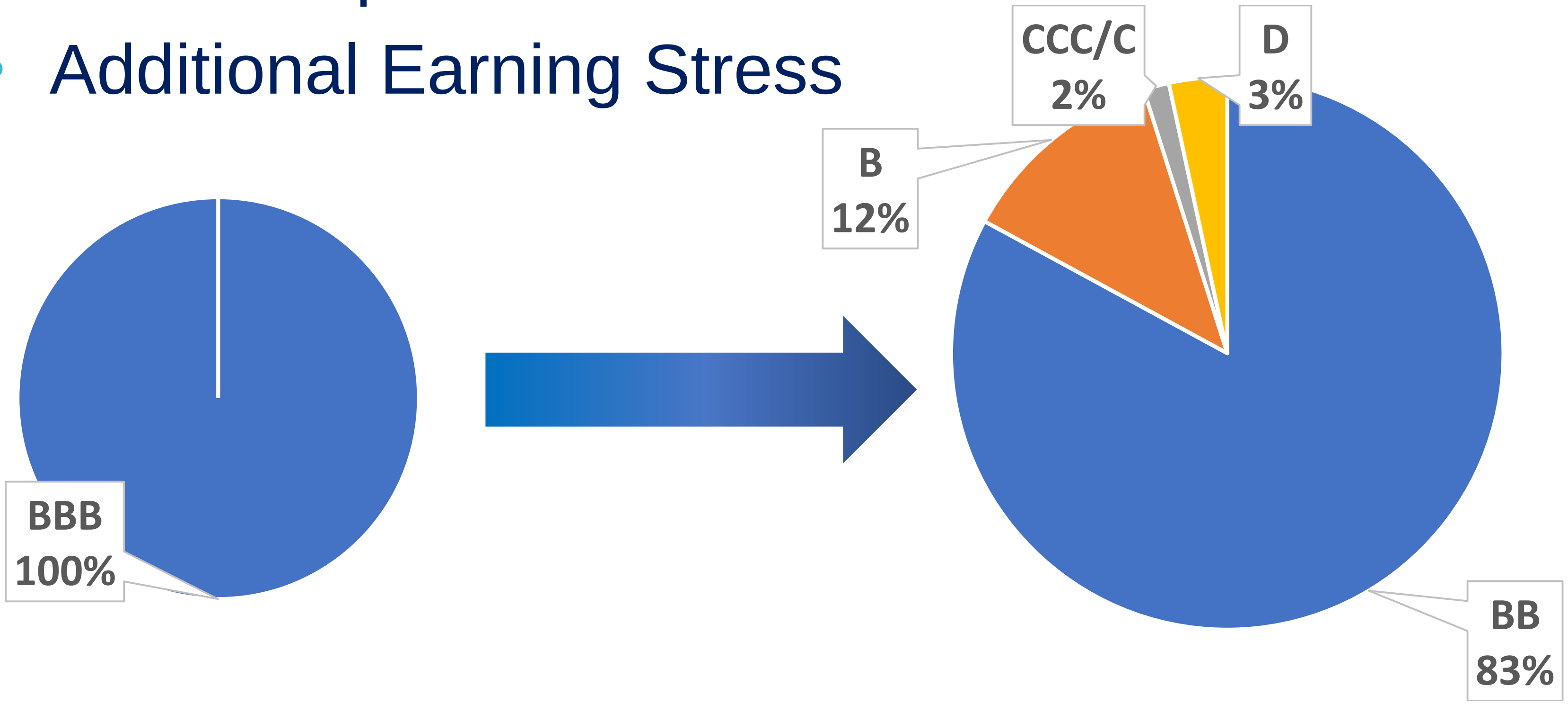
Credit Cycle Turns: What's the Impact on Life Insurers?

- Bond Downgrades → Higher Capital Charges
- Bond Impairments (OTTI) → Loss of Surplus, Earnings, Capital Charges (lower/higher?)
- Non FI Impairments → Loss of Surplus, Earnings
- Non Investment Portfolio:
  - Equity Market Exposure, Hedging Costs
  - Sales
  - Redemptions/Lapses/Utilization
  - Others?

Hypothetical Stress Scenario

- Occurs over a two year period (mirrors 2008-9)
- 1st year: 5% of BBBs are impacted; 2nd year: 4.5%
- Non FI impairments: 3% of TAC
- Additional Earning Stress



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Quick side-note on S&P Capital Model

- Compares Total Adjusted Capital to stressed required capital
- Measures TAC redundancy or deficiency, compared to four required capital levels:
  - Excellent (AAA) ➔ 99.9% Confidence Level
  - Very Strong (AA) ➔ 99.7% Confidence Level
  - Strong (A) ➔ 99.4% Confidence Level
  - Satisfactory (BBB) ➔ 97.2% Confidence Level
- Capital levels **do not** equate to ratings
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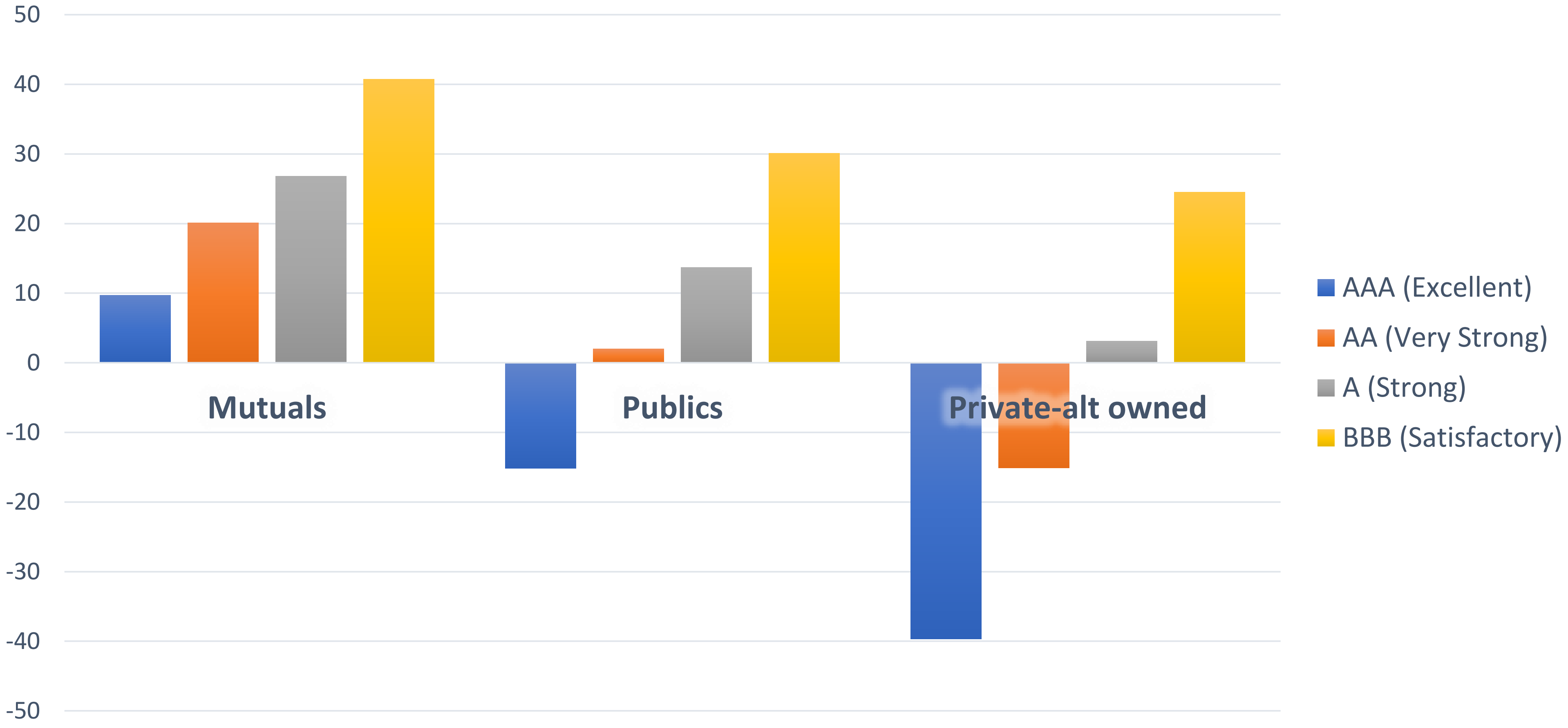
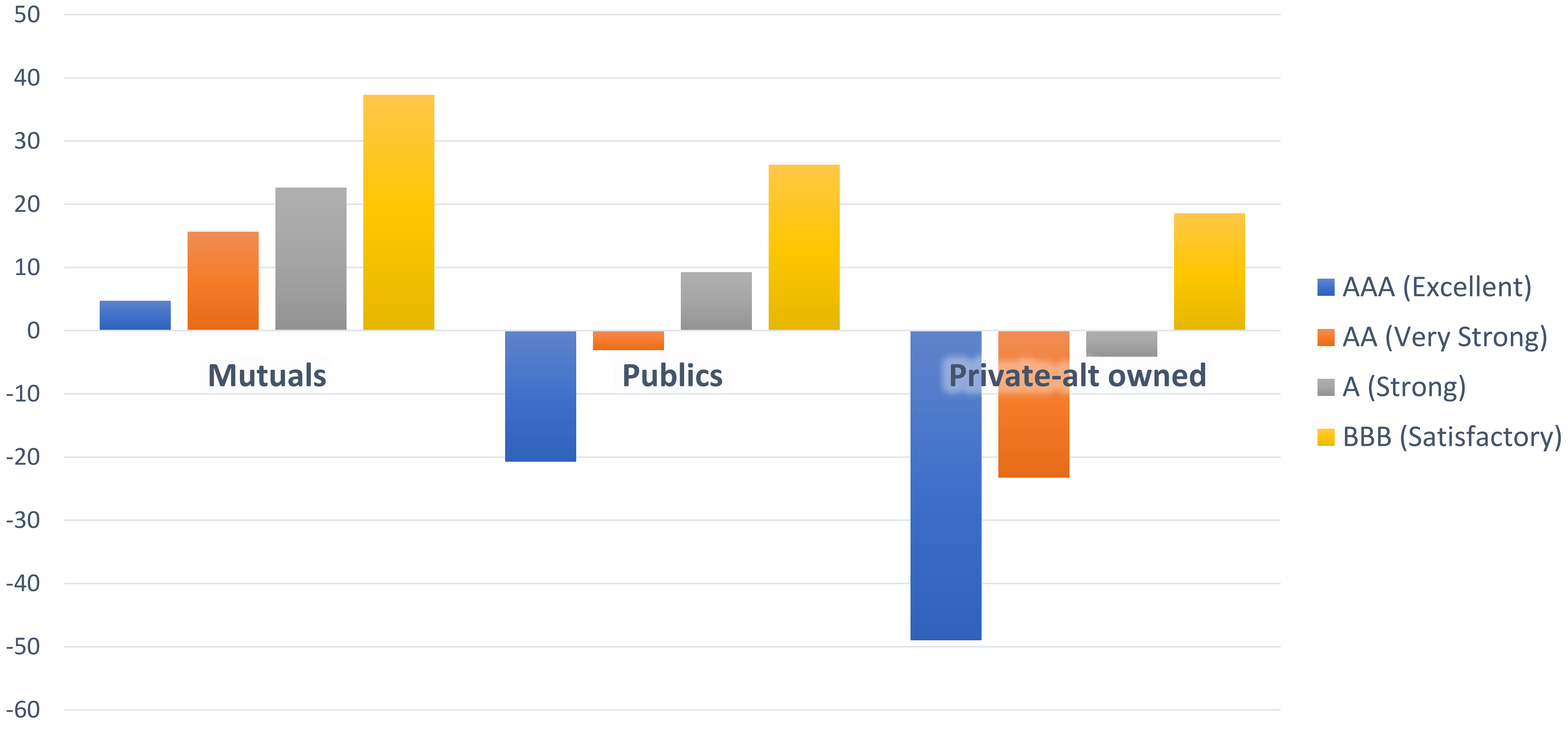
Base Capital Redundancy/Deficiency (%)



Source: S&P Global Ratings insurance capital model

Capital Redundancy/Deficiency Under Stress Scenario (%)



Source: S&P Global Ratings insurance capital model and stress test

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The Impact on Ratings

	Current level of aggregate capital redundancy	Current median rating level	Stressed scenario aggregate capital redundancy	Stress scenario median rating level
Mutuals	AAA (Excellent)	AA-	AAA (Excellent)	AA-
Publics	AA (Very Strong)	A+	A (Strong)	A+
Private-alt owned	A (Strong)	BBB+	BBB (Satisfactory)	BBB

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Source: S&P Global Ratings insurance capital model and stress test

Sample Bond Charges
[Corp. Bonds 5-10 Year Tenor]

	AAA Charge (%)	AA Charge (%)	A Charge (%)	BBB Charge (%)
NAIC1	1.31	1.23	1.15	0.97
NAIC2	5.30	5.04	4.78	4.20
NAIC3	21.00	20.03	19.08	16.97
NAIC4	37.68	36.25	34.84	31.71
NAIC5	76.88	72.63	69.75	62.22
NAIC6	37.50	31.00	26.50	15.00

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Source: S&P Global Ratings insurance capital model and stress test

Key Takeaways

- Life insurers are relatively well positioned for a credit downturn
- Capital redundancy levels matter, but so do business profiles
- The S&P Capital Model is not meant to be an efficient capital allocation tool (a machete, not a scalpel)
- Capital levels **do not** equate to ratings