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European Insurers Find Yield in U.S. Municipal Bond Market.

- **Higher credit quality than corporates fuels foreign interest**
- **Longer maturities are focus for European insurance companies**

The global hunt for yield is so vigorous that payments to protect against car losses, deaths and storms in Europe are helping to bankroll roads and utilities in the U.S.

The $3.8 trillion municipal-bond market, long the investment mainstay of U.S. residents, is seeing demand from European insurance companies drawn to higher yields and ratings than they can find closer to home. It’s boosting the liquidity of a market where U.S. states and local governments raise money. And it’s also providing a new source of business to asset managers.

“It’s been very robust demand,” said Ben Barber, head of municipals at Goldman Sachs Asset Management, which manages about $52 billion of the securities. “We’re seeing brand new entrants into the market that are coming to institutional investors like us.”

The interest from corporations such as Germany’s Munich Re underscores the changing landscape in the municipal market, which is so U.S. focused that radio commercials for New York commuters tout local bonds. By the end of September, foreign buyers had increased their holdings of the securities to about $104 billion, more than double what they held a decade earlier, federal data show.

Municipals once held little allure overseas because federal tax breaks depress the yields. But in the era of low and even negative yields on global bonds, foreigners have taken a closer look, particularly in the taxable sector, where rates are higher.

Higher Quality

European insurers in particular are drawn to the higher quality of municipals compared with corporate debt. Sixty-seven percent of the Bloomberg Barclays Municipal Index is rated AA or higher, while just 11 percent of the comparable U.S. investment-grade corporate bond index is, according to an analysis by Matt Caggiano, who helps oversee more than $9 billion of insurers’ municipal holdings at Deutsche Bank AG.

And for the higher credit quality, foreign investors are getting more in return, even considering currency fluctuations, according to an analysis from Bloomberg Intelligence.

To better match their liabilities, life insurers also favor longer-maturity bonds, which are more common in the municipal market than in the corporate world. And European Union regulations effective in 2016 allow insurers to put aside less in capital for holding infrastructure debt than corporate bonds.

“Municipals are an attractive investment, and we will use opportunities to accentuate our positions,” said Josef Wild, a spokesman for MEAG, the asset manager for Munich Re, which provides reinsurance and insurance. The company likes municipals for their high ratings and spreads over Treasuries and are using them to diversify its investments, he said by email.

New Funds

While Munich Re handles its investments internally, other insurers have outsourced their municipal strategies. Goldman Sachs Asset Management has seen its holdings of taxable municipals for European insurers increase by 89 percent in about a year. In September, Nuveen Asset Management launched a new high-grade municipal fund spurred by interest from clients outside the U.S., according to John Miller, co-head of fixed income. Overall, it's managing $2.5 billion in taxable municipals for foreign insurers as of the end of 2017 from nothing a little more than a year ago, he said.

To make room, some insurers are selling Treasuries, as well as European and U.S. corporate bonds, while others don't necessarily need to.

"There's a lot of cash being thrown off, and it's an easy way for them to make another allocation in decent yielding credit markets," said Jason Pratt, head of insurance fixed income at Neuberger Berman, which manages about $30 billion in assets for insurers.

Foreigners have made an impact: liquidity in taxable municipals has improved as trading activity shows, said Goldman's Barber. And new taxable deals have more potential buyers than bonds available than was seen in the past, said Deutsche's Caggiano.

The European insurers are likely to step up their purchases as they grow more comfortable with municipals, as yields remain competitive globally and as supply of taxable municipals picks up. Some analysts expect that the recent ban on advance refundings in the U.S., a previous source of tax-exempt debt, may compel issuers to refinance via taxable securities.

"We know from talking to potential clients that there's still capacity," Caggiano said.

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By Romy Varghese, Katherine Chiglinsky, and Julie Edde

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