



The Use of Credit Default Swaps in the Insurance Industry: Evidence from U.S. Life and Property-Casualty Insurance Companies

Hung-Gay Fung^a, Min-Ming Wen^b, Gaiyan Zhang^c

a. College of Business Administration & Center of International Studies, University of Missouri-St. Louis

b. College of Business and Economics, California State University, Los Angeles

c. College of Business Administration, University of Missouri-St. Louis

Abstract: Using a unique data set of credit default swaps (CDS) users in the insurance industry for the sample period from 2001 to 2007, we systematically investigate the extent to which and why U.S. insurance companies utilize CDS in purchase and sell positions. We find that insurers participate in the CDS market as both sellers and buyers, with large banks as their primary counterparties. Their overall CDS transactions have increased in number and value over the years, while as a share of total transactions, sell positions have declined in more recent years. In line with asset-liability management, life insurers, compared to property-casualty (PC) insurers, tend to write more CDS contracts and hold the contracts for longer periods. Moreover, stock and mutual insurers with different organizational forms show different CDS transaction behaviors. In particular, stock insurers engage in more CDS transactions than mutual insurers do, supporting the managerial discretion hypothesis. We also identify a number of other firm characteristics (such as size and asset allocation) and the CDS market risk factors that affect the purchase and sell positions of insurers. Evidence shows that insurers participate in the CDS market for reasons beyond hedging.

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Key words: Credit default swaps, hedging, asset replication, life insurers, property and casualty insurers, stock insurers, mutual insurers.
