AMERICAN ACADEMY
of ACTUARIES

June 13, 2024

Mr. Philip Barlow
Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBCIRE WG")
National Association of Insurance Commissioners ("NAIC")

Re: Exposure 2024-19-I—Interim Residual Tranche C1 Factors

Dear Mr. Barlow,

On behalf of the American Academy of Actuaries[1] C1 Subcommittee, I am providing comments on the exposed interim residual tranche proposal by Everlake Life Insurance Company.

The subcommittee is focused on developing a proposal for a long-term asset-backed securities C1 framework, including for residual tranches. Consistent with the Everlake proposal, our comparable attributes approach is likely to result in multiple C-1 factors across different categories of residual tranche. However, it is unlikely that these categories will be determined by collateral type alone, as is proposed by Everlake.

The Oliver Wyman study that was presented to RBCIRE at the Spring National Meeting concluded that middle-market ("MM") collateralized loan obligation ("CLO") residual tranches experience a lower reduction to net present value ("NPV") in tail scenarios vs. broadly syndicated loan ("BSL") CLOs. But this study also showed that MM CLOs tend to have thicker residual tranches and more highly rated debt tranches sitting directly above the residual tranche. The specific MM CLOs that had similar residual thickness and similarly rated debt tranches compared to BSL CLOs did not exhibit a lower reduction to NPV in tail scenarios vs. BSL CLOs. This suggests that MM CLO residual tranches do not inherently have less risk than BSL CLO residual tranches. Within the Oliver Wyman study, MM loan collateral is shown to be correlated with lower risk but is unlikely to cause lower risk. In fact, causation is likely the opposite—all else equal, MM collateral may be riskier than BSL. Common rating agency models assign higher risk to loans made by smaller companies with less access to capital. The structural enhancements observed in MM CLOs relative to BSL CLOs may have been created to mitigate higher risk in MM collateral.

Collateral type (MM vs. BSL), residual tranche thickness, and rating of associated debt tranches are among the candidates that we are considering as potential comparable attributes. We understand that a careful consideration of multiple comparable attributes may not be practical as an interim solution, and we seek to avoid applying selective rigor to this specific proposal. We appreciate the opportunity to use this example to highlight the importance of identifying comparable attributes that represent drivers of risk, not only correlates of risk.

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1. The American Academy of Actuaries is a 20,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

If you have any questions or would like to discuss further, please contact Amanda Barry-Moilanen, the Academy's life policy analyst, at barrymoilanen@actuary.org.

Sincerely,

Stephen Smith
Chairperson, C1 Subcommittee
American Academy of Actuaries