Letter to the NAIC regarding its CLO risk assessment framework

Dear Mr. Therriault and Ms. Genao-Rosado:

We would like to thank the NAIC for working on refining the risk assessment of collateralized loan obligations (CLOs) and greatly appreciate the opportunity to comment. We believe the NAIC's CLO proposal understates some key strengths of CLOs. The current risk-based capital (RBC) charges on CLO tranches, both debt and equity, appear already quite conservative based on through-the-cycle performance data, and therefore increasing RBC charges on CLO investments seems unjustified.

Assuming asset RBC equals liability RBC understates several key benefits of the CLO construct.
As part of the proposal, the NAIC assumed the weighted average RBC charges on all CLO tranches equals that of the underlying collateral pool. This assumption may have understated several key benefits of CLOs. We believe that active collateral management, portfolio diversification, and structural protections have all contributed to the strong track record of CLOs. Data shows collateral managers overall were able to reduce credit losses and opportunistically mitigate par losses through portfolio management. CLOs also benefit from the contractual requirement of portfolio diversification, which has contributed to more stable portfolio performance due to limited default correlation among underlying loans. Structural protections such as overcollateralization and interest coverage (OC/IC) triggers have also led to lower impairments for CLO debt compared to corporates and other asset classes.

CLO debt outperformed corporates, supporting lower RBC charges for CLO debt.
The data below – Moody's 10-year cumulative impairment rates by original rating for CLOs issued between 1993-2016 – clearly demonstrates the outperformance of CLO debt for all rating categories relative to corporates and other structured products. This suggests that RBC charges on CLO debt should not be increased and arguably should be lower than those for other asset classes.

	10-year cumulative impairment rate (%)			
Rating	**CLO**	**Corp**	**RMBS**	**CMBS**
Aaa	0.0	0.1	21.1	3.3
Aa	0.0	0.7	53.1	13.7
A	0.1	2.2	70.9	21.3
Baa	2.0	3.5	80.6	24.1
Ba	4.8	15.7	81.2	47.8
B	14.6	35.5	66.1	63.5
Caa		48.9		73.5

Source: Moody's. RMBS: residential mortgage-backed securities. CMBS: commercial mortgage-backed securities.

Over 75% of CLO equities had no principal losses, indicating current equity RBC charges are already conservative for most deals.
Data published by Amherst below indicates that among 797 CLOs issued between 1997-2016, over 75% of redeemed CLO equities (by deal count) have received their initial principal back. The 25th percentile internal rate of return (IRR) was 3%, which means that the equity in these CLOs received more than their initial principal back, resulting in a positive IRR. In addition, the IRR calculation assumed the equity tranche was issued at par, whereas CLO equity is typically issued below par. This would understate the IRR and further support the fact that greater

than 75% of CLO equities experienced no principal losses. By original equity balance, this trend was more pronounced. Since not all managers are the same, if useful, we are happy to share PineBridge's CLO performance, very strong overall. Nevertheless, the data below shows the current 20% (property and casualty) and 30% (life) RBC charges on CLO equity are likely too onerous for most CLOs.

	Min	25P'tile	50P'tile	75P'tile	Max
IRR	-46%	3%	11%	17%	50%
Orig. Equity Bal. ($million)	3	32	40	53	652

Source: Amherst Pierpont Securities, Portfolio Strategy, 26 July 2021, based on CLOs issued from 1997-2016.

Sincerely yours,
PineBridge Insurance Solutions and Strategies, CLO team, Leveraged Finance team

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