



May 8, 2023

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

Re: Exposure 2023-09-IRE—Interim Residual Tranche C1 Factor

Dear Chair Barlow,

On behalf of the American Academy of Actuaries<sup>1</sup> C1 Work Group (C1WG), thank you for the opportunity to comment on the interim residual tranche C1 factor of 45% that was exposed at the April 20 meeting of RBCIRE WG.

We are continuing our work toward a rigorous approach for setting collateralized loan obligation (CLO) C1 factors, including for CLO residual tranches.

As outlined in our [December CLO report](#) to the RBCIRE WG, the 30% C1 factor that currently applies to residual tranches is based on an analysis of the S&P 500, which is unrelated to residual tranches of structured securities. The same is true for the exposed 45% C1 factor proposal.<sup>2</sup> This is the case not only for CLOs, but for effectively all residual tranches.

We understand that regulators have a concern regarding residual tranche C1 and have exposed a new residual factor to be applied on an interim basis.

We agree with interested parties<sup>2</sup> that equities and residual tranches have materially different risk profiles. For this reason, we believe equities and residual tranches should not automatically share the same C1 factor.

Any factor that is adopted on an interim basis will be the product of regulator judgment, which we respect is at the discretion of regulators. We encourage a directed effort to substitute appropriate analytical basis for regulator discretion to establish statistically justified capital requirements for structured securities.

We look forward to supporting regulators in the broader objective of developing an appropriate basis for structured security C1 factors.

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<sup>1</sup> The American Academy of Actuaries is a 19,500-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.

<sup>2</sup> A 45% factor was first introduced in a Feb. 3 interested party letter by a coalition of life insurers. An April 12 letter by the same group of interested parties elaborated further on their support for a factor equal to at least 45%. The Feb. 3 letter justifies the level of 45% by applying a 1.5-beta adjustment to the current equity factor of 30%. The April 12 letter supplements this with historical loss data on the collateral of structured securities compared against typical sizes for residual tranches.

Sincerely,

Stephen Smith  
Chairperson, C1 Work Group  
American Academy of Actuaries