



Evaluating CLO Modeling Methodology and Stress Test Scenarios

FTI Consulting was engaged by the American Investment Council (“AIC”) to prepare an objective, unbiased study on the collateralized loan obligation (“CLO”) modeling methodology and stress test scenarios proposed by the National Association of Insurance Commissioners (“NAIC”).

SITUATION

Beginning in late 2022, NAIC published its proposed CLO modeling methodology and stress test scenarios to assess the credit risk of CLOs for setting the related capital charges for insurance companies.

AIC, which represents private equity companies, engaged FTI Consulting to review and comment on NAIC’s proposed CLO modeling methodology and stress test scenario assumptions.

FTI Consulting also provided recommendations to enhance NAIC’s proposed methodology for precisely evaluating and distinguishing credit risk between different CLOs.

OUR ROLE

We analyzed the proposed CLO modeling and showed that:

- The proposed CLO modeling failed to account for all factors relevant to credit risk, such as prepayment risk, purchase price discount, and default correlation.
- The proposed CLO modeling ignored qualitative risk factors and CLO dynamics.

We identified the limitations of NAIC’s proposed stress test scenarios, including:

- The proposed default and recovery rate data for the stress test scenarios did not reflect the credit risk of collateral.
- The proposed stress test scenarios did not reflect market reality.

We independently valued NAIC’s selected CLOs using Moody’s CDOnet software and assumptions consistent with the NAIC’s stated approach.

We calculated valuations and expected losses for each tranche with our own analytics using methods such as Monte-Carlo simulation and binomial expansion technique.

OUR IMPACT



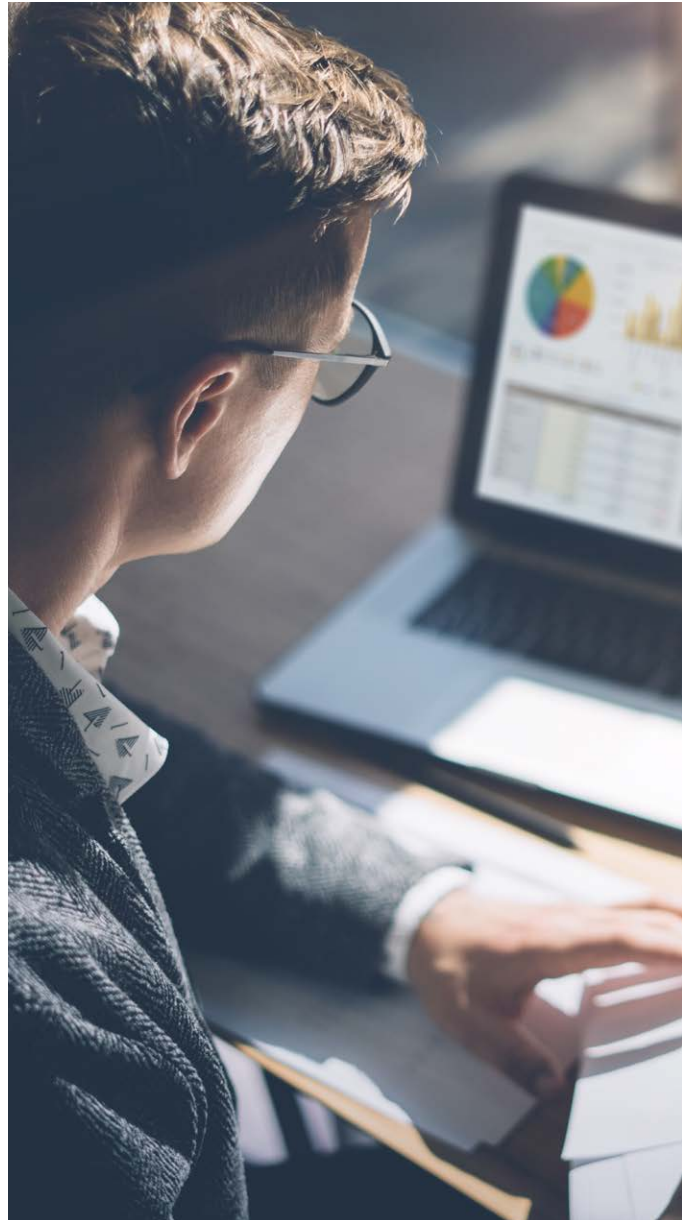
Our report was well received by the client and AIC members and received praise from preeminent private equity firms.



We presented findings and recommendations before the director of NAIC's Structured Securities Group ("SSG") and representatives from the NAIC Valuation of Securities Task Force.



Our work provided the client with key strategic options and critical foundations for evaluating NAIC's future proposal of CLO capital charges.



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