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U.S. Insurers' Exposure to Consumer Asset-Backed Securities as of Year-End 2018

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Executive Summary

- Consumer asset-backed securities (ABS) are structured finance investments that are collateralized by consumer loans and/or receivables that include auto, student loans and credit cards. They are not a significant portion of U.S. insurer investments, but they have the potential for volatility depending on current economic trends.
- The ability of consumer ABS to generate income depends not only on the soundness of the transaction structure, but also on the underlying consumer credit.
- U.S. insurer exposure to consumer ABS was about \$53 billion in book/adjusted carrying value (BACV) at year-end 2018, or less than 1% of total cash and invested assets and about 1% of U.S. insurers' total bond exposure.
- Within this total consumer ABS exposure, the majority of U.S. insurer exposure as of year-end 2018 was with auto loans at about \$30 billion.

For the purpose of this special report, consumer ABS refer to those securities collateralized by auto loans, credit card receivables or student loans. Like other types of structured securities—such as collateralized loan obligations (CLOs), for example—income generated by the underlying collateral pool (that is, principal and interest paid by the obligors) is used to pay full and timely debt service on the ABS on payment dates. The NAIC Capital Markets Bureau published a primer on ABS titled [Consumer Asset-Backed Securities](#) on April 2, 2019, which includes an overview of the mechanics of ABS, as well as inherent risks.

U.S. Insurer Exposure to Consumer ABS as of Year-End 2018

Historically, consumer ABS (and all structured finance securities in general) have been a small proportion of U.S. insurer investments. As of year-end 2018, U.S. insurers' total exposure to consumer ABS was about \$53 billion in BACV as reported by approximately 1,900 companies. Auto, credit card and student loans ABS represented \$30 billion, \$11.3 billion and \$11.6 billion, respectively. Auto ABS has accounted for the largest consumer ABS type held by U.S. insurers at least over the last few years as shown in Table

1. This may be due in part to a steady increase in origination of auto ABS over the last few years, while credit card and student loan ABS originations have fluctuated or remained stable.

Table 1: U.S. Insurer Investments in Consumer ABS, 2016–2018 (\$mil BACV)

ABS Type	2016	2017	2018
Auto	\$ 25,335	\$ 25,041	\$ 30,031
Credit Card	\$ 12,636	\$ 11,453	\$ 11,329
Student Loan	\$ 10,695	\$ 11,891	\$ 11,608
Total	\$ 48,666	\$ 48,386	\$ 52,969

Exposure to auto ABS increased about 20% from 2017 to 2018, while exposure to credit card ABS and student loan ABS remained relatively consistent. Auto ABS represented almost 60% of U.S. insurers’ consumer ABS exposure at year-end 2018. Overall exposure to consumer ABS increased by about 10% from 2017 to 2018—perhaps due to yield opportunities—compared to similarly rated, more “traditional” investments, such as corporate bonds.

Life companies accounted for almost half (47%) of the industry’s consumer ABS investments as of year-end 2018, with property/casualty (P/C) companies accounting for the second largest percentage (42%). (See Table 2.)

Table 2: U.S. Insurer Exposure to Consumer ABS by Industry Type, Year-End 2018, (\$mil BACV)

ABS Type	Life	P/C	Health	Fraternal	Title	Total	Pct of Total
Auto	\$ 12,676.8	\$ 13,683.2	\$ 3,086.6	\$ 578.3	\$ 7.2	\$ 30,032.1	57%
Student Loan	\$ 8,112.1	\$ 3,062.7	\$ 405.6	\$ 27.8	\$ -	\$ 11,608.1	22%
Credit Card	\$ 4,318.1	\$ 5,656.7	\$ 1,224.8	\$ 129.3	\$ 0.4	\$ 11,329.4	21%
Total	\$ 25,106.9	\$ 22,402.5	\$ 4,717.0	\$ 735.4	\$ 7.7	\$ 52,969.6	100%
Pct of Total	47%	42%	9%	1%	0%	100%	

In terms of credit quality, about 95% of U.S. insurer investments in consumer ABS carried NAIC 1 designations at year-end 2018. Another 4% carried NAIC 2 designations, and 1% carried NAIC 3 designations.

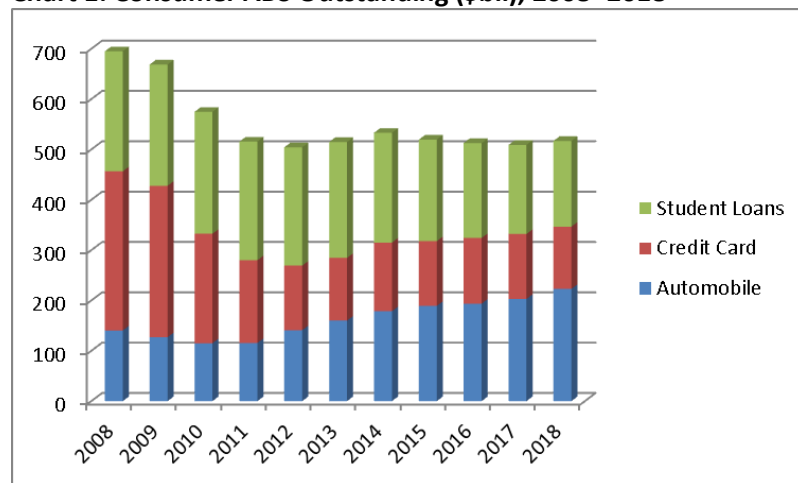
Consumer ABS Market Overview

Total ABS outstanding was about \$1.5 trillion through the first quarter of 2019,¹ a small decrease from \$1.6 trillion at year-end 2018, according to data from the Securities Industry and Financial Markets Association (SIFMA). Auto, student loans and credit cards accounted for an aggregate \$514.1 billion; auto ABS accounted for the majority at \$228.9 billion, followed by student loan ABS at \$165.8 billion and credit card ABS at \$119.4 billion as of March 31, 2019. According to SIFMA data, the remaining \$1 trillion includes commercial ABS, as well as collateralized debt obligations (CDOs) and CLOs. Chart 1 shows

¹ Securities Industry and Financial Markets Association (SIFMA), ABS Outstanding, First Quarter 2019 Year-End 2018.

historical consumer ABS outstanding for the most recent 10-year period. Note that credit card ABS outstandings have been on a declining trend since 2010, while auto ABS have increased.

Chart 1: Consumer ABS Outstanding (\$bil), 2008–2018



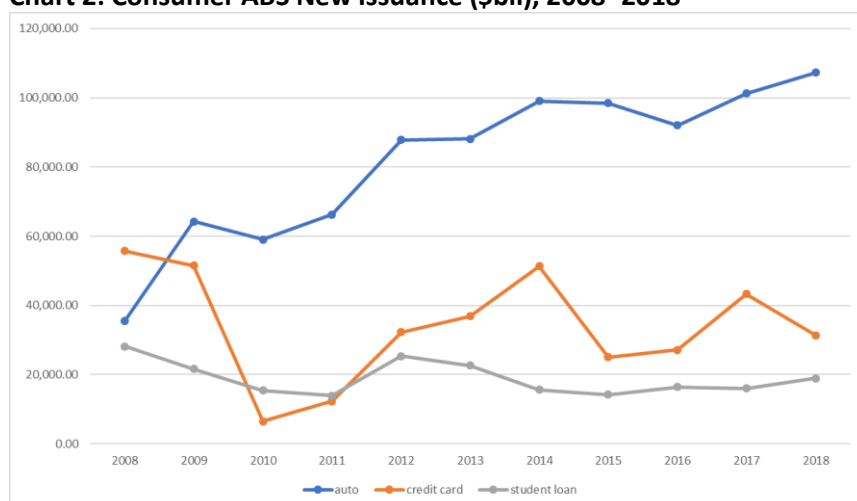
Source: SIFMA

Within auto ABS, those collateralized by subprime borrowers (that is, borrowers with less than mid-600 FICO scores), or subprime auto ABS, comprised 23.5% of total auto ABS outstanding at year-end 2018. This was higher than 16.8% at year-end 2017 and 21% at year-end 2016, according to SIFMA data. In addition, through the first quarter of 2019, subprime auto ABS represented almost 24% of total auto ABS outstanding.

In terms of new issuance, auto, student loan and credit card receivable ABS accounted for \$107.3 billion, \$18.9 billion and \$31.3 billion, respectively, as of year-end 2018, according to SIFMA data (totaling \$157.5 billion). Chart 2 shows historical consumer ABS new issuance for the most recent 10-year period. Auto ABS—which includes subprime (poor borrower credit quality) and prime (borrowers with the least credit risk)—have accounted for the majority of new issuance over the 10-year period. Student loan ABS—which includes transactions collateralized by federal and private loans—has, for the most part, accounted for the least amount of new issuance.

Through the second quarter of 2019, new issuance for auto, student loan and credit card receivable ABS totaled \$82.8 billion (auto: \$65.8 billion; student loans: \$7.3 billion; and credit cards: \$9.6 billion), according to SIFMA. In comparison, through the second quarter of 2018, new issuance was \$84.8 billion for the same three consumer ABS asset types. Specifically, year-over-year (YOY) through the second quarter of 2019, new issuance of auto ABS increased 15%, while there was a 42.7% decrease in credit card ABS and 32.5% decrease in student loan ABS.

Chart 2: Consumer ABS New Issuance (\$bil), 2008–2018



Source: SIFMA

With regard to auto ABS, according to Standard & Poor’s Global Ratings’ (S&P) 2019 outlook, new issuance is expected to increase YOY, led by subprime auto loan ABS.² Prime collateral performance is expected “to remain strong due to positive employment outlook, recovery rates stabilizing, and lenders tightening their credit standards or improving their mix of securitized loans.” The performance of subprime auto loans is expected to be “issuer-dependent,” with larger, more frequent issuers demonstrating results consistent with last year. According to S&P, about \$30 billion in subprime auto ABS new issuance occurred in 2018, compared to about \$25 billion in 2017³, as investors demonstrated comfort with the risk versus reward opportunity.

For credit card ABS, S&P expects new issuance in 2019 to be between \$30 billion and \$40 billion; note it had decreased from about \$47 billion in 2017 to \$36 billion in 2018 (25% decline). According to S&P’s 2019 outlook, new issuance will be driven by the refinancing of maturing notes, investor appetite and as a diversified funding source, among other reasons.

Student loan ABS includes federally backed loans as collateral (Federal Family Education Loan (FFEL) Program), as well as private loans. The FFEL Program ended in 2010, but loans issued out of this program were guaranteed or subsidized by the U.S. government at a low interest rate to students seeking post-secondary education. New issuance of student loan ABS collateralized by FFELP loans are expected to remain steady in 2019, according to S&P, due in part to refinancings as there is a strong investor base for these transactions. One large private issuer of student loans, Navient, is also expected to be active in 2019, thereby increasing new issuance of private student loan-backed ABS.

Summary

While interest rates have slowly and slightly increased over the last year, U.S. insurer investment in consumer ABS has also increased, perhaps due to the attractive relative value of the yield as compared

² S&P Global 2019 Outlook for Global Structured Finance, January 2019.

³ S&P Global, U.S. Auto Loan ABS Tracker: Full-Year and December 2018 Performance, February 2019.

to other fixed income investments with similar credit quality. Notwithstanding, consumer ABS, as well as other ABS and structured securities, account for a relatively small portion of U.S. insurer bond investments. For the three-year period ending 2018, U.S. insurer investments in consumer ABS had increased by about 10%, most of which was derived from auto ABS.

The NAIC Capital Markets Bureau will continue to monitor events and trends in consumer ABS and report as deemed appropriate.

Questions and comments are always welcome. Please contact the Capital Markets Bureau at CapitalMarkets@naic.org.

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