

INVESTMENT SOLUTIONS

What is tranche thickness, and why does it matter for life insurers?

Regulatory developments in structured credit



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Key takeaways

Tranche thickness is moving from technical detail to strategic consideration.

As CLO regulation evolves, structure may matter more alongside ratings.

Insurers that prepare early may be better positioned to manage risk, capital, and manager oversight.

For life insurers, structured credit analysis has long relied on ratings, attachment points, manager quality, and relative value. That framework still matters, but it may no longer be enough. As the NAIC revisits life risk-based capital (RBC) treatment for collateralized loan obligation (CLO), tranche thickness is emerging as an important risk measure, particularly for certain lower-rated debt tranches. The reason is simple: Two securities with the same rating may not produce the same modeled risk or capital outcome.

Tranche thickness explained

At a high level, tranche thickness refers to how large a tranche is relative to the overall CLO capital structure. A thicker tranche spans a larger portion of the liability stack; a thinner tranche covers a smaller slice. That may sound like a structural detail, but it affects how quickly a tranche can absorb losses once stress moves through the deal. In general, thinner tranches have less room for error. If losses begin to reach that part of the structure, the tranche can move from appearing stable to experiencing sharp deterioration more quickly. This is one reason regulators and modelers increasingly view thickness as relevant to tail risk, particularly for lower-rated tranches where structural protection is already more limited. Recent NAIC discussions describe tranche thickness as a potentially useful comparable attribute for assigning CLO C-1 capital factors, especially for tranches rated Baa3 or below.

Illustrative comparison

	Baseline C-1: Simple average	Modeled C-1: Thick tranche (>4%)	Modeled C-1: Thin tranche (≤4%)
Rating	Baa3	Baa3	Baa3
C-1 capital charge	5.94%	2.73%	12.52%
Headline takeaway	Average capital treatment may mask structural differences across similarly rated tranches	Thicker tranche may retain lower modeled capital treatment	Thinner tranche may attract meaningfully higher modeled capital treatment
Why it matters	Useful baseline, but it does not distinguish between thicker and thinner tranches with the same rating	Same rating, but more structural cushion	Same rating, but less cushion and greater sensitivity in stress

The illustrative comparison is directional, but it captures the central point. Under one of the approaches discussed in the current CLO RBC work, a Baa3 tranche that is thicker than the proposed cutoff could remain aligned with a lower factor, while a thinner Baa3 tranche could be treated much more conservatively. External summaries of the March 2026 regulator discussions indicate that the relevant breakpoint under consideration was 4% of the total deal for tranches rated Baa3 or below—reinforcing that structure, not just rating, may influence capital going forward.

Why regulators are focusing on it now

The broader regulatory objective is to refine the RBC framework to better reflect the actual risk profile of increasingly complex investments held by life insurers. In the CLO context, recent NAIC meeting materials and the March 2026 presentation from the American Academy of Actuaries suggest a few key conclusions. First, ratings still carry substantial information and remain the starting point for comparability. Second, senior tranches appear to have relatively low modeled risk, while risk rises sharply further down the capital structure. Third, for some lower-rated tranches, tranche thickness appears to add explanatory power because it helps identify where tail risk may be more concentrated. That is why a concept long understood by structured credit specialists is now becoming relevant to a wider insurance audience, including investment teams, risk leaders, and finance executives.

Implications for life insurers

For life insurers, the takeaway is not that ratings no longer matter, it's that ratings may not tell the full story in every part of a structured credit allocation. If tranche thickness becomes embedded in the RBC framework for certain CLO exposures, portfolio analysis may need to become more granular. That could affect how insurers compare apparently similar bonds, evaluate manager positioning in mezzanine risk, think about capital efficiency, and assess whether spread compensation is sufficient for the structural risk being assumed. It could also influence how insurers engage external managers and surveillance providers. A manager that emphasizes high-quality structured credit may still deliver very different capital outcomes depending on where, and how thinly, it invests within a transaction. In that environment, asking only for ratings distribution may be incomplete; insurers may also want reporting that shows structural positioning, tranche sizing, and concentration in areas where regulatory treatment could tighten.

In practical terms, insurers do not need to wait for final rules to begin preparing. A sensible first step is to identify where existing structured credit exposure may be sensitive to tranche-level structural features, particularly in lower-rated CLO holdings. The goal is not to overreact to a proposal still in development, but to ensure that portfolio construction, manager oversight, and capital planning are informed by the structural details that may matter more going forward.

Bottom line

Tranche thickness has traditionally been the kind of detail discussed by structurers, managers, and specialist analysts. That is changing. As the NAIC continues to evaluate CLO RBC methodology, life insurers should be prepared for a framework that may look beyond ratings alone in selected parts of the capital structure. Even if final rules evolve from the current proposals, the policy direction is clear: Regulators are seeking a more risk-sensitive treatment of structured credit, and structural features may matter more than they have in the past. For insurers active in CLOs and other structured sectors, now is a good time to review portfolio exposures, manager reporting, and internal frameworks to ensure that tranche thickness and similar structural considerations are on the radar before regulatory changes are finalized.

Sources:

- American Academy of Actuaries, C-1 Subcommittee Update on CLO C-1 Factors Modeling, presentation to the NAIC Risk-Based Capital Investment Risk and Evaluation (E) Working Group, March 2, 2026.
- NAIC, Risk-Based Capital Investment Risk and Evaluation (E) Working Group Summary, Spring National Meeting, March 2026.
- NAIC exposed proposal materials on CLO modified RBC structure and tranche thickness, 2026.
- NAIC proposal materials related to CLO factor treatment, 2026.

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