NEUBERGER BERMAN

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# Asset-Based Lending: Does It Work for Insurers?

As seasoned allocators know, asset-based lending (ABL) has been a staple of credit markets for decades. So why, all of a sudden, did the asset class grow so much and top the agenda of so many investors in 2024?

The first reason is that the **underlying assets** in ABL structures are evolving rapidly. Traditional commercial real estate lending, trade finance and credit card receivables are today complemented by assets such as NAV lending, GP financing, data centre loans and residential solar panel receivables.[1]

Secondly, **fintech companies** are becoming an increasingly important source of loans for ABL structures, as they increasingly disrupt banks' traditional hold on consumers with online Buy Now Pay Later or Point of Sale financing solutions.

These two trends have been facilitated, in turn, by the entry of private lenders into the environment. Finance providers seeking to fund their assets would traditionally go to banks, which have been constrained by regulation, or to the structurers of public asset-backed securities (ABS), which can be too standardised to accommodate what are often short-duration, alternative exposures. Private lenders have been able to step into this gap, offering bespoke solutions that match finance providers' assets (for commensurately higher yields), and packaging them into specialist funds or ABL structures for investors, many of whom are eager to find assets with this type of profile.

[1] See Peter Sterling and Sachin Patel, "Specialty Finance: High-Yielding, Short-Duration and Uncorrelated Private Credit" (May 2024), at https://www.nb.com/en/gb/insights/whitepaper-specialty-finance-high-yielding-short-duration-and-uncorrelated-private-credit.

**FIGURE 1. THE DIVERSITY OF UNDERLYING LOANS IN ASSET-BASED LENDING**

| "Traditional" Private Credit | | | "Alternative" Private Credit | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Corporate Lending | Commercial Real Estate Lending | Infrastructure Lending | Asset-Backed Lending / Specialty Finance | | | | | Corporate Lending | Insurance-Linked Solutions |
| | | | Consumer Finance | Hard Assets | Commercial | Real Estate | "Contractual" Cash Flows | | |
| Syndicated Loans | Super Senior Loans | Investment Grade | Credit Cards | Equipment Leasing | SME Lending | Residential Mortgages | IP | Capital Solutions | Industry Loss Warranties |
| Direct Lending | Senior Loans | Non-Investment Grade | Consumer Loans | Solar / Renewables | Trade Finance | Transitional Residential Lending | Royalties | Opportunistic | Catastrophe Bonds |
| | Whole Loans (unlevered) | | Auto Loans | Aviation | Media Lending | | Litigation | Stressed & Distressed Lending | |
| | Whole Loans (levered) | | Student Loans | Shipping | | | Regulatory Capital Relief | Venture Debt | |
| | Mezzanine Finance | | | | | | NAV Lending | Healthcare Lending | |
| | | | | | | | Software Lending | CLO Equity | |
| | | | | | | | GP Finance | GP Finance | |

Source: Neuberger Berman. For illustrative purposes only.

As spreads have tightened in public investment grade credit markets, many investors, including insurance companies, have sought to move further into high grade extended and private credit. However, insurers in particular have been active investors in traditional private credit, such as direct lending, for a decade and, as a result, many now have well-deployed portfolios. The growing diversity of the underlying loan and financing assets in ABL structures, away from traditional corporate exposures and toward more consumer-oriented and other alternative exposures, has made them an increasingly viable option for insurers' credit allocations.

Trade finance, commercial real estate lending and infrastructure debt may have played a sporadic role in asset allocations up until now, but today insurers are systematically scanning the ABL landscape with a view to selecting specific areas of the market to meet particular needs, or gaining broad access to the asset class.

## Does Asset-Based Lending work for insurance companies?

We believe ABL offers insurers several benefits. Figure 2 outlines the key differences between the typical underlying ABL and private credit loan. The borrowers are more diverse, the maturities are shorter and the amortisation schedules more frequent. Longer-duration assets such as student loans, 25-year mortgages and aircraft leases are an important part of the market, but the majority is much shorter.

**FIGURE 2. HOW UNDERLYING ASSET-BASED LENDING LOANS COMPLEMENT TRADITIONAL PRIVATE CREDIT**

| | Typical Asset-Backed Lending Investment | Typical Corporate Direct Lending Investment |
|---|---|---|
| **Borrower Credit & Backing** | Diversified assets, contractual cash flows, ring-fenced or bankruptcy-remote assets | Corporate entity and subsidiaries |
| **Key Investment Metrics** | Asset coverage ratio, amortisation schedule | EBITDA, EBITDA margin, leverage multiple, revenue growth |
| **Amortisation Schedule** | Monthly principal + interest payment - self-amortising | Quarterly interest-only payments, with lump-sum principal at maturity, often through refinancing |
| **Underlying Asset Duration** | Short term (1.5 years) | Long term (2 – 4 years) |
| **Remedies in Default** | Negotiation; in case of failure, enforce lien on assets and sell | Negotiation; in case of failure, become creditor in distressed reorganisation or bankruptcy proceedings |
| **Portfolio Diversity** | Highly diverse exposures (media, small businesses, corporate, real estate, etc.) | Diversified across GICS sectors |

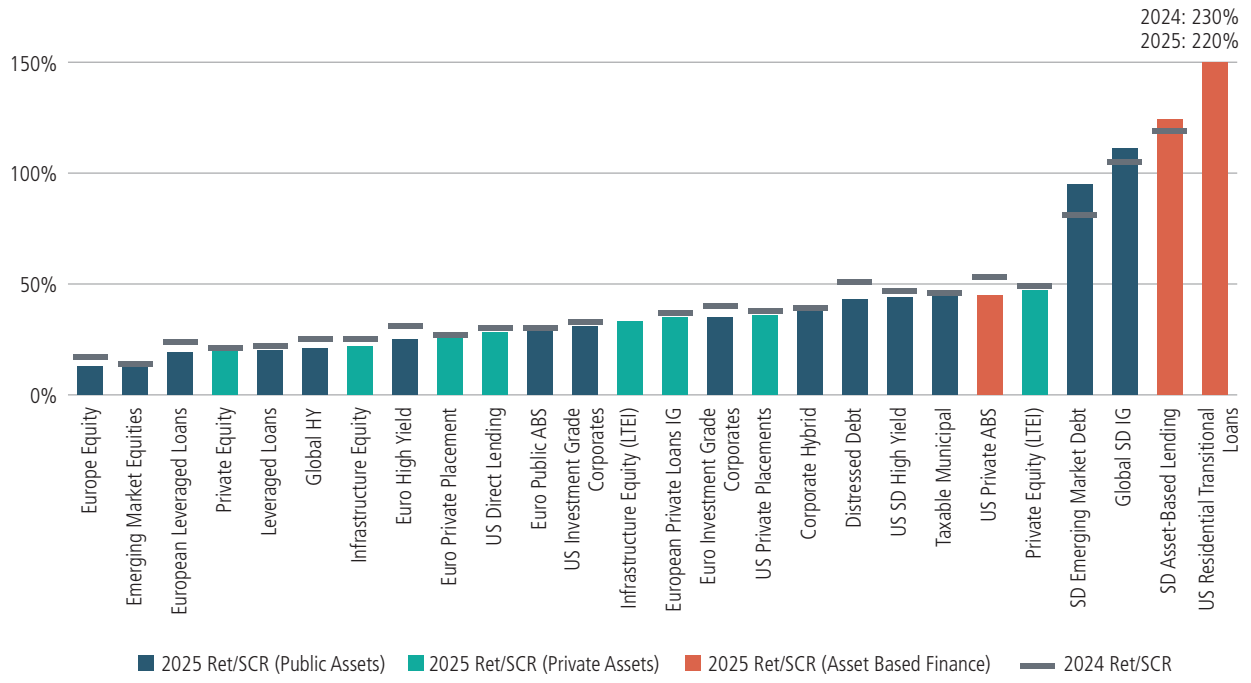
Source: Neuberger Berman. For illustrative purposes only. Illustrative examples are not representative of actual investments. This material is based on Neuberger Berman's market observations and analysis, such views and opinions are subject to change and there is no guarantee that any will prove to be accurate or that industry experts would agree.

This makes ABL not only a high-yielding diversifier, largely uncorrelated with traditional corporate direct lending, but also a highly cash-generative, "self-liquidating" asset class. These characteristics lower the risk of lending to higher-yielding borrowers, relative to other types of private credit, and also increase an investor's flexibility to adjust the risk profile of a portfolio in line with the changing opportunity set. Relative to the typical quarterly repayment schedules for traditional private credit, the monthly repayments associated with most specialty finance assets give investors a real-time view into the evolution of payment rates and delinquencies, potentially enhancing their insight into that opportunity set. Moreover, these are the characteristics of the underlying assets—in addition, investors benefit from the credit enhancement embedded in the ABL structure itself, which can often be customised.

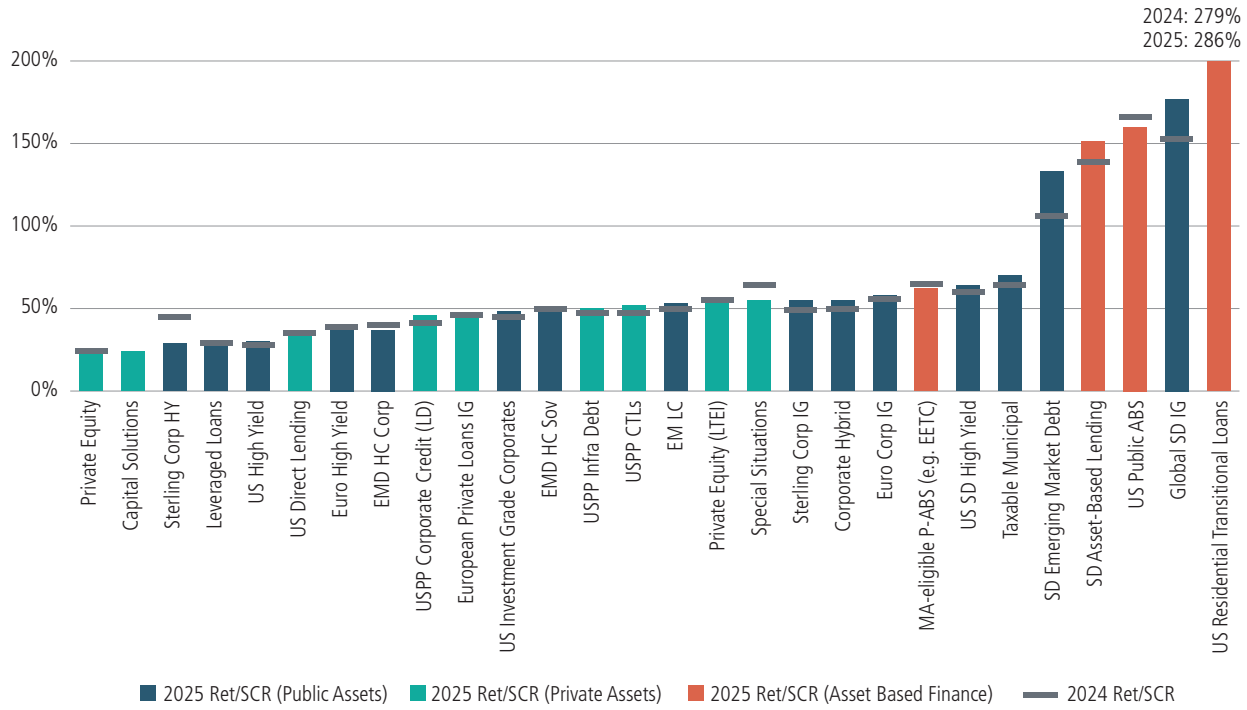
It is this profile, particularly in short-dated ABL, that makes the asset class so attractive in terms of return on Solvency Capital (figure 3).

**FIGURE 3. ASSET-BASED LENDING'S SOLVENCY CAPITAL EFFICIENCY**

Estimated annualised return in EUR divided by market SCR, 2024 and 2025



Estimated annualised return in GBP divided by market SCR, 2024 and 2025




Source: Neuberger Berman, Bloomberg-Barclays, J.P. Morgan, Morningstar LSTA, FTSE Nareit, NCREIF, Burgiss, infraMetrics. 2025 analytics are as of November 30, 2024; 2024 analytics are as of December 31, 2023. Top: Non-Euro assets are hedged to EUR using three-month forwards (-1.67% USD to EUR for 2025; -1.47% USD to EUR for 2024). Bottom: Non-GBP assets are hedged to GBP using three-month forwards (1.77% EUR to GBP and 0.10% USD to GBP for 2025; 1.30% EUR to GBP and -0.17% USD to GBP for 2024).
**IMPORTANT:** The performance and risk projections/estimates are hypothetical in nature and reflect the Neuberger Berman's Capital Market Assumptions. The estimates do not reflect actual investment results and are not guarantees of future results. Actual returns and volatility may vary significantly.

In short, it doesn't surprise us that ABL, and many of its specific underlying credit exposures, such as residential transition or "bridge" loans, became such a big topic of discussion among insurers in 2024.

With its relatively high yields, its short duration and its diverse set of credit exposures—which are still proliferating as technology disrupts the finance sector—ABL can fill a clear gap in insurers' credit portfolios while consuming only a modest amount of Solvency Capital.

## ASSET CLASS ASSUMPTIONS & ESTIMATES

Neuberger Berman Capital Market Assumptions Framework

| Asset Class | Return Estimate | Risk Estimate |
|---|---|---|
| Fixed Income | Market yields of public indices adjusted for default cost[1] | Historical volatility of monthly return series from 2007 |
| Equity | "Building Block" approach[2] | |
| Liquid Alternatives | Factor regression | |
| Illiquid Alternatives | "Building Block" approach[2] | Historical volatility of quarterly series from 2007 with de-smoothing |

Source: Neuberger Berman. For illustrative purposes only.

[1] For certain asset classes where a standard public index may not be readily available, NB will create a proxy index using a combination of similar asset classes. Default costs are estimated at the CUSIP level then aggregated to the index level; where CUSIP-level data is unavailable, NB will estimate default costs at the index level.

[2] Separate estimates are made for different sources of return (income yield, valuation change, earnings growth), and these "blocks" are aggregated to establish an asset class-level estimated return.

Capital market assumptions used herein reflect Neuberger Berman's forward-looking estimates of the benchmark return or volatility associated with an asset class. Estimated returns and volatilities are hypothetical return and risk estimates generated by Neuberger Berman's Institutional Solutions Group. Estimated returns and volatilities do not reflect the alpha of any investment manager or investment strategy/vehicle within an asset class. Information is not intended to be representative of any investment product or strategy and does not reflect the fees and expenses associated with managing a portfolio or any other related charges, such as commissions and surrender charges. Estimated returns and volatilities are hypothetical and generated by Neuberger Berman based on various assumptions and inputs, including current market conditions, historical market conditions and subjective views and estimates. Capital market assumptions shown reflect Neuberger Berman's long-term (20+ years into the future) estimates or intermediate-term (5-7 years into the future) estimates which are reviewed at least annually. Results will differ depending on whether they are based on Neuberger Berman's long-term (20+ years into the future) or intermediate-term (5-7 years into the future) capital market assumptions. Neuberger Berman's capital market assumptions are derived using a building block approach that reflects historical, current, and projected market environments, forward-looking trends of return drivers, and the historical relationships asset classes have to one another. These hypothetical returns are used for discussion purposes only and are not intended to represent, and should not be construed to represent, predictions of future rates of return. Actual returns may vary significantly. Neuberger Berman makes no representations regarding the reasonableness or completeness of any such assumptions and inputs. Assumptions, inputs, and estimates are periodically revised and subject to change without notice. Estimated returns and volatilities should not be used, or relied upon, to make investment decisions.

**Rate of Return Estimate:** Rate of return or geometric return is a measure of average returns of an investment over a period of time. Geometric rate of returns are typically referred to as annualised compound rate of returns and are always less than or equal to the arithmetic mean return of the same time series. Geometric rate of returns are used for straight-line calculations within the analysis, for example, the cash flow calculations. In straight-line calculations, each year is represented as a gain, so the compound (geometric mean) rate of return is used to adjust for the amount needed to make up for a loss in a given year. For example, if you lose 5% in one year, and gain 5% the year after, you still have less than you started with at the beginning of year one.

**Arithmetic Mean Estimate:** Arithmetic mean or average return is calculated by dividing the sum of a series of numbers by the number of overall items. This is more typically thought of as an "average" of the data set. Arithmetic mean or average return ignores the impact of compounding in the context of analyzing investment returns and is the simple average of returns observed over a period of time. Arithmetic mean returns are used in this material and, if applicable, the Efficient Frontier, because, through randomisation, losses and gains are being accounted for each year.

**Standard Deviation:** A statistical measure of the volatility based on the distribution of a set of data from its mean (average value). For example, a portfolio with an average return of 10% and a standard deviation of 15% would return a result between -5% and +25% the majority of the time (68% probability or 1 standard deviation), almost all of the time the return would be between -20% and +40% (95% probability or 2 standard deviations). If there were 0 standard deviation then the result would always be 10%. Generally, more aggressive portfolios have a higher standard deviation and more conservative portfolios have a lower standard deviation.

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