Senior securitisations for UK and European insurers: From capital penalty to portfolio opportunity

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Introduction

Senior non-simple, transparent and standardised (non-STS) securitisation has long sat at the edge of insurers' investable universe. This has rarely reflected a lack of structural merit. Rather, regulatory capital treatment, operational complexity and lingering post-global financial crisis scepticism have often outweighed the asset class's potential portfolio benefits.

That balance is now changing. Regulatory reforms in both the UK and European Union (EU) are making securitisation easier to assess and, in the EU, more capital efficient. For insurers able to approach the asset class selectively and with appropriate governance, the opportunity is becoming increasingly difficult to ignore.

The strongest case remains concentrated in high quality senior exposures. Senior AAA- and AA-rated collateralised loan obligations (CLOs) – securitisations backed by diversified pools of corporate loans – are the clearest example. The investment case also extends to selected senior non-STS securitisations where collateral quality, transparency, legal protections and ongoing surveillance are robust. These assets can provide diversified sources of spread income, significant structural protection and lower interest rate sensitivity than many traditional fixed income investments, supporting insurers' objectives around capital efficiency, income generation and balance sheet resilience.

Key takeaways

- **Regulatory reforms in the UK and EU are improving the investment case for securitisation by reducing operational barriers and, in the EU, introducing more risk sensitive capital treatment.** Over time, this could support a larger and more liquid market.
- **UK and European insurers remain under-allocated to securitised credit relative to US peers,** reflecting historical regulatory and implementation constraints more than any fundamental mismatch with insurers' investment objectives.
- **The most compelling opportunity remains in high quality senior exposures, in our view.** Senior CLOs, alongside selected residential mortgage-backed securities (RMBS), asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS), offer structural protection, diversification and attractive spread income without moving down the credit spectrum.
- **Implementation remains critical.** While delegation can reduce operational complexity, successful allocations still require robust governance, effective manager oversight and a disciplined approach to portfolio construction. Lloyd's syndicates and other investors using internal capital models may be particularly well positioned to benefit.

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A market that is becoming easier to reassess

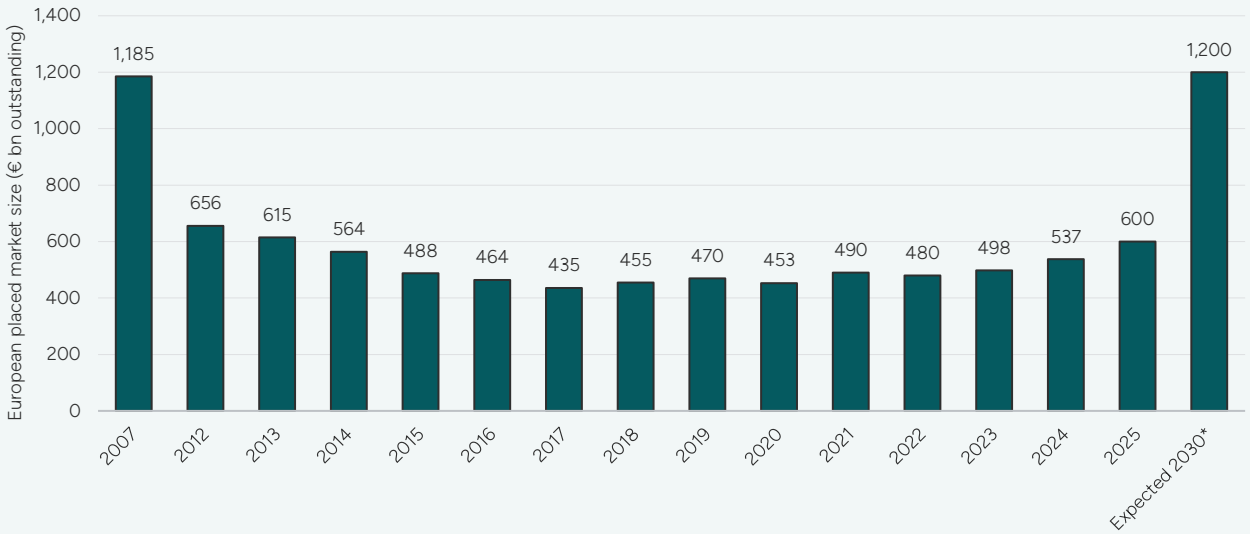
The case for senior securitisation has historically been stronger than aggregate insurer allocations would suggest. Senior tranches can offer exposure to diversified collateral pools outside the traditional corporate bond universe, often with floating rate coupons, substantial subordination (where junior tranches absorb losses first) and significant structural protection. Yet for many insurers, particularly those subject to standard regulatory capital formulas, the capital and operational burden has often outweighed these advantages.

Insurers using internal models have generally been better positioned to distinguish the risk profile of senior securitised assets from the broader regulatory treatment applied to the asset class. This helps explain why adoption has been uneven. The challenge has not simply been whether senior securitisation offers attractive risk-adjusted returns, but whether it can be implemented in a way that is capital efficient, operationally practical and sufficiently understood by investment committees, boards and regulators.

The result is a market that remains structurally under-owned by European insurers rather than structurally unsuitable for them. That distinction matters because regulatory and technical constraints have played a far greater role in shaping demand than concerns about the underlying risk profile of senior securitised assets. If capital treatment becomes less punitive and operational requirements more proportionate, insurers may find themselves reassessing a part of the market that has long sat outside mainstream allocations. The opportunity is as much about unlocking previously constrained demand as it is about rediscovering an overlooked asset class.

The significance of the reforms extends beyond lower capital charges. Reduced regulatory friction could help revive and deepen a market that remains well below its pre-crisis peak. When the revised rules become applicable on 30 January 2027, the investor-placed European securitisation market could grow from around €600 billion today to approximately €1.2 trillion over the next five years. A larger market would improve scale while supporting greater diversification, broader issuance and stronger secondary market liquidity.

European securitisation market growth could improve scale, depth and liquidity



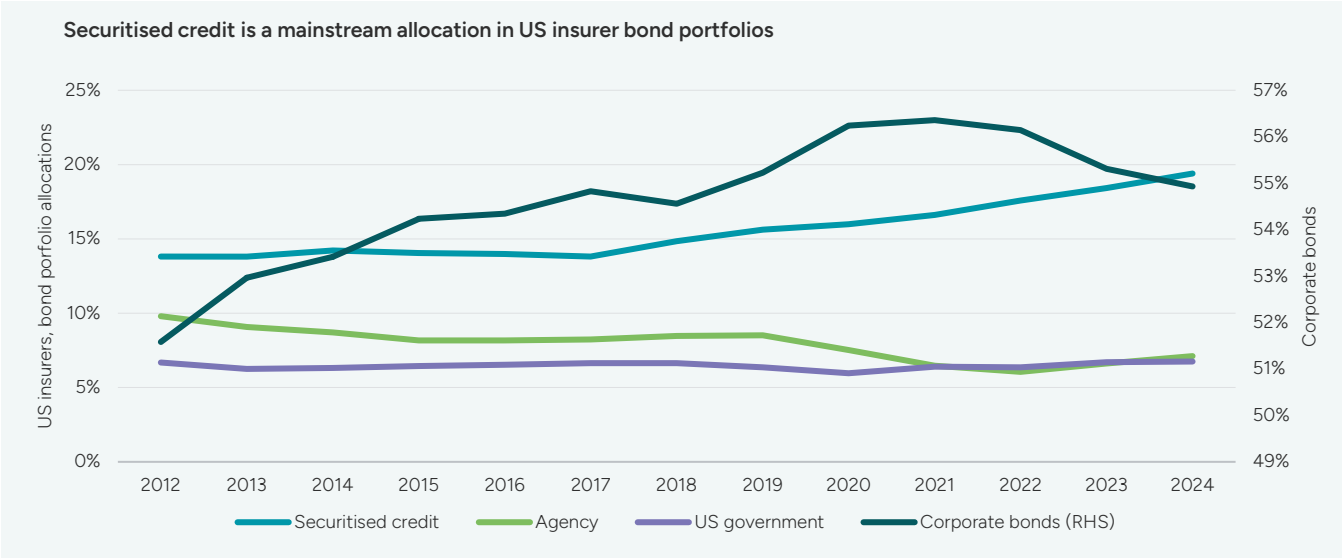
Source: M&G, Morgan Stanley Research, 31 December 2025.

Notes: *Forecasts are estimates and are not guaranteed.

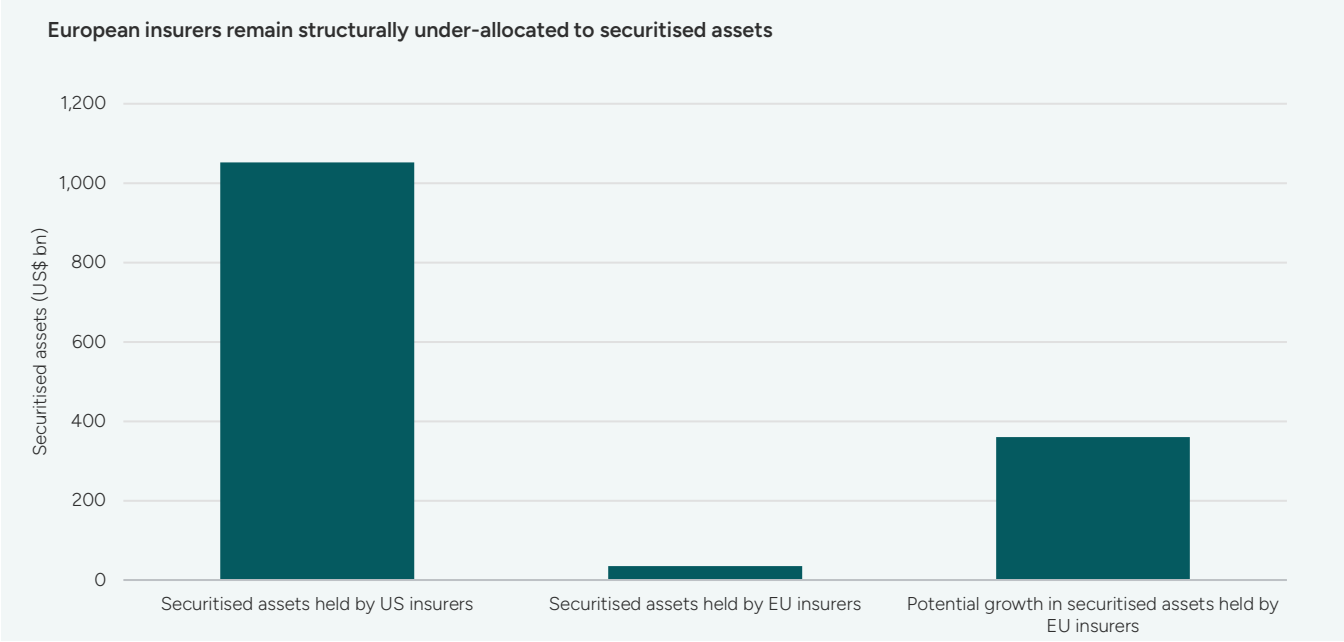
While securitised credit remains a relatively small allocation for European insurers, it represents a much larger share of US insurer portfolios. Once the asset class becomes less punitive from a capital perspective, even modest changes in allocation could have a meaningful impact.

This is why the current reform agenda matters. Beyond lowering capital charges, it has the potential to reshape the scale and liquidity of the European securitisation market. A more proportionate framework could encourage greater insurer participation, supporting deeper issuance and stronger secondary market liquidity.

The US provides a useful reference point. Securitised credit is not a niche allocation within US insurer bond portfolios. It has grown steadily over time and now accounts for around 19% of bond holdings (as shown on the chart overleaf). Corporate bonds remain the dominant allocation, but securitised credit has become an equally established component alongside agency and government exposures.



Source: M&G, Morgan Stanley, June 2026.



Source: M&G, Morgan Stanley, June 2026.

Notes: Figures shown are estimates and should be interpreted as indicative.

This does not suggest that European insurers should replicate US portfolios. However, it does demonstrate that securitised credit can play a mainstream role in insurance portfolios when the capital and implementation framework is more supportive. Viewed through that lens, Europe's low allocation to ABS appears less a judgement on asset quality and more a reflection of the legacy effects of punitive capital treatment and operational complexity.

The regulatory backdrop is becoming more supportive – but implementation still matters

The regulatory environment for securitisation is becoming more supportive, although the UK and EU are taking different approaches. In the UK, reform has focused on making the framework more practical for institutional investors through more flexible delegation of due diligence, less prescriptive reporting requirements and a more principles-based approach to implementation. In the EU, the more significant development for insurers is capital related. The Solvency II recalibration adopted in 2025 becomes effective from 30 January 2027 and introduces materially lower Solvency Capital Requirement (SCR) charges for senior securitisation exposures under the standard formula.

While both jurisdictions are moving in a more supportive direction, the emphasis differs. The UK has moved further on operational simplification, while the EU has moved further on capital recalibration. UK insurers should not assume automatic alignment with the EU regime, as Solvency UK capital treatment has not yet been revised in the same way. However, the UK framework is already becoming more accessible from a governance perspective, particularly through the clearer ability to delegate elements of due diligence and ongoing monitoring to specialist asset managers.

UK and EU securitisation reforms are moving on different tracks

1 November 2024

UK securitisation regime launch

New UK rules took effect, replacing assimilated EU legislation with provisions in domestic legislation and the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) rulebooks. The framework introduced a more principles-based approach to aspects of institutional-investor due diligence. .

17 June 2025

EU reform package proposed

European Commission unveiled proposals to amend the Securitisation Regulation, Capital Requirements Regulation (CRR), Liquidity Coverage Ratio (LCR) framework and Solvency II. With the intention of reducing capital and operational burdens, especially for senior non-STS tranches.

29 October 2025

Solvency II capital recalibration adopted (EU)

Delegated Regulation (EU) 2026/269 adopted. Introduced significantly lower SCR charges for senior STS and non-STS securitisations. Published in the Official Journal on 18 February 2026.

February – May 2026

UK PRA and FCA consultations

UK regulators consult on further reforms to the securitisation regime. Proposals include simplified due diligence and reporting, but no changes yet to Solvency UK capital treatment.

30 January 2027

EU Solvency II reforms effective

New capital rules for securitisation exposures under the standard formula become applicable. Senior tranches benefit from materially reduced SCR charges.

Q2 2027

UK implementation expected

Final UK rules from 2026 consultations anticipated to take effect, though final timing and requirements remain subject to the outcome of the consultation and publication of final rules. Potential for future Solvency UK capital updates remains under review.

Source: M&G, based on UK PRA/FCA and European Commission regulatory developments.

The Lloyd's market is especially relevant in this context. Lloyd's syndicates operate within an internal model framework, which means they are better placed than standard formula users to recognise the distinction between senior securitised risk and more generic regulatory treatment. High rated securitised assets are also permitted within both regulated (eg, Credit for Reinsurance Trust Fund) and non-regulated (eg, Lloyd's Dollar Trust Fund) portfolios, while Funds at Lloyd's (FAL) rules provide meaningful headroom for AAA- and AA-securitised assets before additional capital charges become relevant. For Lloyd's syndicates and other internal model investors, the opportunity is therefore not purely prospective. The combination of internal model recognition, trust fund eligibility and operational reform means senior securitised assets are already more investable than headline standard formula treatment would suggest.

For senior non-STS securitisation, the Solvency II recalibration is particularly significant. While it does not remove the need for careful asset selection, it materially changes the standard formula capital equation for senior tranches. As the tables below and overleaf show, the greatest capital relief is concentrated in senior non-STS exposures, where the existing framework often failed to distinguish adequately between senior and non-senior risk.

Under the revised framework, seniority becomes a far more meaningful driver of capital treatment. High quality senior non-STS tranches move significantly closer to traditional fixed income, while non-senior exposures remain materially more capital intensive. The same pattern is visible across both shorter and longer duration examples, reinforcing that this is a structural recalibration of how senior securitised risk is recognised, rather than a simple duration effect.

Revised Solvency II capital charges distinguish more clearly between senior and non-senior securitisation risk

2.5-year duration				
Current SCR	**STS senior**	**STS non-senior**	**Non-STS senior**	**Non-STS non-senior**
AAA	2.5%	7.0%	31.3%	31.3%
AA	3.0%	8.5%	33.5%	33.5%
A	4.0%	11.5%	41.5%	41.5%
BBB	7.0%	19.8%	49.3%	49.3%
Revised SCR	**STS senior**	**STS non-senior**	**Non-STS senior**	**Non-STS non-senior**
AAA	1.8%	5.0%	6.8%	18.5%
AA	2.3%	6.5%	8.3%	22.5%
A	3.5%	10.0%	11.0%	30.0%
BBB	6.3%	17.8%	18.8%	47.0%
% reduction	**STS senior**	**STS non-senior**	**Non-STS senior**	**Non-STS non-senior**
AAA	-30.0%	-29.0%	-78.0%	-41.0%
AA	-25.0%	-24.0%	-75.0%	-33.0%
A	-13.0%	-13.0%	-73.0%	-28.0%
BBB	-11.0%	-10.0%	-62.0%	-5.0%

Source: Bloomberg, Morgan Stanley, June 2026.

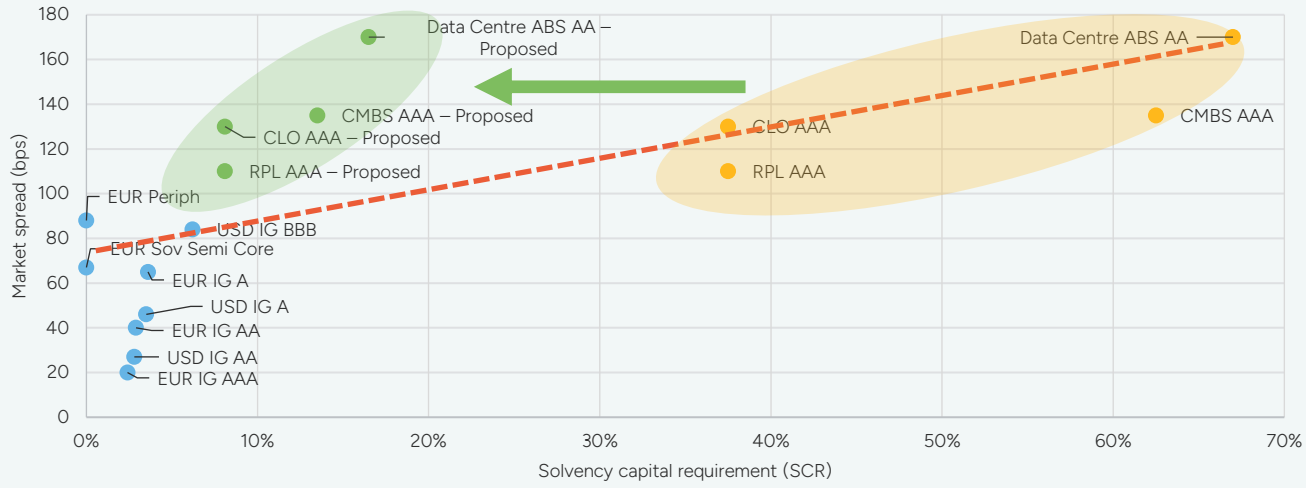
5-year duration				
Current SCR	**STS senior**	**STS non-senior**	**Non-STS senior**	**Non-STS non-senior**
AAA	5.0%	14.0%	62.5%	62.5%
AA	6.0%	17.0%	67.0%	67.0%
A	8.0%	23.0%	83.0%	83.0%
BBB	14.0%	39.5%	98.5%	98.5%
Revised SCR	**STS senior**	**STS non-senior**	**Non-STS senior**	**Non-STS non-senior**
AAA	3.5%	10.0%	13.5%	37.0%
AA	4.5%	13.0%	16.5%	45.0%
A	7.0%	20.0%	22.0%	60.0%
BBB	12.5%	35.5%	37.5%	94.0%
% reduction	**STS senior**	**STS non-senior**	**Non-STS senior**	**Non-STS non-senior**
AAA	-30.0%	-29.0%	-78.0%	-41.0%
AA	-25.0%	-24.0%	-75.0%	-33.0%
A	-13.0%	-13.0%	-73.0%	-28.0%
BBB	-11.0%	-10.0%	-62.0%	-5.0%

Source: Bloomberg, Morgan Stanley, June 2026.

This is consistent with the regulatory intent. The reforms are not an unconditional endorsement of securitisation as an asset class. Rather, they seek to distinguish more clearly between senior exposures with substantial structural protection and lower ranking positions that remain more vulnerable to collateral deterioration. For insurers, the opportunity therefore remains concentrated at the top of the capital structure, where high quality senior securitised assets now receive capital treatment that is more proportionate to their credit enhancement and structural protection.

The investment implications become even clearer when spread is considered alongside capital consumption, as illustrated in the chart below. Under the current framework, many senior securitised assets offered attractive spreads but were disadvantaged by relatively punitive standard formula capital charges. Under the revised framework, selected senior securitised exposures move materially left on the SCR axis while retaining a meaningful spread premium.

Revised SCR treatment improves the spread-versus-capital profile of senior securitised assets



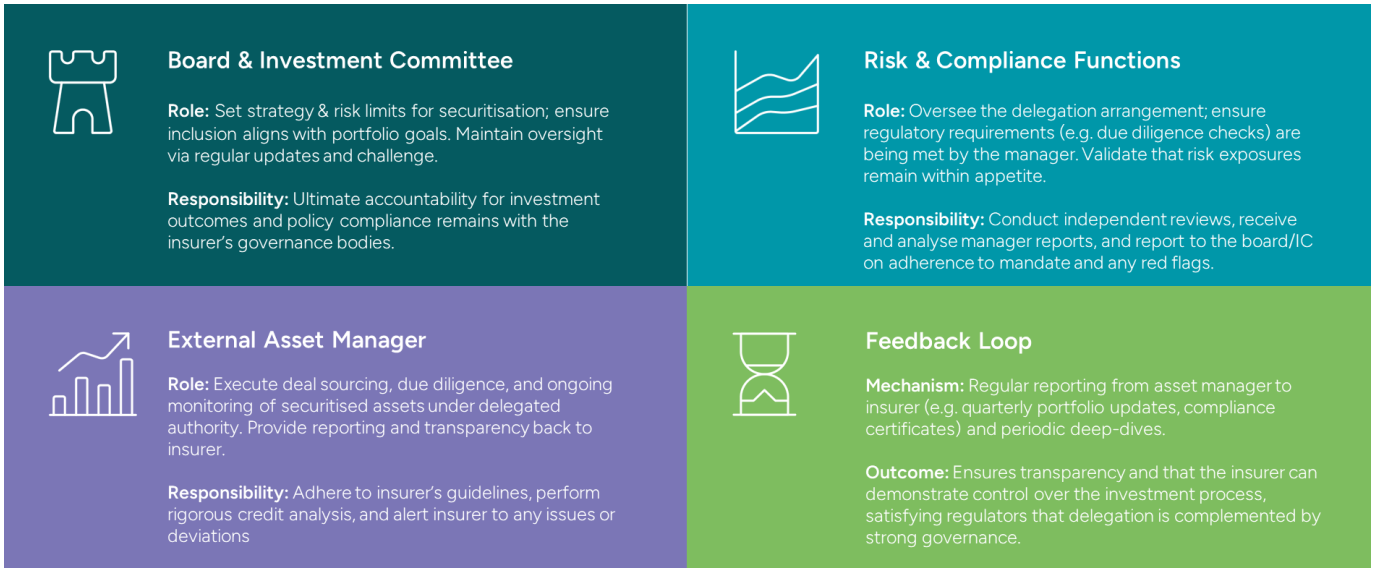
Source: Bloomberg, Morgan Stanley, June 2026.

Notes: Assets in the top left of the chart have higher return (market spread) and lower regulatory capital (standard model SCR). The adopted recalibration (orange points to green points) materially improves the attractiveness of securitisation exposures.

Operationally, however, lower friction does not mean lower standards. Delegation can materially reduce the burden of investing in securitised assets, particularly for insurers without large in-house structured credit teams, but it does not remove accountability. Investment committees and boards still need to understand the role securitisation plays within the portfolio, how risks compare with corporate credit and other spread assets and how manager oversight will operate in practice.

Delegation is therefore best understood as a control framework rather than a transfer of responsibility. The asset manager may perform deal sourcing, credit analysis, due diligence and ongoing monitoring under delegated authority, but the legal allocation of responsibility depends on the status of the delegating investor and managing party and on the terms of the delegation. In specified circumstances under the UK rules, the managing party may be responsible for failure to perform a delegated securitisation obligation. Irrespective of that regulatory allocation, investment, risk and compliance functions need to oversee the delegation arrangement, review reporting, test adherence to mandate and escalate issues where required. The table below illustrates the governance architecture needed to make that delegation work in practice.

Delegated due diligence requires clear roles, oversight and reporting loops



Source: M&G.

Notes: Illustrative governance framework for delegated securitisation due diligence and monitoring.

Senior securitised assets: Structural resilience, diversification and relative value

For insurers, the case for senior securitised assets begins with portfolio function rather than headline yield. Senior AAA- and AA-CLO tranches are among the most visible and scalable examples, but the broader opportunity extends across selected senior securitisations where the underlying collateral is understandable, the structure is robust and ongoing monitoring can be performed effectively.

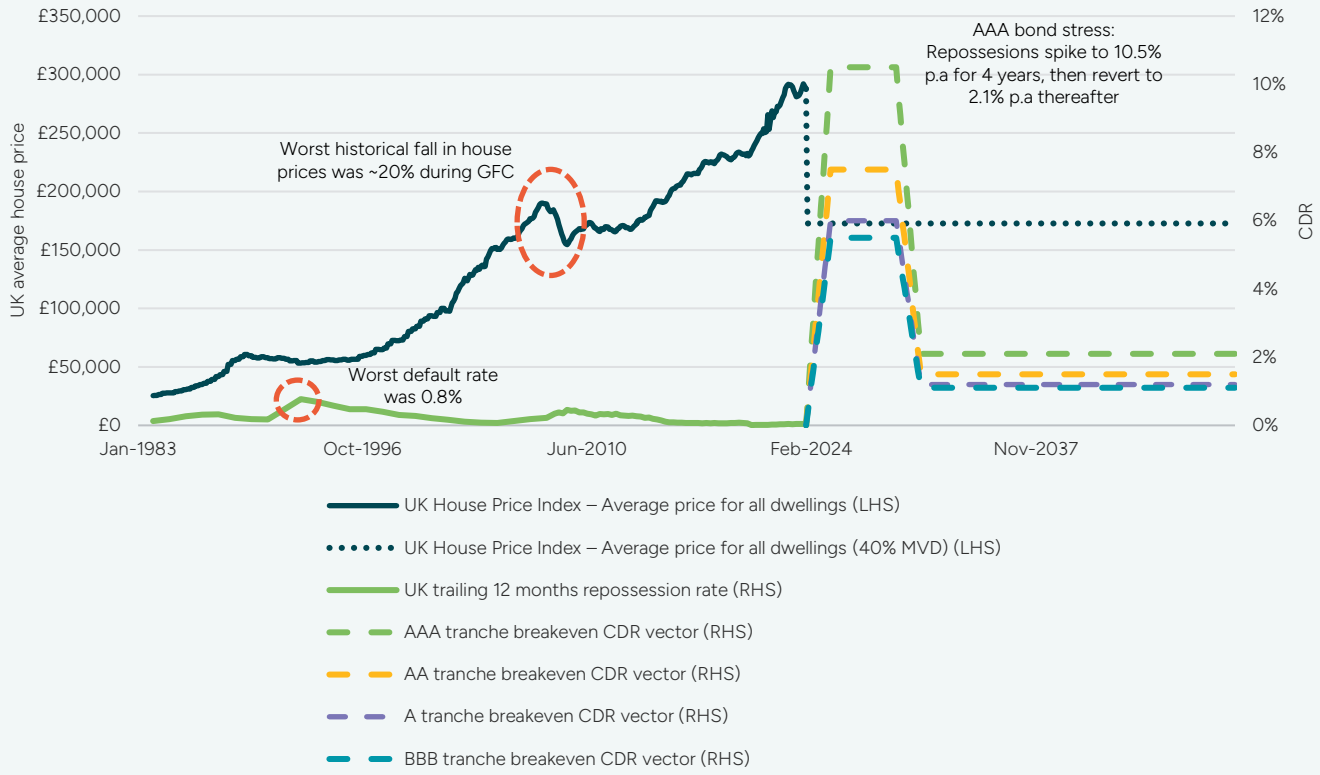
The appeal is rooted in three characteristics: diversification, structural protection and relative value. CLOs, for example, provide exposure to diversified pools of senior secured loans across a broad range of borrowers, sectors and vintages. This breadth of underlying exposure can be difficult to replicate in a traditional corporate bond portfolio, where credit risk is often concentrated in a smaller number of large issuers. Other areas of the senior securitisation market, including RMBS, consumer ABS, auto ABS and CMBS, can provide exposure to collateral pools that are distinct from the unsecured corporate credit universe. This can broaden the sources of spread income available to insurers.

Most senior securitised assets also offer limited interest rate duration. Senior CLO notes are typically floating rate instruments, while other securitised assets often have shorter spread duration than traditional fixed rate corporate bonds. For non-life insurers and Lloyd's syndicates, this can be especially relevant. The objective is not simply to add yield, but to earn compensated spread income without materially increasing interest rate sensitivity, liquidity strain or mark-to-market volatility.

The defensive characteristics of senior securitised assets are equally important. Senior securitised assets are not simply direct exposures to pools of loans, mortgages or receivables. They benefit from structural protections including subordination, over-collateralisation (collateral exceeds debt issued), eligibility criteria, performance triggers and cashflow diversion mechanisms. Together, these features are designed to absorb deterioration in the underlying collateral before losses reach senior investors.

These characteristics are illustrated by the UK RMBS stress example below. The exhibit shows the degree of deterioration required before an illustrative AA-rated UK RMBS bond incurs principal loss. In this scenario, losses would only begin after a highly severe combination of stresses: a 40% fall in UK house prices with no recovery, together with defaults on more than 70% of the underlying mortgage pool. This is set against a historical backdrop in which the worst historic fall in UK house prices shown was around 20% during the global financial crisis, while the worst observed default rate was 0.8%. The modelled stress therefore assumes a far more severe combination of house price and default outcomes than the historical stress periods shown in the chart.

Senior securitised assets can demonstrate significant structural resilience



Source: M&G, Bloomberg, Intex, January 2024. For illustrative purposes only.

Notes: CDRs are annualised figures.

The point is not that all securitised assets behave in the same way or that historical experience provides a guarantee of future outcomes. Rather, it demonstrates why tranche seniority and credit enhancement matter. Where collateral quality is robust and structures are appropriately designed, senior securitised assets offer downside protection that is not captured by a simple look-through to the underlying collateral pool.

This distinction is particularly important for CLOs. A senior CLO tranche is not equivalent to owning the underlying leveraged loan portfolio directly. Whilst the underlying collateral is sub-investment grade, the senior tranche benefits from diversification, subordination and contractual protections before principal losses are incurred.

The relative value case is the second part of the argument. Senior securitised assets have typically offered wider spreads than equivalently rated corporate bonds, reflecting a combination of complexity premium, regulatory capital treatment, technical demand constraints and the specialist nature of the market.

This does not make senior securitised assets a direct substitute for corporate bonds. The risks are different. Securitised assets require specialist analysis of collateral quality, structural protections, documentation, servicer behaviour, manager quality and liquidity. But that is also why the premium exists. For investors with the governance framework and manager capability to evaluate these features, the asset class can provide a distinct source of compensated spread rather than simply another expression of corporate credit beta – which is arguably already over-represented in existing insurer balance sheet allocations.

What insurers should focus on

For insurers considering the asset class, four questions are central, in our view:

1. **What role should the allocation play?** Senior securitisation supports several objectives: diversifying corporate credit exposure, adding compensated spread income, reducing reliance on fixed rate duration, improving capital efficiency or accessing collateral pools that are not available through traditional corporate bond markets. The intended role should be explicit from the outset, as it will shape the appropriate asset mix, rating profile, liquidity requirements and governance framework.
2. **Where in the capital structure should the insurer invest?** For most insurers, the strongest case remains at the senior end. The adopted EU Solvency II recalibration reinforces this point by providing the greatest relative improvement in capital treatment for senior tranches, while leaving mezzanine and junior exposures materially more capital intensive.
3. **Which collateral types are appropriate?** CLOs may offer scale, floating rate exposure and spread, but they are not the whole opportunity. Senior RMBS, consumer ABS, auto ABS and selected CMBS may also be relevant, depending on the insurer's objectives, liquidity needs, risk appetite and governance capacity. The common requirement is not the asset class label, but the quality of the collateral, the transparency of the structure and the ability to monitor performance through time.
4. **How will due diligence and monitoring be performed?** Delegation can reduce the operational burden, particularly under the UK's more principles-based framework, but it does not remove accountability. Insurers still need to understand what has been delegated, what reporting they will receive, how limits will be monitored and how exceptions will be escalated. Manager selection, documentation review, collateral surveillance and liquidity monitoring remain central to responsible implementation.

These questions are the conditions under which the opportunity can be accessed responsibly. The insurers most likely to benefit are those that treat senior securitisation as a disciplined portfolio allocation, rather than as a tactical search for additional yield.

Conclusion

Senior AAA- and AA-rated CLOs, alongside selected senior non-STS securitisations, are not new instruments. What is changing is the environment in which insurers assess them. The UK has made securitisation more accessible through a more flexible framework and greater scope to delegate due diligence, while the EU has adopted a more risk sensitive capital regime for senior securitisation exposures that will take effect from 30 January 2027. At the same time, UK and European insurers remain materially under-allocated to securitised credit relative to their US peers.

For Lloyd's syndicates and other internal model investors, the implications are especially immediate. These investors are already better placed to assess senior securitised assets through a more risk-sensitive lens, making the opportunity more immediate than a post-2027 story. For European standard formula insurers, the adopted capital recalibration will make senior securitisation easier to assess relative to traditional fixed income, particularly where spread income, diversification and capital efficiency are important portfolio objectives.

The opportunity is not simply an uplift in yield. It is the ability to build a credit portfolio that is more diversified, more structurally protected, less dependent on unsecured corporate risk and better aligned with insurer balance sheet objectives. As regulatory treatment becomes more risk-sensitive and insurers continue to search for resilient sources of spread, senior non-STS securitised assets are moving from the margins of the allocation debate to a more central role in portfolio construction.



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