



ALLIANCEBERNSTEIN®

AB DIMENSIONS

## Residential Mortgage Loans

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Mortgage Credit,  
Rebuilt for Insurance Portfolios

Residential mortgage whole loans (RMLs) are emerging as one of the most compelling private, fixed-income-like allocations for US insurers. They combine a private credit yield premium with high credit quality and amortizing cash flows, while offering balance-sheet advantages insurers care about most: low risk-based capital (RBC) factors as set by the National Association of Insurance Commissioners (NAIC), amortized-cost statutory accounting, and Federal Home Loan Bank (FHLB) pledgeability that unlocks stable, low-cost contingent liquidity—features that are difficult to find elsewhere in private markets.

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# Why RMLs and Why Now?

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## Key Takeaways

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### Low Risk-Based Capital (RBC) Requirements:

For life insurers, the ability to hold less capital against these assets frees up resources for other uses.

2

### Stable and Predictable Accounting:

Insurers can account for the loans at amortized cost—the loan's original cost adjusted for repayments and interest—rather than their market value. That comes with several advantages. For example, a rise in interest rates would not show up as a reduction in statutory capital.

3

### Federal Home Loan Bank (FHLB) Pledgeability:

Loans can be used as collateral with the FHLB, providing insurers with liquidity and access to stable, low-cost funding.

4

### Yield Premium:

Private whole loans have the potential to enhance income generation by offering a yield premium over comparable public loans while helping to diversify exposure to corporate credit and commercial real estate.

## A Structural Shift in the Mortgage Market

Today's backdrop likely strengthens the case: chronic US housing undersupply, high borrower equity and strong underwriting standards have helped produce resilient credit fundamentals, while banks and agencies have stepped back, creating wider spreads and deeper opportunity sets for private buyers. This environment aligns well with the long-duration, liability-aware nature of insurance balance sheets.

Since the global financial crisis (GFC), access to this market has been especially critical for long-term investors. With a lower volume of traditional structured products and the majority of non-agency mortgage risk now trading in whole-loan form, insurers that are not investing in loans are effectively missing an entire asset class. Without a loan platform or the ability to invest directly in residential loans, it is increasingly difficult to capture the full mortgage credit opportunity set.

Investments in US non-agency mortgages today are more often available in whole-loan form, and lending continues to migrate from commercial banks to asset managers and other private lenders. A supportive macroeconomic backdrop, marked by a chronic US housing shortage and high borrower equity, also helps to fortify the credit fundamentals of these assets.

## Lessons from Stress Periods

Periods of market stress have reinforced that how insurers access residential mortgage risk matters as much as whether they do. Pre-GFC, most non-agency mortgage risk was packaged into structured products; today, a much smaller share of origination ends up in securitizations, and a far larger share trades in whole-loan form. Investors who simply wait for CUSIPs and buy bonds are competing for a relatively limited supply, while those with the ability to invest directly in loans can access the broader opportunity set.

Stress environments have also underscored that residential mortgage whole loans (RMLs) are most attractive when supported by the full toolkit described above: disciplined, loan-level underwriting and analytics, robust diligence and servicing oversight, thoughtful structuring, and insurance-grade reporting and governance. In our experience, these elements are essential to navigating volatility, preserving credit performance and fully realizing the benefits of the asset class—particularly when the market is dislocated.

# Why Residential Loans Make Sense for Insurance

Private loans offer key benefits for insurance company balance sheets that are difficult to replicate elsewhere in private credit markets:

- **Capital Efficiency**

For life insurers, RMLs are assigned a 0.68% RBC factor, versus 0.82% for A-rated and 1.52% for BBB-rated corporate bonds. When combined with loss-adjusted yields, this has the ability to translate into meaningfully higher return on RBC (RoRBC) for Prime Jumbo, Agency NOO and Non-QM RMLs relative to A/BBB corporates.

- **Favorable Accounting Treatment**

Insurers can account for the loans at amortized cost—the loan’s original cost adjusted for repayments and interest—rather than their market value. That comes with several advantages. For example, a rise in interest rates would not show up as a reduction in statutory capital, providing stability through rate cycles.

- **Liquidity Access via FHLB Pledgeability**

Loans can be used as collateral with the FHLB, providing insurers with liquidity and access to stable, low-cost funding. This pledgeability unlocks contingent liquidity that is difficult to find elsewhere in private markets.

- **Yield Premium**

Unlike public mortgage-backed securities, private whole loans often come with more robust underwriting standards. They have the potential to enhance income generation by offering a yield premium over comparable public loans while helping to diversify exposure to corporate credit and commercial real estate (CRE).

- **Diversification Benefits**

Whole mortgage loans have the potential to diversify insurers’ commercial real estate and corporate credit holdings. Insurers can also select individual loans in relation to their credit requirements, allowing for tailored portfolio construction.

- **Credit Quality in a Supportive Environment**

Strong underwriting standards, high borrower equity and structural housing undersupply have helped produce resilient credit fundamentals. The chronic US housing shortage supports property values, while high borrower equity provides a cushion against potential losses.

## Attractive Investment Characteristics



Private credit yield premium with fixed-income characteristics; diversifies corporate and CRE credit



Strong demand and regulatory support provide tailwinds for US housing market



Large and growing market results in ample supply of high-quality assets



Greater risk management and control over credit/risk selection and servicing versus public residential credit

## Efficient Asset Class for Insurance Investors



Attractive return on regulatory capital



Loans are carried at amortized cost for statutory reporting, so rising rates don’t reduce statutory capital

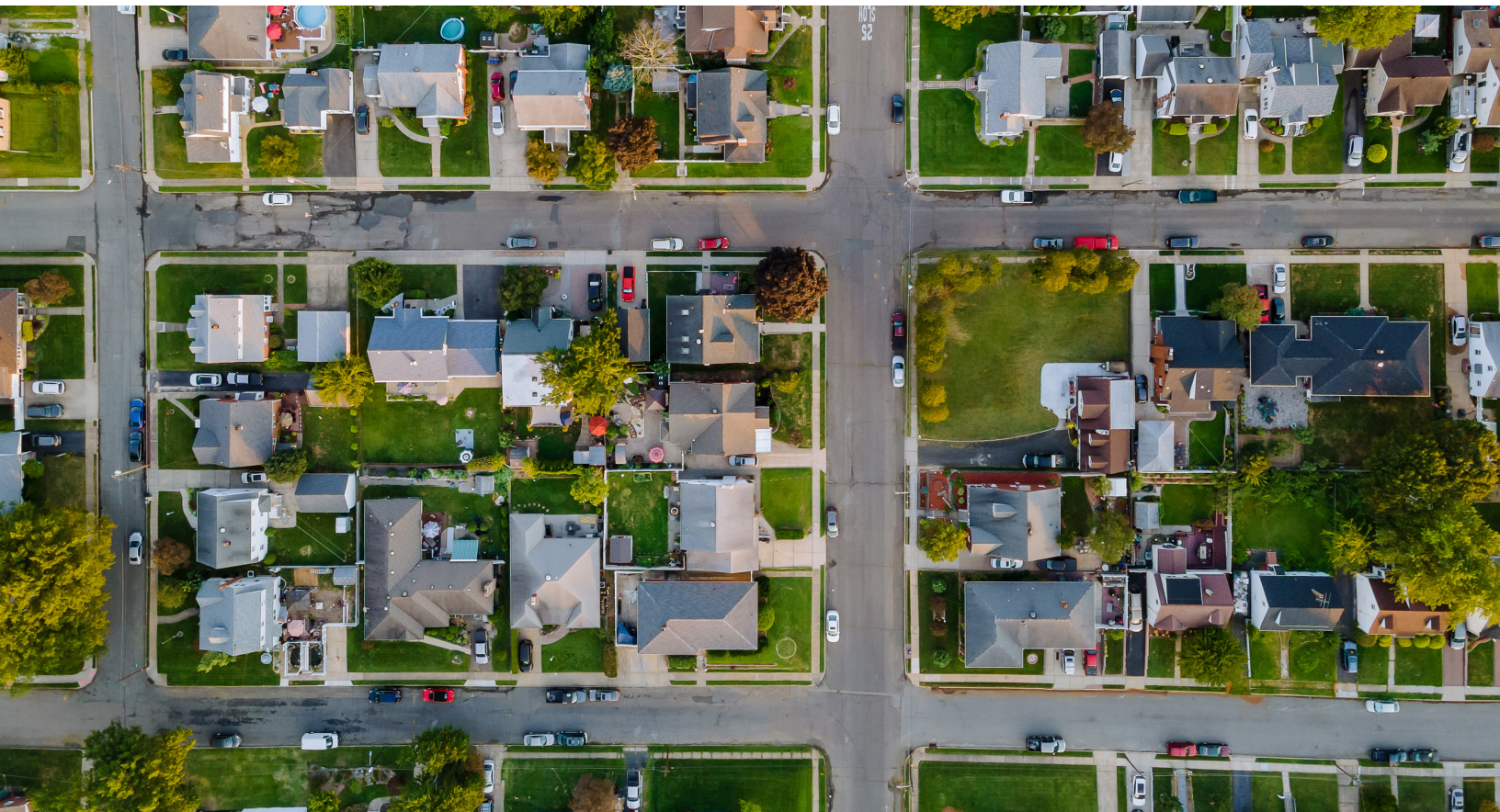


Assets can be pledged to the FHLB in exchange for stable, low-cost advances

## Types of Residential Loans Insurers Can Consider

An insurer-optimized portfolio seeks to blend sub-sectors with complementary credit and convexity traits. The following loan types offer different risk/return profiles that can be combined to meet specific balance-sheet objectives:

- **Prime Jumbo**  
High FICO, low loan to value (LTV), full documentation, best-in-class credit quality; core holding for conservative balance sheets.
- **Non-QM**  
Creditworthy but nontraditional documentation (e.g., self-employed); attractive coupons and prepayment penalties that enhance yield and convexity.
- **Debt Service Coverage Ratio (DSCR)/Investor Loans**  
Underwritten to property cash flow; strong collateral coverage and prepay protections; useful for yield and convexity.
- **Agency NOO/Investor**  
Agency-eligible investor properties with distinct prepayment dynamics compared to owner-occupied loans. These offer a different behavioral profile that can complete other loan types in a diversified portfolio.
- **Seasoned/Discounted Pools**  
Loans with a seasoning history and purchase discounts that often deliver positive convexity and strong cash carry. The combination of seasoning and purchase discounts can provide attractive risk-adjusted returns with favorable duration characteristics.



# Convexity—What Matters and How We Manage It

## Beyond the Agency MBS Paradigm

Insurers often equate “mortgages” with the negative convexity of agency mortgage-backed securities (MBS). Non-agency RMLs behave differently. Prepayment frictions (penalties in non-QM/DSCR), borrower rate locks (sub-4% legacy mortgages), smaller balances, state/judicial dynamics and purchase discounts all contribute to muted negative or even positive convexity, especially in non-QM/DSCR and seasoned pools.

Agency MBS issued by Fannie Mae and Freddie Mac—once the mortgage mainstay of insurance company balance sheets—came with high negative convexity. That was mostly a function of prepayment risk: when interest rates declined, borrowers refinanced their loans, and the securities were often paid off prematurely.

Non-agency residential mortgages often behave differently. Pacing of deployment, prepayment restrictions, smaller balances, borrower “rate locks” and other common features of nonqualifying loans all have the potential to mitigate negative convexity in large pools of nonqualifying and seasoned loans.

## AB’s Approach to Convexity Management

AB’s process embeds convexity considerations at portfolio construction:

- **Multi-Scenario Modeling** (Base, Stress, Severe Stress)  
On all acquisitions, with constant prepayment rate/constant default rate (CPR/CDR), loss severity, duration and convexity measured loan by loan. This framework underpins security selection, pricing and convexity/asset and liability management (ALM) construction.

- **Securitization Optionality**

Aggregate-and-securitize execution with tailored tranche retention/sales can further fine-tune outcomes—shaping duration and convexity while preserving economics and optionality for exit. The mix of products we invest in is also designed to help offset traditional negative convexity.

- **DSCR Loans**

These typically feature prepayment penalties, which slow refinancings and help support more stable, convexity-friendly cash flows.

- **Prime Jumbo Loans**

We often target seasoned or discounted paper, including lower-coupon loans purchased below par, which can reduce prepayment sensitivity and improve convexity.

- **Non-QM Loans**

Borrowers often have fewer “plain vanilla” refinancing options (e.g., nontraditional documentation or higher debt-to-income ratio), which can make these loans less purely rate-driven and more resilient to standard refinance waves.

- **Agency Exposure**

We are selective in our use of agency product and generally avoid “plain vanilla” agency pools that carry the most pronounced negative convexity.

## Portfolio Management: Negative Convexity Mitigants

Ability to model and understand behavior on a loan level based off all relevant characteristics is paramount for mitigating negative convexity

<b>Discount Loans</b>	Borrowers locked in by lower-than-market loan rates have little incentive to refinance or move to a new home, providing lower speeds and positive convexity.
<b>Loan Features</b>	Prepayment penalties found in non-QM/DSCR loans discourage borrowers from refinancing loans and compensate lenders when they are refinanced early.
<b>Loan Type</b>	For on-the-run originations, non-QM loans are observed to have the best convexity, followed by agency investor non-owner occupied, with prime jumbo loans generally having the worst negative convexity.
<b>Loan and Property Characteristics</b>	Smaller balance loans, higher LTV loans and loans in certain states are generally observed to have slower prepayment speeds.
<b>Originators</b>	Originator behavior may include soliciting borrowers persistently to increase origination volumes.

The correspondent business acquires loans daily, capturing current rates and avoiding timing risk.

# RBC Treatment and Capital Efficiency

## Life Insurers

As mentioned, for life insurers, RMLs are assigned a 0.68% RBC factor, versus 0.82% for A-rated and 1.52% for BBB-rated corporate bonds. When combined with loss-adjusted yields, this can translate into meaningfully higher RoRBC for prime jumbo, agency NOO and non-QM RMLs relative to A/BBB corporates. In addition, life insurance companies can pair the capital efficiency of RMLs with FHLB pledgeability to create a source of contingent liquidity that supports product growth and liability management without sacrificing spread.

## P&C and Health Insurers

For property and casualty (P&C) and health insurers, the National Association of Insurance Commissioners (NAIC) framework applies a 5% base RBC factor to mortgage loans. In practice, however, the covariance dynamics in the P&C and health RBC formulas typically reduce the effective capital charge well below that headline 5% level, making RMLs competitively capital-efficient on a portfolio basis. P&C insurers are often especially focused on liquidity and are generally comfortable with shorter-duration portfolios, which can make certain RML sub-sectors—and even selective agency exposure—attractive given their financing flexibility and ability to be converted into cash. In our experience, P&C clients have used RML portfolios not only for income and capital efficiency but also as collateral that can be pledged and financed, allowing them to draw down liquidity when needed.

## Capital-Adjusted Framework

Across all insurer types, RMLs are often evaluated using a capital-adjusted yield or spread framework that nets out both expected losses and the cost of holding RBC. On this loss-adjusted and capital-adjusted basis, RMLs can compare favorably with BBB and high-yield corporates, reflecting both their spread premium versus BBB corporates and their lower loss experience and capital cost versus high yield.

AB has experience helping insurers implement either Schedule B or Schedule BA reporting, depending on how they prefer to hold and report the assets and on their capital, tax and ALM objectives. Our teams have implemented RML strategies for both life and P&C balance sheets and have practical experience structuring portfolios that are eligible for pledging, so that insurers can use the collateral to access funding lines and enhance overall liquidity management.

## Illustrative Relative Return on RBC of Residential Loans vs. Investment-Grade (IG) Corporates

	Prime Jumbo	Agency Eligible	Non-QM	Public Corp. (A)	Public Corp. (BBB)
Loss-Adjusted Yield	5.90%	5.94%	6.14%	4.78%	5.09%
Yield Premium Over IG (A)	1.12	1.16	1.36	—	—
Yield Premium Over IG (BBB)	0.81	0.85	1.05	—	—
Life RBC Factor (pre-tax)	0.68	0.68	0.68	0.82	1.52
RoRBC	65.11	67.11	76.40	11.03	12.45

# How Insurers Can Hold RMLs: Reporting and Structure Options

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AB has experience helping insurers implement either Schedule B or Schedule BA reporting, depending on how they prefer to hold and report the assets and on their capital, tax and ALM objectives. The NAIC is also in the process of finalizing formal guidance for residential mortgage loan trusts to qualify for Schedule B reporting, and AB is prepared to adapt structures and reporting approaches as that guidance is implemented.

## **AB's Flexible Structure**

AB's master/series trust structure (with a national bank trustee) keeps economics on balance sheet, mitigates state licensing issues and supports Schedule B versus BA flexibility, FHLB readiness and pledge ring-fencing.

Reporting integrates with Aladdin by BlackRock, Clearwater Analytics and insurer books of record; current expected credit losses (CECL) views and monthly loan-level valuations are standard.





## Federal Home Loan Bank Pledgeability

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Loans can be used as collateral with the FHLB, providing insurers with liquidity and access to stable, low-cost funding. This FHLB pledgeability unlocks contingent liquidity that is difficult to find elsewhere in private markets—a key advantage for insurance balance sheets.

### How FHLB Advances Work

When eligible RMLs are pledged to the FHLB, insurers can typically borrow at a spread over the FHLB's cost of funds, creating an attractive funding rate relative to other sources of secured financing. Advance rates are generally in the 80%–85% range, depending on the specific loan characteristics and FHLB district. AB works with insurers to develop loan-eligibility guidelines that are pre-vetted and accepted by the relevant FHLB, so that as long as loans remain performing and within those guidelines, they can be readily identified and used as collateral without the insurer having to comb through the entire portfolio. The insurance company ultimately negotiates the

advance rate and borrowing spread with the FHLB, and AB can either directly support the pledging process or provide the necessary loan-level data and documentation for the insurer to manage it themselves.

### Holding-Structure Considerations

The method an insurer uses to purchase and hold RMLs may impact whether the collateral can be pledged to the FHLB. AB's master/series trust structure supports FHLB readiness and pledge ring-fencing.

### AB's FHLB Support

AB has pledged roughly \$10 billion of residential whole loans as collateral to the FHLB and has deep experience supporting insurers through the pledge process. AB's loan-level reporting is designed to meet FHLB requirements, and the team can provide comprehensive support for collateral eligibility assessment and ongoing compliance.

# What Differentiates AB as a Manager

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There's no substitute for direct, hands-on experience.

AB brings more than 30 years of direct residential mortgage loan investing experience across trading, sourcing, portfolio management, operations, reporting, servicing oversight, technology, analytics, securitization, FHLB borrowing, NAIC reporting, accounting support, CECL and more. Over that time, the team has purchased more than \$40 billion of residential whole loans, securitized approximately \$13 billion, and pledged roughly \$10 billion of residential whole loans as collateral to the FHLB.

Each of the roughly 80,000 residential whole loans acquired has gone through the same disciplined, securitization-grade acquisition process, contributing to consistently strong loan performance. In our view, that track record is not accidental; it is the product of a repeatable pre-acquisition framework and hands-on portfolio and servicer oversight throughout the life of the investment.

## **A Turnkey, Insurance Native Platform**

Setting up an RML program internally demands specialized underwriting, data, licensing/servicer oversight, and statutory and FHLB reporting, plus securitization and ALM know-how. AB delivers a “white glove” approach: fund an account, sign the core docs, and receive loan-level data and insurer-ready reporting while AB manages funding flows, document custody, distributions, reconciliations, servicer oversight and structuring.

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## **Scale, Sourcing Engine and Selectivity**

The platform is designed for multibillion run-rate capacity, supported by 50–100+ active correspondents and multiple channels (best efforts daily flow, bulk/mini bulk, forward commitments, seasoned portfolios). Recent activity demonstrates disciplined selection and broad counterparty coverage—critical to maintaining quality through cycles.

Managers with strong sourcing and underwriting capabilities can acquire pools of newly originated or seasoned loans at a discount and repackage them into portfolios that meet specific insurer requirements. This might mean excluding mortgages with loan-to-value ratios above, and FICO scores below, certain thresholds. AB may also enter into forward-flow arrangements with partners—agreements that supply either daily flow or a predetermined number of new mortgages from a bank or a private lender for a certain time, providing insurers with a steady pipeline of loans.

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## **Loan-Level Analytics and 100% Diligence**

AB underwriting of residential mortgage loans is calibrated to approximately 220 million historical loans via Black Knight Capital, with multi-scenario prepay/default/severity modeling (base, stress, severe stress) and 100% securitization-grade diligence prior to purchase. That framework underpins security selection, pricing and convexity/ALM construction. The size of this market requires the ability to analyze loans against a vast historical database and model multiple potential outcomes—from prepayments to defaults and beyond. That puts a high premium on the underwriting skill that underpins security selection and pricing.

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## **Insurance Native Structures and Reporting**

A master/series trust structure (national bank trustee) keeps economics on balance sheet, mitigates state licensing issues, and supports Schedule B versus BA flexibility, FHLB readiness and pledge ring-fencing. Reporting integrates with Aladdin by Blackrock, Clearwater Analytics and insurer books of record; CECL views and monthly loan-level valuations are standard.

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## **Backed by AB's Insurance Franchise**

AB manages assets for insurers globally, which is a part of AB's \$860 billion firmwide AUM and \$117 billion general account AUM. That scale shows up in closing/accounting resources, risk systems and governance. The platform is already being used by a range of external insurance clients, giving AB practical experience with the governance, statutory, capital and operational requirements specific to the sector.

# Conclusion

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We believe residential mortgage loans offer insurers a combination of yield, diversification, capital efficiency and liquidity value that is difficult to replicate elsewhere in private credit. In a market shaped by structural housing undersupply, strong borrower credit and expanding non-agency issuance, RMLs present a timely and scalable opportunity.

For insurers, RMLs can enhance income, diversify corporate credit exposure, boost capital efficiency (via low RBC factors) and strengthen liquidity profiles (via FHLB pledgeability) when implemented with the right partner. Our intent is to continue growing this business in a measured way with select insurance partners, leveraging the experience we have gained to design and execute programs that are tailored to each client's balance sheet, capital and risk objectives.

AllianceBernstein provides a one-stop, insurance-native solution grounded in decades of experience, disciplined underwriting, robust governance and comprehensive operational infrastructure. With thoughtful construction and execution, RMLs can help insurers enhance income, stabilize statutory capital and strengthen long-term portfolio resilience.

## Implementation: Getting Started with AB

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Our intent is to continue growing this business in a measured way with select insurance partners, leveraging the experience gained to design and execute programs that are tailored to each client's balance sheet, capital and risk objectives.

A typical implementation follows five steps:

- 1. Asset-class approval and internal socialization**  
Align on role, sizing and guardrails for RMLs; brief key stakeholders (CIO, ALM, actuarial, risk, finance).
- 2. Structure and reporting model design**  
Choose ownership structure (direct, LLC, trust) and determine Schedule B versus BA based on capital, tax and ALM goals.
- 3. Partnership agreement and legal documentation**  
Put in place IMAs, trust and custody agreements and servicing/oversight frameworks.
- 4. Systems integration and reporting setup**  
Connect data feeds, integrate with risk/accounting systems and stand up loan-level/statutory/FHLB reporting.
- 5. Deployment and ongoing management**  
Ramp exposure via flow and/or bulk purchases, then provide ongoing underwriting, surveillance, ALM, capital and FHLB support.

## Next Steps

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For insurers that decide residential mortgage loans are a strategic fit, the next step is to formalize the partnership and implementation path.

Once an insurer approves the asset class and target role for RMLs, AB can:

- Develop and negotiate an investment management agreement (IMA) that reflects the insurer's risk, capital and ALM objectives.
- Design and implement the appropriate structure, including trust- or LLC-based solutions, to support Schedule B/BA reporting, FHLB eligibility and governance requirements.
- Coordinate vendor and servicing contracts and establish the operational framework needed to begin purchasing loans on the insurer's behalf.

From there, AB will work with the insurer to finalize systems integration and reporting, and then begin deploying capital through flow and/or bulk purchases in line with the agreed ramp plan.

# Authors and Contributors

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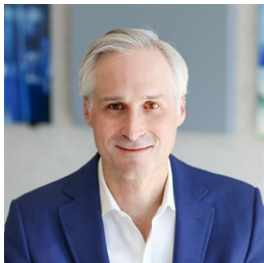
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Jess Dvorak is a managing director for AB CarVal, leading the US residential loan portfolios and residential mortgage-backed securities strategy. He joined AB CarVal in 2008 and has led the execution of the residential strategy since 2010. Dvorak previously worked at GMAC ResCap; Opus Northwest; Boulay, Heutmaker, Zibell & Co.; and D.R. Horton. He holds a BA in accounting from the University of St. Thomas and is a Certified Public Accountant (inactive).



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