

Viewpoint

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Esoteric ABS: Riding the Growth Wave Into 2025

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Demand for esoteric asset-backed securities (ABS) – securities backed by less traditional collateral such as music royalties, timeshare loans, and leases for aircraft and data center space – surged in 2024 and is expected to remain high in 2025.

In 2024, buyer interest in esoteric ABS far exceeded the record level of available supply. Fortunately for insurers, who have helped lead the charge to invest in these securities, supply conditions in the year ahead appear promising: the tighter spread environment and high demand for esoteric ABS are favorable for both programmatic and first-time issuers.

Insurers are drawn to the asset class for opportunities to enhance portfolio yield, achieve effective asset-liability matching, and diversify risk. Esoteric ABS has proven to be particularly attractive because it offers relative value and diversification compared to investment-grade corporate bonds, along with structural protections for investors during economic downturns.

Given the interest from insurers and favorable conditions for issuers, we expect the supply and demand for esoteric ABS to be strong in 2025.

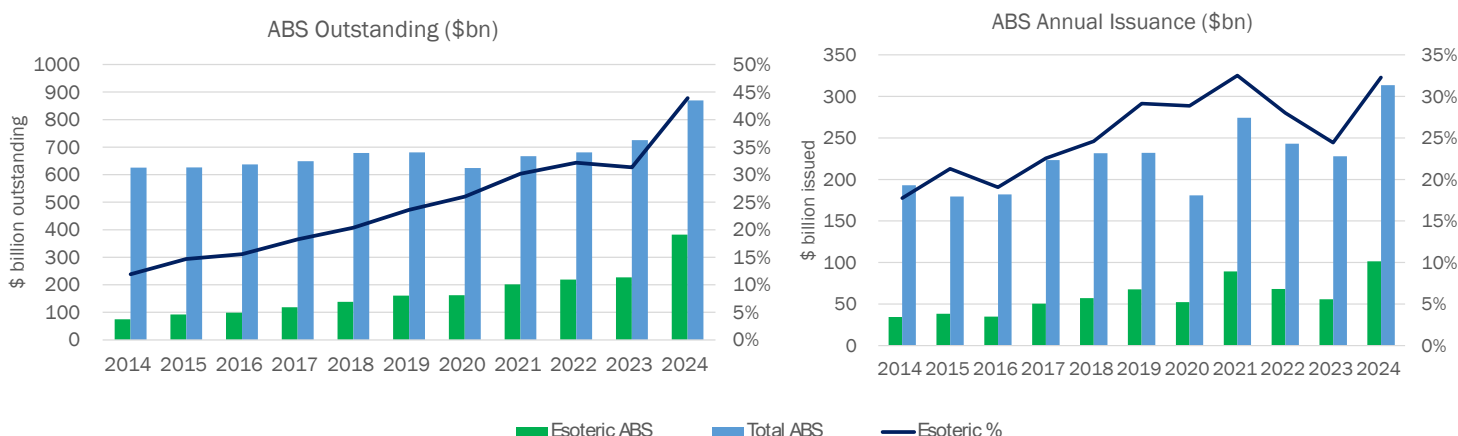
Record ABS Issuance in 2024

ABS reached a post-Great Financial Crisis (GFC) record in supply with \$338 billion in new issuance, and esoteric ABS made up more than 30% of the total (see Figure 1).

In addition, because of the record issuance and higher interest rate environment post-COVID, fewer deals are being called, helping drive up the outstanding amount to nearly \$900 billion; the esoteric ABS share of that is higher as well, currently some 40% (also illustrated in Figure 1).

This larger supply should improve access to deals compared to 2023 and 2024, where the prevailing narrative was a lack of supply.

Figure 1 - Total ABS Outstanding and Annual Issuance, 2014-2024

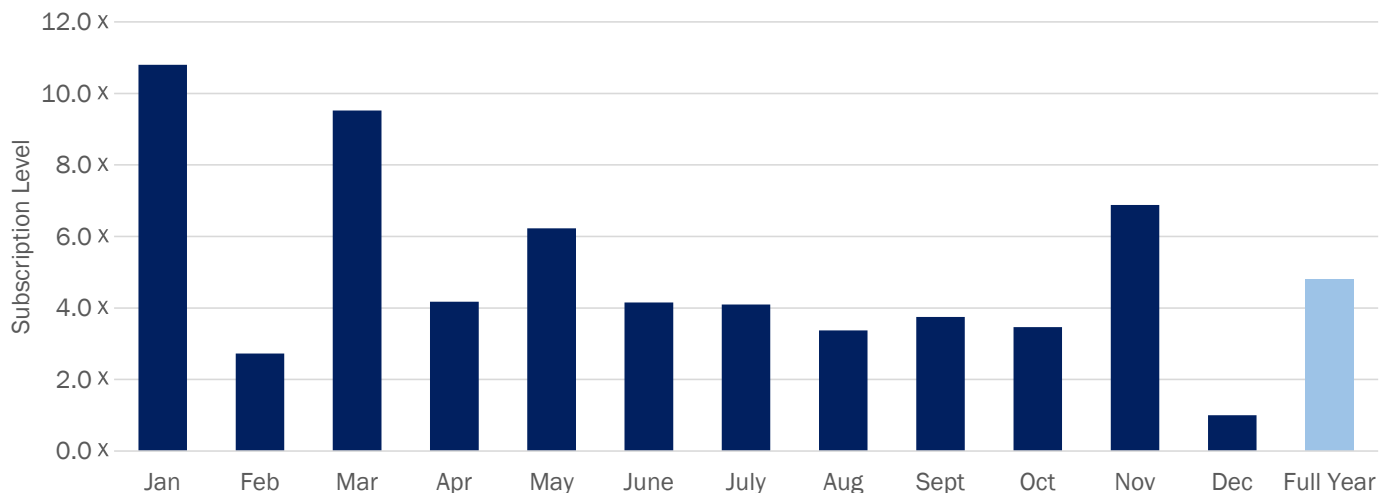


Oversubscription Illustrates High Demand

Oversubscription rates for new-issue esoteric ABS deals in 2024 reached levels that underscore the strong demand. To be sure, while the market was combatting record supply in 2024, the overall investor base might have been able to digest 1.5-2x the amount of supply with relative ease given the level of deal subscription. (If an ABS deal is \$300 million in size and a syndicate desk receives \$1 billion in orders from end-accounts, that deal is deemed to be 3.33x oversubscribed.)

Figure 2 provides a snapshot regarding new-issue orders during 2024 at a subset of brokers Conning surveyed that are heavily involved in the primary/new-issue market for esoteric ABS securitizations. Their deal oversubscription was well over 1x in all months - and nearly 10x in January - except in December, when issuance was very light.

Figure 2 - 2024 Esoteric ABS Average Subscription Rates by Month



Prepared by Conning, Inc. Data per Conning survey of select broker syndicate desks active in esoteric ABS new issue.

Deal oversubscription in 2024 was on average just shy of 5x, with much more oversubscription down the capital stack in securities rated BBB and BB (see Figure 3), tranches that offer much more spread and are typically smaller class sizes.

Consistent Cash Inflows in 2024

To better understand the strong technical backdrop and the consistent cash flows that entered the part of the duration spectrum where ABS generally resides, we looked at retail fund flows for the Ultra-Short 1-3-year ETF space. As illustrated in Figure 4, we sampled 25 large retail ETFs and tracked week-over-week growth in total fund assets.

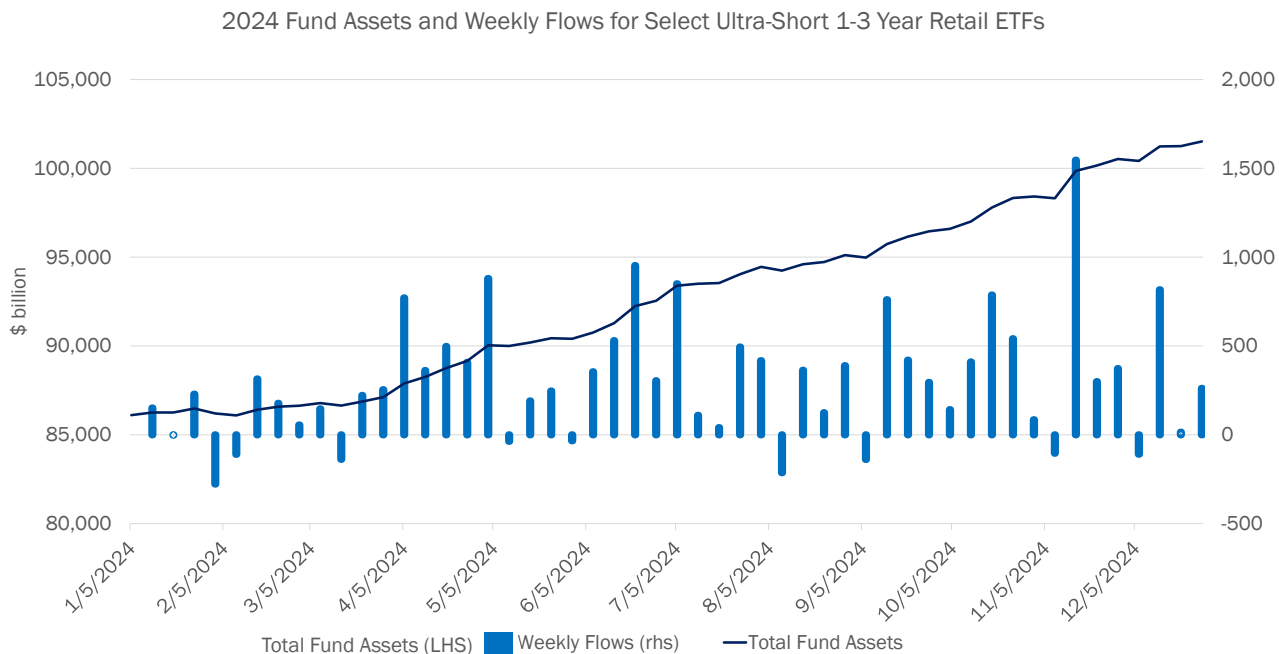
In this sample, the substantial growth at the front end of the risk spectrum kept pace all year, with only nine weeks showing a net outflow from the funds. For the 25 ETFs sampled, we saw an aggregate 2024 inflow of more than \$15 billion. While a relatively small sample size, these 25 ETFs are predominantly retail-based funds; institutional demand is likely multiples of what we can observe.

Figure 3 - 2024 Esoteric ABS Average Subscription Rates by Quality

Quality	Average Subscription Rate
AAA	4.7x
AA	3.7x
A	3.7x
BBB	6.4x
BB	6.6x
Grand Total	4.8x

Prepared by Conning, Inc. Data per Conning survey of select broker syndicate desks active in esoteric ABS new issue.

Figure 4 - Fund-Flow Proxy Suggests Strong Technical Backdrop for ABS



Prepared by Conning, Inc. (c) 2025 Bloomberg L.P. Data represents assets and flows of 25 select Ultra-Short 1-3-Year ETFs.

Valued Asset-Liability Fit

As insurers' investment strategies evolve beyond traditional fixed-income investments to meet business needs, they are increasingly seeking tailored esoteric ABS structures that can closely align with specific liability profiles.

For example, insurance companies with long-duration liabilities, such as annuity payments or pension obligations, are particularly interested in esoteric ABS strategies that offer cashflows over extended periods, in many instances around five years upon new issue. Music royalty-backed ABS deals are one approach insurers may consider, as they could potentially provide steady income streams that align closely with the timing of policyholder obligations. The predictable nature of these cash flows is critical for insurers who need to meet policyholder claims over the long term.

Opportunities to Enhance Yield, Diversification

In the current environment of tight credit spreads, esoteric ABS might also enhance portfolio yield. For example, ABS securities backed by aircraft leases or fiber optic network contracts can provide insurers with attractive yields that are independent of traditional market volatility.

Additionally, esoteric ABS allows insurers to diversify their portfolios beyond conventional asset classes. Traditional fixed-income investments can be highly correlated with economic cycles, and in the current environment, many traditional fixed-income sectors are experiencing volatility due to a number of factors including monetary, fiscal, and legislative policy. By incorporating esoteric ABS into their portfolios, insurers can gain exposure to asset classes that may be less directly impacted by interest rate fluctuations, providing more stability in the face of broader economic uncertainty.

Continued Insurance Demand in 2025

As we move into 2025, we expect the demand for esoteric ABS among insurers to remain robust, driven by the environment of elevated all-in yields when compared to the decade immediately following the GFC. In the current environment, with spreads on investment-grade corporate bonds close to historically tight levels, institutional investors are looking to securitized credit, and more specifically esoteric ABS, as an alternative to the well-trodden path of investment grade.

Esoteric ABS, with its ability to provide higher yields and relatively stable cash flows, will continue to be an attractive option for insurers looking to diversify their portfolios while maintaining effective asset-liability matching. The sustained appeal of esoteric ABS, given its ability to offer more predictable returns that are less sensitive to interest rate fluctuations, makes them a vital part of insurers' investment strategies in 2025 and beyond.

While the esoteric ABS asset class offers a number of valuable features, we note that it is a less common asset class and managers vary in their experience and analytical skills to best match these securities with the needs of their clients' portfolios. We encourage insurers to seek managers that have both a strong history in investing in esoteric ABS and a deep understanding of the unique needs of insurance company investment portfolios.



Mike Nowakowski is a Managing Director and Head of Structured Products at Conning, responsible for overseeing the structured research and trading team. Prior to joining Conning in 2022, he was a portfolio manager focused on Agency MBS and ABS at GE Asset Management, State Street Global Advisors, and most recently People's United Bank. Previously, Mr. Nowakowski was a portfolio manager focused on Money Markets. Mr. Nowakowski earned a bachelor's degree in business and graduated Magna Cum Laude from Plymouth State University.

About Conning

Conning (www.conning.com) is a leading investment management firm with a long history of serving insurance companies and other institutional investors. Conning supports clients with investment solutions, risk modeling software, and industry research. Founded in 1912, Conning has investment centers in Asia, Europe and North America.

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