

'Rated Note Feeders' Attract NAIC Attention

By Kerry Pechter Tue, Feb 25, 2025

Holding a rated note (instead of an unrated private equity fund) can reduce the extra capital that life insurers need to post when buying risky, unrated private assets. Insurance regulators have taken interest in the strategy but are responding at a crawl. (Image: 'Sleeping Guards,' Piero della Francesca.)



The National Association of Insurance Commissioners (NAIC) has formed a Risk-Based Capital Model Governance Task Force to reassess and modernize capital requirements for insurance companies, according to the NAIC. The action is expected to focus in part on the use of “rated feeder funds,” which are controversial investment gimmicks.

A February 9, 2025, NAIC [Memorandum](#) from the task force acknowledges the now-established trend toward life/annuity companies' investments in private credit. Private credit assets under management, economy-wide, more than tripled since 2010, to \$1.6 trillion, and are projected to accelerate to \$2.5 trillion by 2029, according to [Fitch Ratings](#).

The three-page NAIC memorandum states:

The prolonged low-interest rate environment that has existed since the Global Financial Crisis (GFC) of 2007–2009 created an industry trend to search for yield in investment portfolios and a material shift in the complexity of insurers' investment strategies, resulting in more market and credit risk than historically normal. Traditional banks have also retreated from providing credit due to stricter post-GFC regulations and there has been a notable increase in private capital. These factors have contributed to insurers now serving as a growing source of real economy financing.

Risk-based Capital (RBC) is a tool used by regulators to identify weakly capitalized insurance companies. In doing so, RBC quantifies the risks taken by insurance companies by establishing minimum levels of required capital necessary to absorb those risks. Failure to hold certain prescribed levels of capital results in regulatory action in accordance with the level of capital shortfall. Capital requirements are generally calibrated to a targeted level of statistical safety, established to cover losses associated with a given risk within a desired level of confidence.

The RBC Model Governance (EX) Task Force will be tasked with developing guiding principles for updating the RBC formulas to address current investment trends with a focus on more RBC precision in the area of asset risk and to ensure that insurance capital requirements maintain their current strength and continue to appropriately balance solvency with the availability of products to meet consumer needs.

The NAIC has been under pressure to scrutinize life insurer's investment in private credit. (See today's open letter from Larry Rybka to NAIC actuary Scott O'Neal and Peter Gould's open letter to the NAIC's Life Actuarial Task Force.) The opacity, uniqueness, and complexity of private asset deals make that difficult.

Complex finance structures

In a [commentary](#) on the NAIC's memorandum, attorneys at the MayerBrown law firm point to three kinds of deals in the "fund finance market" that could be affected by the task force's future recommendations: These are subscription credit facilities, NAV (net asset value) loans, and rated note feeders. Here's some background on those structures:

Rated note feeders

These are structured financial vehicles used by investment funds to attract institutional investors, like insurance companies. The "rated" part means that a credit rating agency (like Moody's or S&P) assigns a risk rating to the notes. Insurers prefer or, in some cases, are required to invest in assets with credit ratings.

Since private assets are typically unrated and seen as high-risk, rated note feeders provide a way for these investors to participate in private assets while complying with regulations. Holding a rated note (instead of an unrated private equity fund) can reduce the capital they need to reserve.

Here's what Bloomberg [said](#) about rated note feeders last November:

Rated feeders are part of a broader push by private credit firms to convince the U.S. insurance industry, which controls trillions in long-term capital, to pour money into the asset class. In fact, for many of private lending's biggest players, insurers have become so critical to their growth efforts that they've built out or bought large insurance units of their own.

The transactions aren't public and therefore hard to track, but virtually every private credit

manager has begun taking advantage of the structure, market watchers say. Ares used one as part of its record-breaking capital raise earlier this year. Blackstone, Carlyle, and KKR have also utilized them, according to documents seen by Bloomberg and people familiar with the deals. Kroll Bond Rating Agency has graded over \$20 billion of the products since the start of 2021, and says this year is on pace to be the busiest yet.

Subscription credit facilities

These are short-term loans given to investment funds (like private equity funds) based on commitments from their investors. These loans allow investment funds to make quick investments without waiting for investors to send their money. The loans are backed by the investors' promises to contribute capital.

NAV loans

These are loans secured by the value of a fund's assets rather than investor commitments. Investment funds use NAV loans when they are later in their lifecycle and have already invested most of their capital. Lenders look at the value of the fund's investments to determine loan amounts and terms.

'Regulators are actively looking at this space'

The MayerBrown memo on the new task force said in part:

"The implications of this initiative are broad. Lenders relying on insurance company participation in fund finance should prepare for potential changes in insurers' approach to underwriting and pricing. Subscription credit facility lenders may find that RBC refinements reinforce the low-risk profile of their loans, supporting continued insurance company investment. NAV lenders, however, face an open question. A more sophisticated treatment of NAV lending could result in a capital framework that recognizes the nuances of these facilities, but it could also introduce new regulatory considerations. Market participants should watch closely as the task force clarifies its approach. Fund sponsors, particularly those utilizing rated note feeder structures, should also monitor developments, as changes in capital treatment could impact the economics of these investment vehicles.

"The fund finance industry should remain engaged as the task force's work progresses. The NAIC's focus on insurers' involvement in alternative assets and structured products signals a broader regulatory shift that could reshape how insurance

companies participate in fund finance markets. Given the task force's mandate and its placement under the NAIC Executive Committee, the fund finance industry should expect substantive developments with potential long-term implications. Close monitoring, proactive engagement, and early assessment of potential regulatory impacts will be critical as the framework evolves."

Commenting on rated note feeders, an attorney at Ropes & Gray said they are "a fairly new product and the insurance company regulators are actively looking at this space, so while these products currently address the regulatory capital needs of insurance companies, sponsors should think about adding flexibility to revise the terms or collapse the structure if the regulatory landscape changes in the future."

According to a December 9, 2024 [report](#) from the law firm of Willkie, Farr and Gallagher:

"...Rated feeder fund" interests [are] a way to attract insurance company capital to invest in private credit strategies. The interest in the industry has been driven by the confluence of a challenged fundraising environment for traditional private capital managers as well as increased appetite from insurance companies to better match the regulatory capital treatment of investments in these funds with the regulatory capital treatment of the funds' underlying credit investments.

"In these structures, the insurance company investor obtains a debt commitment in or purchases notes from a feeder vehicle. In order for the insurance company investor to obtain favorable NAIC Designation treatment, the investment manager facilitates these notes by obtaining a private letter credit rating, which letter would typically include a rationale report (a "Rationale Report"), from nationally recognized statistical rating organizations ("Rating Agencies"). When a private letter credit rating is obtained, the notes are considered "privately rated securities" for insurance regulatory capital purposes."

On February 10, a FitchRatings [report](#) on growth and regulation of private credit said:

"Insurance companies' allocations to private asset classes continue to increase, reflecting growth in private credit markets, and the incremental yield from illiquidity and complexity premia. The increase has also been driven by increased affiliations with alternative IMs [investment managers], which have been neutral to ratings to-date, but could lead to conflicts of interest, including incentivizing above-average growth levels, and single-manager concentrations. Scrutiny of private credit, particularly from bank and insurance

regulators, is expected to increase, given limited transparency and potential spillover risks.”

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