Implications of private asset volatility for US life insurers

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Long part of life insurer investment portfolios, private credit assets have become increasingly important and material in carrier balance sheets in recent years. According to the Federal Reserve, life insurer private placement holdings more than doubled between 2015 and 2024 and now account for a significant part of the sector's total debt holdings.

But there's increasing concern about certain private asset credit quality. News outlets have reported redemptions and fears of increased defaults at some private funds and business development companies (BDCs). If volatility continues, it could lead to more widespread concerns about insurers' balance sheets, market liquidity, and the financial system's overall stability.

Because private credit assets have become such an important part of their portfolios, carriers could be affected in many ways:

- Erosion of capital and solvency
- Contentious restructuring
- Liquidity and run-on-the-bank risks
- Regulatory intervention
- Systemic risk and pro-cyclicality

Erosion of capital and solvency

Potential credit downgrades, both onshore and off, could impact both capital and solvency.

Valuation adjustments

The fair value of private credit assets is likely to decline if credit quality decreases. Modeling declines is difficult, though. Because private credit assets aren't traded in the open market and many are infrequently valued, their perceived value in the market can quickly and unexpectedly change. Rating downgrade and default events could trigger sharp, nonlinear downward revaluations of a portfolio that previously appeared to be performing well.

Financial losses

Increased defaults would lead to realized credit losses before recoveries and "other-than-temporary impairments" that directly reduce an insurer's net income, capital and surplus.

Risk-based capital (RBC) strains

Deteriorating credit conditions and rising defaults not only impair portfolios, they also can lead to lower NAIC designations like shifts from NAIC 1/2 to NAIC 3 or lower. Lower designations automatically trigger potentially significant RBC charges, with nonlinear increases in required capital. Accelerating downgrades can rapidly escalate to an available capital crisis, resulting in regulatory actions, a need for capital infusions, and even insolvencies.

Furthermore, rating agencies may lower company ratings, potentially putting distribution partnerships and sales under pressure, increasing the cost of capital, and requiring affected insurers to hold more capital against the same assets. In short, carriers could find themselves in a vice where one side pressures capital availability and the other side pressures sales volumes and existing premiums.

M&A and insolvencies

Combined with potential liquidity strains, sudden reductions in asset values and increases in regulatory capital requirements could result in regulatory intervention, rehabilitation, block sales, or distressed legal entity sales.

Liquidity and run-on-the-bank risks

The illiquidity trap

Private credit assets are often significantly less liquid than public bonds and traded much less frequently than their public equivalents. In a high-default environment, finding willing buyers for these assets can be difficult and costly. This can lead to “fire sale” discounts if an insurer is forced to sell or has limited ability to raise funds otherwise.

Policyholder surrenders

For life insurers, a decline in the value of backing assets, particularly when combined with a higher for longer interest rate environment, could trigger increased policy lapses and surrenders as customers seek better returns elsewhere. If investment portfolios are tied up in defaulted or illiquid assets, the carrier may face a liquidity crisis as it tries to meet cash demands. And thanks to automation of 1035 exchanges, it’s never been easier for policyholders to move money quickly when they want better returns.

Systemic risk and pro-cyclicality

Financial interconnectedness

The life insurance sector is deeply interconnected with the wider financial system because it lends to other financial institutions and specialized funds. In good times, pro-cyclicality can greatly improve financial performance and solvency. Yet, the reverse can be true in bad times: Significant private credit defaults could cause global contagion.

Private equity ownership vulnerabilities

Private equity-owned insurers and joint ventures face a unique pro-cyclical risk. A downturn with rising investment defaults could simultaneously affect the sale of new insurance products, the quality of existing assets, and the profitability of PE groups' own asset-originating platforms.

Contentious restructuring

Aggressive liability management

Stressed borrowers are increasingly using liability management transactions such as “up tiers” and “drop downs” to secure relief. These often lead to “creditor-on-creditor violence,” where a majority group of lenders negotiates a deal that disadvantages minority lenders by stripping away their collateral or payment seniority.

Equitization of debt

If turnaround efforts fail, increased defaults in private credit are more likely to result in consensual debt-to-equity conversions in which equity owners are wiped out and the lenders become the owners of the company, sidestepping traditional bankruptcy.

Asset opacity

Private credit can lack transparency when investors:

- Don’t have timely access to underlying loan information, or
- Haven’t directly modeled underlying loans to determine if there’s risk in the underlying portfolios that could drive systemic defaults.

Regulatory intervention

Enhanced requirements

We've already seen the NAIC and Bermuda Economic Balance Sheet (EBS) enhance requirements for proactive monitoring of and reporting on credit activity. These changes are compelling carriers to more vigilantly assess the health of their assets. Furthermore, enhanced scrutiny of internal models means they also need to monitor and improve their model management to facilitate accurate measurement.

Stricter standards

The NAIC's 2025 Principles-Based Bond Definition (PBBD) allows it to challenge the classification of complex assets. A near-term increase in defaults would likely accelerate these efforts, potentially resulting in capital charges that reflect a worsening risk environment.

Intense surveillance

If private credit asset quality appears to further decline, insurance regulators would likely initiate "non-routine analysis" of insurers they consider troubled, requiring more frequent reporting and potentially targeted financial examinations.

What insurers can do now

You can address real and possible declines in private credit performance through proactive balance sheet management, enhanced risk oversight, and liquidity planning.

Review and, when necessary, enhance credit underwriting standards.

Scrutinize portfolio companies and sponsors, including stress testing under adverse macro and refinancing scenarios.

Assess transparency, information timeliness and accuracy, valuation, and impairment recognition practices to determine if balance sheets accurately reflect risk.

Review concentrations across sectors, vintages, sponsors, and capital structures to determine if you’re exposed to highly leveraged or structurally weak credits, as well as how to reduce that exposure. This includes assessing actual and potential reinsurance arrangements, collateral, capital buffers, and asset-liability management—as well as offloading assets that no longer fit your risk profile.

Determine if you’re maintaining sufficient, high-quality, liquid assets and have realistic contingent funding plans should market liquidity for those assets suddenly evaporate.

Engage industry peers and regulators on systemic issues and any related concerns.

For more information

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