Private Credit's State Backstop: How Private Equity Socializes Risk Through Insurers

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Private equity (PE) firms have acquired large life insurers and increasingly loaded their balance sheets with private-credit assets that are opaque and difficult for regulators to value. This Article explains how PE profits from these insurers while shifting the resulting risk onto competitors and taxpayers.

Unlike ordinary firms, life insurers do not pass through bankruptcy when they fail. Instead, when a life insurer becomes insolvent, state-based guaranty funds protect insurance policyholders by "assessing" *surviving* insurers to cover the shortfall. In most states, such outlays are fully creditable against state premium taxes over time, transforming an ostensibly industry-funded system into a public backstop. The result is a system that socializes losses more sharply than banking's federal deposit insurance, and does so with an insolvency and regulatory architecture that is more fragmented and less able to address macroprudential concerns. With the rise of PE's new private-credit strategy, insurance's unique insolvency, tax, and financial regulation regimes now form critical components of private credit's submerged legal infrastructure.

PE firms exploit this regulatory regime by pairing life insurers with private credit to capture value from both sides. After acquiring an insurer, the PE firm earns profits in two ways: a spread between what the insurer promises policyholders and what its investments earn, and management fees on those investments. Guaranty funds and their accompanying regulatory regime implicitly subsidize this model in three ways. First, opacity in private credit permits insurers to appear better capitalized than their true risk exposure warrants. Second, weak incentives for policyholder monitoring permit PE to siphon gains through inflated fees while shifting losses onto insurer balance sheets. Third, because guaranty-fund assessments are based on premium volume rather than risk contribution, conservatively-managed insurers (and, ultimately, taxpayers) finance the more aggressive strategies of their PE-owned competitors.

PE-owned life insurers reflect a structural transformation in which an insurer supports a broader asset-management business that is designed to extract value upfront and disperse losses. Having traced that transformation, this Article proposes to curb the veiled subsidies for this shift with reforms that make insurance risks legible, price risk pre-failure, and allocate losses to insurance affiliated groups post-failure. Doing so would restore insurance insolvency, tax, and financial-regulation law to their policyholder-protection role.

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I. INTRODUCTION

Private credit has become one of the most important and contested sectors of American finance. In little more than a decade, non-investment-grade lending that was once perched on bank balance sheets has has shifted to private investment funds and other nonbank lenders. The resulting market promises high-risk, high-reward loans, but has also generating mounting concern: when fast-growing markets for private, hard-to-value loans falter, should investors be concerned about systemic risk or, even worse, a full-blown financial crisis?[1]

Leading academic accounts have framed the larger risks of private credit as problems of how transparent the market is, whether funds can meet withdrawal requests from investors, and how connected banks are to the industry.[2] Although these aspects are relevant, legal scholarship has missed a channel of risk transmission in private credit that is not usually associated with high-risk lending: life insurers. News reports have covered a private equity (PE) shift towards purchasing insurers to use as part of a platform for private-credit issuance, but often chalks the trend up to a smart decision to employ life insurers' relatively stable funding model.[3] All of these narratives have failed to appreciate how PE's makeover of insurers into private-credit machines has leveraged implicit subsidies in insurance tax, insolvency, and financial-regulation law to shift losses outwards to rival insurers and, in most states, to taxpayers. We provide the first systematic account of insurance law's role in encouraging the massive expansion of private credit and creation of a taxpayer backstop of a large swath of the sector, and explain what regulators should do in response.

Life insurance was long understood to be a staid, conservative corner of finance. Its basic business model was straightforward. Insurers pooled mortality and longevity risks by collecting premiums from policyholders, and invested the resulting funds into safe, fixed-income assets like investment-grade corporate bonds.[4] The insurer's promise was long-term and asymmetric: the policyholder had to pay up first, often decades before the insurer would have to pay out its end of the bargain, which made confidence in the insurer's long-term solvency paramount. A life insurer that promised its customers protection in the future had to be solvent in the future to make good on that promise.

PE has rapidly displaced this traditional model. Firms like Apollo, Blackstone, and KKR are no longer purely buyout shops. They are now diversified asset-management platforms looking for steady revenue and

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[1] Sam Boocker & David Wessel, *What is private credit? Does it pose financial stability risks?*, BROOKINGS (Feb. 2, 2024), https://www.brookings.edu/articles/what-is-private-credit-does-it-pose-financial-stability-risks/.

[2] *See, e.g.,* Jared A. Ellias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 YALE L. J. 779 (2025); Michael Rand & Melinda Roth, *Private Credit's Public Consequences*, VILL. L. REV. (2026); Patrick M. Corrigan, *The Bank and Private Capital Shadow Venture*, 79 STAN. L. REV. (2027).

[3] *See*, e.g., Matt Wirz & Leslie Scism, *Private Equity Taps Insurers' Cash to Speed Up Growth*, WALL ST. J. (Jan. 31, 2023), https://www.wsj.com/articles/private-equity-taps-insurers-cash-to-speed-up-growth-11675128742; Antoine Gara & Sujeet Indap, *Private Equity-Backed Insurers Under U.S. Scrutiny over Risky Loans*, FIN. TIMES (Feb. 26, 2023), https://www.ft.com/content/d4693b91-242a-430b-afed-5034cda5ca48?syn-25a6b1a6=1; Allison McNeely & Dawn Lim, *Apollo's Big Bet on Insurance Put to Test as Interest Rates Rise*, Bloomberg News (May 22, 2023), https://www.bloomberg.com/news/articles/2023-05-22/apollo-s-big-bet-on-insurance-put-to-test-as-interest-rates-rise; Chris Cumming, *Private Equity's Move into Insurance Provokes Systemic-Risk Concerns*, WALL ST. J. (Jan. 4, 2024), https://www.wsj.com/articles/private-equitys-move-into-insurance-provokes-systemic-risk-concerns-ccebf0cf; Matt Wirz & Shane Shifflett, *Life Insurers Aren't Just Investors in Private Credit. They're Major Lenders, Too*, WALL ST. J. (June 24, 2026), https://www.wsj.com/finance/investing/life-insurers-arent-just-investors-in-private-credit-theyre-major-lenders-too-c64ea527.

[4] Ralph S. J. Koijen & Motohiro Yogo, *Understanding the Ownership Structure of Corporate Bonds*, 5 AM. ECON. REV.: INSIGHTS 73, 76 (2023).

pools of money they can manage for a fee. The economics of a life insurer supply both, leading to their reputation as a source of "permanent capital."[5] Their liabilities are relatively predictable and long-duration, their policyholders are relatively likely to stick around, and their premium income provides a large funding base to use for investments in illiquid assets.[6] Institutions like McKinsey have praised the "virtuous flywheel"[7] of making a life insurer a centerpiece of the large-scale asset manager, hailing what they consider to be a tremendous financial innovation.

Celebratory accounts of this transformation have missed the underlying legal subsidies and public risks. Ordinarily, individual or institutional investors that choose to take a risk are the ones who bear the loss if the bet goes wrong. For example, when the loans of a private-credit fund go sour, the losses fall on the fund's investors, who used the money to place a risky bet rather than park their cash in a safe place and accepted that it might not pay off. Normal bankruptcy law implements this logic by keeping a company's direct losses inside the company, dividing the bankrupt firm's remaining assets among the investors and lenders who backed it. Life insurers, however, do not follow these standard rules because they do not go through the bankruptcy process if they fail.[8] Instead, when an insurer fails, state "guaranty funds" protect its policyholders—who may have paid premiums for decades and would otherwise be devastated to find their contracts cancelled—by "assessing" the state's surviving insurers to cover the shortfall. In most states, insurers receive tax credits that they use to completely offset the cost of the assessment over time (usually five years).[9] The result may look like an industry rescuing its own, but in practice it is a public bailout of the failed insurer.

In the new world of PE-controlled life insurers, where balance sheets feature opaque and risky investments in private credit, guaranty funds act as a mechanism for transferring the downside risk of private credit away from the PE firm and towards taxpayers. The traditional justification, where guaranty funds are supposed to protect policyholders from insurer failure, backfires.

Readers may be familiar with a system that is somewhat analogous to insurance guaranty funds: federal deposit insurance in banking. However, a comparison to deposit insurance only further exposes the structural flaws of the insurance regime. Banking insolvency law is designed to address an analogous problem: it protects depositors who would otherwise be at risk of losing their money if their bank failed by setting up an alternative to the bankruptcy regime.[10] Depositors receive socialized protection because legally assuring depositors forestalls bank runs, which generate devastating effects on monetary stability and the broader economy. Banking law pairs this public backstop with a federal institutional architecture designed to mitigate the moral hazard (incentive for risk-taking due to downside protection) that deposit insurance creates. When the Federal Deposit Insurance Corporation (FDIC) collects assessments from banks, it does so before any particular bank fails and scales the fee based on the riskiness of each bank. The FDIC also centralizes receivership of failed insured banks and operates within a broader federal supervisory

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[5] Ramnath Balasubramanian, Alex D'Amico, Rajiv Dattani, & Diego Mattone, *Why private equity sees life and annuities as an enticing form of permanent capital*, (Feb. 2, 2022), https://www.mckinsey.com/industries/private-capital/our-insights/why-private-equity-sees-life-and-annuities-as-an-enticing-form-of-permanent-capital (last visited June 1, 2026).

[6] In forthcoming work with Jeffery Zhang, we address to what degree life insurers' funding is actually stable, and find a nuanced answer.

[7] Andrew Reich, Ramnath Balasubramanian, Henry Torbey, & Ying Zhao, *Private capital in insurance 2.0: Building the flywheel*, MCKINSEY & COMPANY (June 26, 2024), https://www.mckinsey.com/industries/financial-services/our-insights/private-capital-in-insurance-2-point-0-building-the-flywheel (last visited Apr 29, 2026).

[8] 11 U.S.C. § 109(b)(2), (3)(A).

[9] *See infra* n. 96-98.

[10] 11 U.S.C. § 109(b)(2) (excluding a "domestic insurance company, bank, savings bank, cooperative bank" from ordinary Chapter 7 eligibility); 12 U.S.C. § 1821(c)(2)(A)(ii), (d)(2)(A)(i) (providing that the FDIC "shall be appointed receiver" for certain failed banks and succeeds to "all rights, titles, powers, and privileges" of the failed bank).

structure designed to limit bank risk-taking behavior through capital regulation, supervision, activity restrictions, stress testing, resolution planning, and more.[11]

Compared to federal deposit insurance, insurance guaranty funds share the feature of socialization of risk but lack the risk-regulation infrastructure. They are funded with post-failure assessments that are based on insurers' premium volume, not risk contribution. This funding structure means that the failed insurer never contributes a dollar to the fund that rescues its policyholders. As a result, conservatively-managed insurers functionally subsidize aggressive ones. This regime, analogously to banking, reduces depositor/policyholder incentives to monitor their financial institution as it protects their financial claims (up to statutory limits).[12] However, while the FDIC, Federal Reserve, and Office of the Comptroller of the Currency (OCC) police the risk of large banks in depositors' place, insurance does not have a comparable regime for large insurers because states have near-complete control over insurance regulation.[13] Insurance regulation is coordinated through the National Association of Insurance Commissioners (NAIC), a nonprofit body whose members write the model rules, capital standards, and reporting requirements that most states adopt.[14] The NAIC commands nothing close to the budgets, examination staffs, and enforcement powers of the federal banking agencies.

PE firms have powerful incentives to exploit this regime and use insurance balance sheets to earn profits while taking on more risk in several ways. First, they can use policyholders' premiums to invest in higher-risk assets, even if that raises the probability of failure in the future, by allocating funds to opaque and complex private-credit assets. Second, they can report inflated values of such assets based on private and confidential credit rating provider reports so as to defuse regulatory scrutiny. Third, they can charge excessive management and service fees from assets that are nominally held on the insurer's balance sheet but managed by another asset-manager affiliate in the PE constellation. Fourth, they can siphon money out of an ailing insurer by having it purchase underperforming assets from elsewhere in the portfolio. And fifth, they can conceal risk by employing "shadow" reinsurance that obscures their true balance sheets.

The speed and scale of insurers' transformation means these incentives are not just theoretical. Empirical studies in economics have catalogued substantial and immediate changes in insurer asset allocations following PE acquisitions.[15] We do not claim that PE ownership of life insurers is inherently illegitimate, that private credit can never have a place on insurer balance sheets, or that guaranty funds serve no valuable purpose. The problem is that each year, the combined veiled subsidies of insurance tax, insolvency, and financial-regulation law create more and more of a risk of a de facto bailout as billions more pour into PE-controlled insurers that employ an asset-management model suited to exploiting these laws.

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[11] 12 U.S.C. § 1817(b)(1)(A), (C) (requiring FDIC assessments and defining a "risk-based assessment system" by reference to, among other things, the probability of Deposit Insurance Fund (DIF) loss and "different categories and concentrations of assets"); 12 U.S.C. § 5365(b)(1)(A)(i)–(iv), (i)(2)(A) (requiring enhanced prudential standards, including "risk-based capital requirements," "resolution plan requirements," and "periodic stress tests").

[12] See *infra* n. 87-89.

[13] 15 U.S.C. §§ 1011, 1012(a)–(b) (declaring that "continued regulation and taxation by the several States" of the insurance business is in the public interest; subjecting insurance to "the laws of the several States"; and barring federal statutes from being construed to "invalidate, impair, or supersede" state insurance law unless they specifically relate to insurance).

[14] Timothy Stoltzfus Jost, *Reflections on the National Association of Insurance Commissioners and the Implementation of the Patient Protection and Affordable Care Act*, 159 U. PA. L. REV. 2043, 2044 (2011) (describing the NAIC as "a private, nonprofit organization" whose members are state and territorial insurance commissioners and explaining that it has "drafted model statutes and regulations"); Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625 (1999) (describing NAIC functions such as the "drafting of model laws and regulations" and arguing that state insurance departments are "hopelessly underfunded and understaffed").

[15] *See infra* Part IV.

This Article proceeds in four Parts.

Part II explains the traditional life-insurer business model, the state-based system of insurance regulation, and the bankruptcy baseline from which insurance departs.[16] It demonstrates the economic reasons for why insurers are appealing to PE: their liabilities are long-dated, their customers are unlikely to run, and their policyholder premiums provide large balance sheets to use as repositories for assets generated by a broader surrounding asset-management platform.

Part III explains the law of insurer insolvency and guaranty funds, as compared to federal deposit insurance.[17] It demonstrates the regulatory-subsidy reasons for why insurers are appealing to PE. While banking law pairs socialized depositor privilege in insolvency with ex-ante, risk-based assessments and federal supervisory infrastructure for large banks, insurance law relies on ex-post, volume-based assessments; state-by-state administration; and premium-tax credits that implicitly allocate losses to the public. This comparison illustrates how guaranty funds intensify moral hazard and shocks, and remain fundamentally untested by a national insurer's failure.

Part IV turns to private equity and private credit.[18] It shows how PE firms have come to employ life insurers to capture value on both sides of the balance sheet. PE firms can place private credit, which is often issued to companies within the PE firm's portfolio, onto insurance balance sheets, while leveraging stable premiums and "shadow" reinsurance on the liability side. The PE firm captures asset-management fees while leaving the downside risk within the insurer, where it can be distributed to, ultimately, taxpayers.

Part V turns to our proposals for reform.[19] State legislators and regulators should make insurance risks more legible by (1) levying procedural penalties on balance sheets that heavily feature opaque private credit and (2) compelling look-through disclosure of "shadow" reinsurance. They should force internalization of pre-insolvency risk through (1) systemic review of affiiated transactions, (2) treatment of excessive affiliate-firm fees as dividend equivalents, and (3) restructuring of insurance guaranty fund premiums on an ex ante, risk-calibrated basis. They should force internalization of insolvency risk by (1) ending state tax credits for guaranty-fund assessments and (2) placing insurance holding companies on the hook for at least part of the cost of securing policyholders in an affiliated-insurer insolvency. And finally, though the NAIC has made some admirable strides in adapting regulation to the new world of life insurance, if it cannot act boldly enough the federal government should step in with legislation or revival of systemic-risk authority.

Insurance law has become a critical part of private credit's submerged legal infrastructure. We hope to make that structure visible, so that we can redesign it before we are required to pay for it.

II. BACKGROUND: LIFE INSURANCE, STATE REGULATION, AND ORDINARY BANKRUPTCY

In this Part, we establish the basic function of life insurance, the traditional business model of life insurers, and the default bankruptcy law that would apply to life insurers if they were not specifically excluded. Throughout, we emphasize the structural features that make life insurers especially (1) attractive as acquisition targets for private equity firms and (2) prone to exploitation by aggressive asset managers.

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[16] *See infra* Part II.
[17] *See infra* Part III.
[18] *See infra* Part IV.
[19] *See infra* Part V.

A. Life Insurance and the Traditional Life-Insurer Model

Insurance is a risk-transfer contract where a customer pays a set amount now so that the insurer bears the financial cost of an uncertain future event.[20] A life insurance contract, which protects against the financial risk of a death, involves four roles. The policyholder owns the policy and pays the premiums; the insurer issues the contract, receives the premiums, and bears the risk of paying; the insured person is the person whose death triggers insurer payout; and the beneficiary receives the payout.[21] This payout is commonly referred to as the "death benefit." Before issuing a policy, the insurer "underwrites" it by estimating how likely the insured is to die during the coverage period, using financial and health data, and then sets the premium accordingly. Once both sides agree and the policy takes effect, the policy remains in force while the policyholder keeps up with the premiums.

1. Types of Life Insurance Products

Life insurers sell several kinds of long-term contracts that combine protection, savings, and investment in different proportions. The simplest is a "term life" policy.[22] A term policy covers a fixed period, such as ten years, and pays the death benefit only if the insured dies within that period; if the insured outlives the term, the policy expires without a payout. Therefore, term life is pure protection without a savings or investment component.

Other forms, such as "cash value" or "permanent" life,[23] retain the basic set of relationships of term life but route part of each premium into an investment account held inside of the policy. That account can grow over time, so these policies combine protection against premature death with savings accrual.[24] From the point of view of the insurer, the policy's accumulated cash value reduces its exposure.[25] Life insurers also sell annuities. An annuity, rather than insuring against an early death, insures against living too long and exhausting one's savings ("longevity risk").[26] In an annuity, customer pays the insurer up front and, in return, receives a guaranteed income stream for life that can either be fixed or variable.[27]

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[20] George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1539-40 (1987) (explaining that the policyholder pays a premium in exchange for the insurer's promise to pay if a probabilistic loss occurs).

[21] The policyholder and the insured person are not necessarily the same person, but frequently are. A person may not purchase a policy on just anyone; under standard law, a policy beneficiary must have an "insurable interest" in the life of the insured person where they would be financially disadvantaged if the insured person died. This doctrine may be porous. *See generally* Sharo Michael Atmeh, *Regulation Not Prohibition: The Comparative Case Against the Insurable Interest Doctrine*, 32 NW. J. INT'L L. & BUS. 93 (2011).

[22] KENNETH BLACK JR., HAROLD D. SKIPPER & KENNETH BLACK III, LIFE INSURANCE 40-41 (15th ed. 2015).

[23] Subtypes of cash value life insurance include whole life, variable life, universal life, and more.

[24] Extremely favorable tax treatment of the "cash value" of life insurance has led to such products becoming frequent features of high-net-worth estate planning. *See generally* Ari Glogower & Andrew Granato, *Reforming the Taxation of Life Insurance*, 44 VA. TAX REV. 235 (2025).

[25] For example, if a policyholder purchased a policy with a $1 million death benefit, but at the time of the death of the insured person had investments held within the policy worth $100,000, then the insurer would only be risking $1 million - $100,000 = $900,000 of its own money. In an extreme case, if the cash value account approached $1 million in value, then the insurer would not be risking any of its own funds and would functionally be a fund manager for the policyholder.

[26] Olivia S. Mitchell, James M. Poterba, Mark J. Warshawsky & Jeffrey R. Brown, *New Evidence on the Money's Worth of Individual Annuities*, 89 AM. ECON. REV. 1299, 1299-1300 (1999) (life annuities let retirees insure against "the risk of outliving their assets").

[27] Life insurers also frequently offer insurance products for disability income, paid leave, long-term care, and supplemental benefits. See *Industry Products*, AMERICAN COUNCIL OF LIFE INSURERS, https://www.acli.com/about-the-industry/industry-products (last visited Apr 13, 2026).

A common feature of this group of products is an asymmetry in the timing of each party's obligations. The policyholder must pay premiums from the beginning of the contract, but the insurer must perform its obligations later, potentially decades later.[28] On the insurer's books, these deferred promises are liabilities; because they come due so far in the future, they are called "long-duration" liabilities. Two results follow from this dynamic. First, the accumulated premiums give the insurer a large, relatively stable pool of money to invest in the meantime. And second, policyholders must count on the insurer remaining solvent for a very long time to receive what they paid for. Part IV explains how this dependence lies at the heart of private equity's interest in the industry.

2. The Traditional Business Model of Life Insurers

A life insurer has been understood as a relatively conservative intermediary. We emphasize that it stands in sharp contrast to the higher-yield, more complex structure of PE-managed life insurance that we describe in Part IV.

A life insurer is a business that does two things: it pools risk and it invests. Pooling comes first. The insurer cannot predict when any single insured person will die, but across a large group of policies, the timing of deaths and associated payouts becomes far more predictable. That predictability lets the insurer estimate how much it will owe and when.[29] At sufficient scale, this risk pooling enables the insurer to bear mortality risk more effectively than any individual family because it converts uncertain individual deaths into an anticipated liability stream.

The insurer invests the premiums until those payouts come due. An insurer therefore profits when the combination of premiums and investment returns exceeds the cost of claims and expenses. On an insurer's balance sheet, its liability side includes its promises to policyholders as well as additional debt obligations to lenders. On its asset side are the investments it buys with premiums. With a predictable liability stream, the insurer can structure its asset portfolio to have cash at the ready to make payouts. For example, by investing in bonds that are scheduled to repay principal when policyholder claims are expected to come due, the insurer achieves "asset-liability matching" that limits the risk of having to sell assets at a bad time.[30]

Consequently, life insurers' asset holdings are traditionally conservative: a safe portfolio both bolsters the chances that cash will be at the ready for death-benefit payouts and should signal to policyholders that the company will remain solvent. Life insurers are historically the largest buyers of investment-grade corporate debt; for decades, insurers (including property & casualty insurers) have owned about 40% of all corporate bonds.[31] At the end of 2011, 76% of life insurer general account assets were held in bonds, while only about 4% of such assets were held in equities and derivatives.[32] At that time, most insurer holdings of

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[28] *See* Randall, *supra* note 14, at 627.

[29] This business model relies on the statistical concept of the Law of Large Numbers (LLN). Mathematically, this concept holds that when a large number of independent random samples are taken from an underlying distribution, the average of results garnered from the samples will converge to the mean of that distribution. When applied to insurance, the LLN implies that, across a sufficiently large pool of risks, aggregate payouts to beneficiaries become more predictable even when the outcomes of individual insureds remain uncertain. Michael L. Smith & Stephan A. Kane, *The Law of Large Numbers and the Strength of Insurance*, *in* INSURANCE, RISK MANAGEMENT, AND PUBLIC POLICY 1, 1-2 (Sanda G. Gustavson & Scott E. Harrington eds., 1994).

[30] Kyal Berends, Robert McMenamin, Thanases Plestis & Richard J. Rosen, *The Sensitivity of Life Insurance Firms to Interest Rate Changes*, 37 ECON. PERSP. 47, 55 (2013).

[31] Ralph S. J. Koijen & Motohiro Yogo, *Understanding the Ownership Structure of Corporate Bonds*, 5 AM. ECON. REV.: INSIGHTS 73, 76 (2023).

[32] Robert McMenamin, Anna Paulson, Thanases Plestis & Richard J. Rosen, *What Do U.S. Life Insurers Invest In?*, 309 CHICAGO FED LETTER (2013). Life insurer 'general accounts' correspond to assets held in connection with traditional life insurance policies in which the insurer is liable for fixed amounts of benefit payments. 'Separate accounts,' by contrast,

corporate bonds received the highest-credit-quality rating possible from ratings agencies.[33] This safe strategy provides modest returns to the insurer while maximizing the strength of the portfolio supporting the issued policies.

Part IV explains how private equity has upended this traditional arrangement by reworking both the asset and liability sides of that balance sheet, ending the caution that has defined the industry.[34]

B. The Unusual Structure of Life Insurance Regulatory Law

Unlike securities, banking, and commodity markets, insurance is primarily regulated by states rather than a unified federal regime. This state-based system is in turn coordinated to a remarkable degree by the National Association of Insurance Commissioners (NAIC).[35] The NAIC, which is a private, nonprofit association of the state regulators, cannot directly enact laws on its own. It instead exercises substantial harmonizing power through standardized financial statements, examinations, valuation services, regulator trainings, consulting to policymakers, model laws, "handbooks," and "manuals" that gain legal force when states adopt them.[36] Some state laws permit automatic incorporation of NAIC handbooks and manuals into state law by reference.[37] This fragmented and quasi-privatized structure helps explain why insurance regulation often remains peripheral to the federal policymaking apparatus ordinarily tasked with ensuring financial stability.

To see how insurance came to occupy a position where national policymakers hold such a limited role over the industry, we sketch the history that left primary regulatory authority in state hands. In the early 1800s, state legislatures occasionally regulated insurers directly, and by the mid-1800s states had begun creating dedicated insurance departments led by boards or commissioners.[38] The Supreme Court froze insurance regulation in state hands in 1868 by ruling that insurance dealing was not "commerce" for the purposes of the federal Commerce Clause.[39] This doctrine remained in place until 1944, when the Court reversed course and held that insurance transactions constituted "commerce."[40]

Congress promptly disclaimed its new power by enacting the McCarran-Ferguson Act, which re-authorized state primacy over insurance regulation and declared that "the continued regulation and taxation by the several States of the business is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States."[41] Under McCarran-Ferguson, only federal legislation that "specifically relates to the business of insurance" will "invalidate, impair, or supersede any law enacted by any State for the purpose of regulating

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correspond to segregated accounts where the policyholder bears the investment risk, such as variable life and variable annuities.

[33] Berends, McMenamin, Plestis & Rosen, *supra* note 30, at 57.

[34] *See infra* Part IV.

[35] Jonathan R. Macey & Geoffrey P. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role in Insurance Regulation*, 68 N.Y.U. L. REV. 13, 16 (1993).

[36] Randall, *supra* note 14, at 637-638.

[37] Daniel Schwarcz argues that these incorporation-by-reference provisions are unconstitutional under state constitutional law. *See generally* Daniel Schwarcz, *Is U.S. Insurance Regulation Unconstitutional?*, 25 CONN. INS. L.J. 197 (2018).

[38] *See* Spencer L. Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, 45 MINN. L. REV. 471, 473 (1961); Randall, *supra* note 14, at 630.

[39] Paul v. Virginia, 75 U.S. (8 Wall.) 169, 183 (1868). The U.S. Constitution gives Congress the authority to regulate "Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. I, § 8, cl. 3.

[40] United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944)

[41] 15 U.S.C. § 1011.

the business of insurance."[42] McCarran-Ferguson thus preserves the basic primacy of states in insurance regulation even though Congress now has the authority to regulate the industry directly.[43]

Beginning in the late 1800s, states coordinated insurance regulation through what began as a meeting of different states' insurance commissioners and became the NAIC.[44] Periods of turmoil in the insurance industry, such as a series of insurer failures in the 1980s, have repeatedly generated calls for stronger federal involvement.[45] But such episodes have not displaced the NAIC-centered model of state coordination, leaving insurance much more insulated from national financial-stability oversight than banks, broker-dealers, or other major financial institutions.[46] This unusual allocation of regulatory authority matters not only for regimes like consumer protection and antitrust, but also for how insurer distress is managed when insurers approach insolvency.

C. Default Bankruptcy Law and Within-Firm Loss Allocation

The federal Bankruptcy Code, which provides a nationally uniform framework for managing financial failure and allocating losses among the debtor's investors and creditors, governs most business failures in the United States. Rather than shifting those losses by law onto unrelated firms or the public at large, the Code channels them through the debtor's direct investors via a system of priority rules.[47] We briefly describe bankruptcy's logic here as a point of contrast to the insurance guaranty fund regime that we explore in Part III.

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[42] 15 U.S.C. § 1012(b).

[43] However, the primacy of states in insurance regulation is not absolute. For example, President Donald Trump signed a bill partially repealing the McCarran-Ferguson antitrust law exemption for health and dental insurance. Competitive Health Insurance Reform Act of 2020, Pub. L. No. 116-327, § 2. Other federal intrusions into insurance regulation have fewer teeth: for example, the Federal Insurance Office, which was established under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, has the ability to "monitor" insurers to identify accumulation of systemic risk, but has no regulatory authority. *About FIO*, U.S. DEPARTMENT OF THE TREASURY, https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/federal-insurance-office/about-fio (last visited Apr 13, 2026). Dodd-Frank also granted the federal Financial Stability Oversight Council (FSOC) the ability to declare nonbank financial institutions, including insurers, to be Systemically Important Financial Institutions (SIFIs) subject to additional regulation from the Federal Reserve. FSOC designated three insurers, Metlife, Prudential, and American International Group (AIG), to be SIFIs in 2013 and 2014, but, following a Metlife victory overturning its designation in federal district court, FSOC stopped pursuing nonbank SIFIs. The last nonbank SIFI, Prudential, was de-designated in 2018. *See generally* Jeremy C. Kress, *The Last SIFI: The Unwise and Illegal Deregulation of Prudential Financial*, 71 STAN. L. REV. ONLINE 171 (2018).

[44] JOHN G. DAY, U.S. GOVERNMENT PRINTING OFFICE, ECONOMIC REGULATION OF INSURANCE IN THE UNITED STATES, at 52 (1970).

[45] An extended academic literature debates the proper role of federalism in financial and insurance regulation. *See, e.g.,* Randall, *supra* note 14; Macey & Miller, *supra* note 35; Schwarcz, *supra* note 37; Lee A. LeBlanc, *The Effects of the Insurance Industry Insolvency on Pensioners' Incomes: A Plan for Federal Insurance*, 3 U. MIAMI BUS. L. REV. 68 (1992); Jeffrey E. Thomas, *Insurance Perspectives on Federal Financial Regulatory Reform: Addressing Misunderstandings and Providing a View from a Different Paradigm*, 55 VILL. L. REV. 773 (2010); Daniel Schwarcz, *Regulating Insurance Sales or Selling Insurance Regulation?: Against Regulatory Competition in Insurance*, 94 MINN. L. REV. 1707 (2010); Daniel Schwarcz & Steven L. Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHI. L. REV. 1569 (2014); Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States*, 5 U.C. IRVINE L. REV. 537 (2015) [hereinafter Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States*] [hereinafter Schwarcz, Critical Take on Group Regulation]; Christopher French, *Dual Regulation of Insurance*, 64 VILL. L. REV. 23 (2019).

[46] Randall, *supra* note 14, at 641-664.

[47] The Constitution explicitly authorizes Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States," meaning that states may only apply their own bankruptcy laws if Congress enacts no national law. U.S. CONST. art. I, § 8, cl. 4.

General business bankruptcy is a flexible regime for sorting claims against a distressed firm and distributing the firm's remaining value. A debtor can voluntarily file for bankruptcy,[48] and in some circumstances creditors may force one as well.[49] Once in bankruptcy, a business typically proceeds under one of two main chapters. In a "Chapter 7" liquidation, the debtor ceases operations, its assets are collected and sold, and the proceeds are distributed to claimants.[50] In a "Chapter 11" reorganization, by contrast, the debtor attempts to negotiate with creditors to restructure its debt obligations and continue operations under a court-approved plan.[51]

In both liquidation and reorganization, bankruptcy law structures loss allocation through a system of priority. In Chapter 7, the property of the bankrupt business is distributed according to a statutory order of claims.[52] In Chapter 11, a judge may not confirm a plan to reorganize the business over the objection of a dissenting class of claimants if the plan violates the Code's ordering principles, including the "absolute priority" rule of seniority.[53] Under this seniority rule, secured creditors enjoy first claim to the value of their collateral,[54] unsecured creditors are ranked in descending order of seniority, and equityholders are only entitled to anything if creditors are first paid in full.[55]

Although bankruptcy formally guides financial losses onto a firm's investors, a firm's failure is of course not costless for outsiders. Firm failure can impose substantial spillover costs onto parties like employees (who get fired), suppliers (who lose customers), customers (who cannot shop there anymore), and local communities (that require economic vitality).[56] But such impacts are not the Bankruptcy Code's central loss-allocation device. Because the Code's architecture routes the debtor's insufficient value through the debtor's own capital structure and priority scheme, investor claimants have incentive to know their rights in bankruptcy and discipline firm behavior accordingly. Lenders, for example, negotiate for debt covenant provisions in credit agreements that protect them if the firm becomes financially distressed.[57]

Insurers, like their conceptual cousins in banking, depart from bankruptcy's baseline by protecting a favored class of financial claimants in insolvency proceedings: policyholders for insurers and depositors for banks. The next Part demonstrates how insurer and bank insolvency systems guarantee the safety of

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[48] 11 U.S.C. § 301.

[49] 11 U.S.C. § 303. An involuntary business bankruptcy requires additional procedural requirements; for example, if there are twelve or more creditors, at least three creditors must petition for the bankruptcy. 11 U.S.C. § 303(b)(1), (2).

[50] 11 U.S.C. §§ 725, 726.

[51] 11 U.S.C. § 1129. This depiction of the bankruptcy process is simplified for clarity. Among other possibilities, the firm may also try to auction itself to a third party under 11 U.S.C. § 363.

[52] 11 U.S.C. §§ 507, 724, 726.

[53] 11 U.S.C. § 1129(b).

[54] Secured creditors only hold a claim to their collateral or equivalent value and hold no claim on the debtor as a going concern. Melissa B. Jacoby & Edward J. Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, 96 TEX. L. REV. 673 (2018).

[55] In negotiated reorganization plans, creditors may consent to plans that violate absolute priority. This phenomenon has been the subject of much debate, and may be the result of negotiations that take place in the shadow of valuation uncertainty. *See* Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930 (2006).

[56] A classical debate in bankruptcy scholarship is to what extent bankruptcy should focus on maximizing the value of the debtor's estate with respect to creditors vs. establishing a distribution of losses that takes into account the interest of non-creditor counterparties like employees or customers. Foundational articulations of each set of reasoning can be found, respectively, in Douglas Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97 (1984); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987).

[57] Nearly all private debt agreements contain covenants, though level of strictness varies widely. Michael R. Roberts & Amir Sufi, *Control Rights and Capital Structure: An Empirical Investigation*, 64 THE JOURNAL OF FINANCE 1657, 1662-1663 (2009).

these claimants by socializing the costs of financial failure, embedding spillovers directly into their principal loss-allocation mechanisms.

III. SOCIALIZING FINANCIAL FAILURE: DEPOSIT INSURANCE, GUARANTY FUNDS, AND MORAL HAZARD

In this Part, we explain how insurance insolvency works and highlight its differences from ordinary bankruptcy and banking regulation. Ordinary bankruptcy holds a failed firm's investors bear its financial losses. Banking and insurance depart from that structure in order to protect institutionally important types of claimants: depositors and policyholders, respectively. However, banking and insurance law differ on how to structure their respective protections. Banks pay into the federal-deposit-insurance fund before failures occur and banks that pose greater risks must pay more. Insurance guaranty funds assess surviving insurers only after a failure, allocate those assessments by premium volume rather than risk, and usually allow insurers to recover the payments through tax credits that conceal bailouts. Insurance insolvencies are also administered through a relatively fragmented state-based regime, even for the largest insurers. These structural differences in insurance law sharpen incentives for aggressive insurers to pile on risk, perversely amplify stress on surviving insurers during downturns, and remain largely untested by the failure of a large national insurer. Part IV then explains how PE-controlled life insurers exploit these design features.

A. The Banking Insolvency Exception: Federal Deposit Insurance

The most familiar alternative to ordinary bankruptcy in American insolvency law is federal deposit insurance in banking. Banking provides a useful benchmark for understanding insurance guaranty funds because both alternative insolvency regimes depart from bankruptcy's loss-allocation rules to protect a special class of claimants. But the banking comparison is helpful for another reason as well: it showcases that when the law socializes a large part of the cost of firm failure, it must also confront the perverse incentives that such protection creates.

Banks are unique because they issue liabilities that function as most of the nation's money supply.[58] When customers place their funds into bank accounts, they become creditors of the bank and receive a highly liquid claim (e.g. a checking account, savings account, or related product) that they can use as money in ordinary economic life.[59] These "demand deposit" products are meant to be near-instantaneously convertible to literal cash, without incident or penalty, at any moment. Because these deposit liabilities are central to the payments system, the implementation of monetary policy, and basic financial stability, financial distress at a bank poses dangers that extend far beyond the ordinary failure of a private firm.[60]

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[58] *See, e.g.*, Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143, 1158-1165 (2017); Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, 74 VAND. L. REV. 951, 974-978 (2021); Lev Menand & Morgan Ricks, *Federal Corporate Law and the Business of Banking*, 88 U. CHI. L. REV. 1361, 1389-1394 (2021).

[59] The banks take that money and loan it to individuals and firms, who in turn deposit much of that money into their own bank accounts, setting off a cycle where a strong majority of Americans' money is held in the form of these specialized loans. About $2.5 trillion currently circulates as physical currency, but $19 trillion is held in deposits at commercial banks. *Liabilities and Capital: Other Factors Draining Reserve Balances: Currency in Circulation: Week Average (WCURCIR)*, FRED, FEDERAL RESERVE BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/WCURCIR (last visited Apr 14, 2026); *Deposits, All Commercial Banks (DPSACBW027SBOG)*, FRED, FEDERAL RESERVE BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/DPSACBW027SBOG (last visited Apr 14, 2026).

[60] *See, e.g.,* Hockett & Omarova, *supra* note 59.

The core danger to financial stability, in this context, is a "bank run," which ordinary bankruptcy cannot forestall. Banks fund their own activities (e.g. the making of loans) with demand deposits, but such loans have longer duration and are less liquid than depositors' claims. If depositors become concerned that a bank may be unable to repay them in full, they have incentive to withdraw all of their deposits immediately. Because no bank has the liquid assets to satisfy all depositors at once, widespread withdrawals can themselves trigger the bank failure that depositors fear.[61] Bankruptcy is poorly suited to managing a bank run because it would force depositors to wait out a lengthy bargaining process with other unsecured creditors. That delay would undermine the confidence that deposits require precisely at the moment when confidence is most important and, in equilibrium, reduce the amount of money supply.

Federal law therefore bars banks from entering bankruptcy and instead creates a distinct bank-resolution regime with the primary goals of depositor protection and financial stability. Banks are not allowed to file as "debtors" in Bankruptcy Courts.[62] Instead, the FDIC makes the unilateral decision to put a distressed bank in "receivership"—a process in which it seizes control of the institution—and administers its resolution outside of the standard judicial process.[63] The FDIC, by statute, insures the first $250,000 of each depositor bank account.[64] Uninsured deposits are not guaranteed but "depositor preference" ranks them ahead of other unsecured claims.[65] This strategy of removing depositors from ordinary unsecured-creditor bargaining is core to the regime.[66]

The bank insolvency regime, therefore, partially externalizes the cost of bank failure. Rather than confining losses entirely to the failed bank's direct investors, federal deposit insurance places the burden of depositor protection on a government institution funded by collective bank payments, with the public serving as the final backstop. The Deposit Insurance Fund does not receive annual appropriations from Congress, but instead receives revenues from assessments on banks (essentially, insurance premiums) and interest earned on such revenues.[67] In the event that the fund is exhausted by insurance payouts, the FDIC is backed by the "full faith and credit" of the U.S. government, which necessarily requires the use of

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[61] Bank runs were first mathematically formalized in Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401 (1983). Bank deposits are meant to have the properties of "safe assets" whose value is information-insensitive and are accepted at par, no questions asked; a bank run represents a tipping point threshold where bank deposits lose such qualities. Tri Vi Dang, Gary Gorton, Bengt Holmström & Guillermo Ordoñez, *Banks as Secret Keepers*, 107 AM. ECON. REV. 1005 (2017); Gary B. Gorton, Chase P. Ross & Sharon Y. Ross, *Making Money*, J. FIN. (forthcoming).

[62] 11 U.S.C. § 109(b)(2), (3)(B). For a history of banking insolvency law, see Peter P. Swire, *Bank Insolvency Law Now That It Matters Again*, 42 DUKE L.J. 469, 477-490 (1992).

[63] David A. Skeel Jr., *The Law and Finance of Bank and Insurer Insolvency Regulation*, 76 TEX. L. REV. 723, 727-731 (1998); Richard M. Hynes & Steven D. Walt, *Why Banks Are Not Allowed in Bankruptcy*, 67 WASH. & LEE L. REV. 985, 998-1000 (2010). The FDIC can also in theory place the bank into a conservatorship and attempt to re-establish the bank as a going concern, but in practice this almost never occurs. Skeel Jr. at 729.

[64] 12 U.S.C. § 1821(a)(1)(A), (E). The FDIC in effect becomes the largest creditor of the distressed bank. Hynes & Walt, *supra* note 64, at 1012-21.

[65] 12 U.S.C. § 1821(d)(11)(A). Deposits that are solely payable at an office outside of the U.S. do not receive such preference. 12 C.F.R. § 330.3(e)(1).

[66] The FDIC undertakes the rest of the bank resolution process using the method that is the least costly to the Deposit Insurance Fund." 12 U.S.C. § 1823(c)(4)(A)(ii). The FDIC may also take other actions if the Secretary of the Treasury, the President, and Board of Governors of the Federal Reserve determine that such action is necessary to mitigate "systemic risk." 12 U.S.C. § 1823(c)(4)(G). For example, the deposit insurance cap was lifted to cover all deposits at Silicon Valley Bank in 2023. Joint Press Release, Dep't of the Treasury, Bd. of Governors of the Fed. Rsrv. Sys., Fed. Deposit Insurance Corp., Joint Statement by Treasury, Federal Reserve, and FDIC (Mar. 12, 2023). The FDIC may orchestrate a merger of the failed bank into a solvent one or manage the lengthy process of resolving the failed bank's portfolio.

[67] 12 U.S.C. § 1817(b)(1)(A).

taxpayer resources.[68] Additionally, relatively small banks may deduct the cost of regular assessments from their federal taxable income as an "ordinary and necessary" business expense, but larger banks cannot.[69] Deposit insurance thus reflects a judgment that the social importance of stable money justifies shifting some of the losses of bank failure beyond the failed bank and its immediate counterparties.

Crucially, deposit insurance creates the problem of "moral hazard": a situation where an individual or institution takes excessive risks because they are protected from the consequences, usually because another party bears the cost.[70] In this setting, both depositors and banks know a public backstop stands behind them during crises. Therefore, banks have a greater incentive to invest customer deposits into riskier ventures that have higher potential upside but worse potential downside.[71] At the same time, depositors, who are technically creditors of a bank, have less incentive to monitor bank behavior as they are insured against the consequences of bank failure.[72] This dynamic sits in stark contrast to other kinds of lenders that comprehensively examine firms for creditworthiness and negotiate for covenants.[73] Banks can therefore increase their equityholders' wealth by raising risk, which increases shareholder returns in the event that the risks pay off, but does not symmetrically reduce shareholder returns further in the event of insolvency.[74]

Banking law deals with moral hazard by charging banks before failure in a manner that scales with risk and pairing deposit insurance with ex-ante risk regulation that is integrated into a federal macroprudential infrastructure. FDIC assessments are based on the bank's risk level, size, and the revenue needs of the Deposit Insurance Fund.[75] And while banking supervision in the US operates through a "dual banking

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[68] Each insured depository institution must display a sign with this message. 12 U.S.C. § 1828(a)(1).

[69] Banks in general were historically able to deduct Deposit Insurance Fund assessments from their federal taxable income under the general principle that "ordinary and necessary" business expenses are deductible. I.R.C. § 162(a). Following the Tax Cuts and Jobs Act of 2017, taxpayers with over $50 billion in "total consolidated assets" may not deduct regular FDIC premiums, with a phase-in range between $10 billion and $50 billion, so now only taxpayers with $10 billion or less in "total consolidated assets" may fully deduct such premiums. I.R.C. § 162(r). For an explanation of the computation, see Susan R. Boltacz, *Disallowance of deduction for FDIC premiums under Sec. 162(r)*, THE TAX ADVISER (June 1, 2020), https://www.thetaxadviser.com/issues/2020/jun/disallowance-deduction-fdic-premiums-sec-162r/. IRS guidance permitted all banks to deduct the cost of "special assessments" used to cover losses related to Silicon Valley Bank and Signature Bank in 2023 for federal income tax purposes. I.R.S. Chief. Couns. Adv. Mem. AM-2024-003 (Nov. 8, 2024). State corporate income tax rules generally mirror federal rules, but many states implement bank net income taxes as separate franchise taxes, so federal deductions may not be mirrored at the state level. *See, e.g,* Synovus Bank v. S.C. Dep't of Revenue, 444 S.C. 30 (Ct. App. S.C. 2024), reh'g denied (Sept. 5, 2024), cert. denied (Jan. 14, 2025) (denying Synovus Bank the ability to use federal tax deductions for state tax purposes because the state bank tax is a franchise tax, not a corporate income tax).

[70] The term "moral hazard" goes back hundreds of years. Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 239 (1996). Modern economic analysis of moral hazard is commonly credited to begin with Kenneth J. Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941 (1963).

[71] Michael C. Keeley, *Deposit Insurance, Risk, and Market Power in Banking*, 80 AM. ECON. REV. 1183 (1990) ("It has long been recognized that a fixed-rate deposit insurance system…can pose a moral hazard for excessive risk taking. The reason is that banks or thrifts can borrow at or below the risk-free rate by issuing insured deposits and then investing the proceeds in risky assets with higher expected yield").

[72] Jonathan R. Macey & Geoffrey P. Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1205 (1988) (arguing that protected depositors "have very little incentive to engage in monitoring").

[73] *See supra* n. 57.

[74] Mathematically, this deposit-insurance dynamic can be modeled as the government writing a European-style put option on banks' assets where the strike price is the value of the bank's insured deposits. Robert C. Merton, *An analytic derivation of the cost of deposit insurance and loan guarantees: an application of modern option pricing theory*, 1 JOURNAL OF BANKING & FINANCE 3, 4 (1977).

[75] 12 U.S.C. § 1817(b)(1)(C), (b)(2) (defining the FDIC's "risk-based assessment system" as one based on the probability that the Deposit Insurance Fund will incur loss, taking into account "different categories and concentrations of assets," "different categories and concentrations of liabilities," "any other factors" the FDIC deems relevant, "the likely amount of any such loss," and "the revenue needs of the Deposit Insurance Fund"). An early argument for using bank risk to price

system" where many banks are formally supervised by state-level banking authorities,[76] the FDIC administers deposit insurance and the resolutions of failed insured banks.[77] Large national banks and bank holding companies are embedded in a federal supervisory architecture involving the FDIC, Office of the Comptroller of the Currency (OCC), and the Federal Reserve.[78] This architecture requires intensive supervision, capital regulation, activity restrictions, stress testing, living wills and resolution planning, and other "safety and soundness" rules designed to reduce the likelihood that the public backstop will ever have to be employed.[79] In other words, banking law does not wantonly socialize downside risk, but constructs a national regulatory apparatus meant to constrain the behavior that such socialization encourages.

Banking insolvency law therefore provides a helpful benchmark for analyzing insurance insolvency. Such law identifies a policy problem (bank runs and monetary instability) that ordinary bankruptcy cannot adequately address, creates a special loss-allocation regime tailored to that problem (federal deposit insurance and depositor preference), and attempts to counteract the resulting moral hazard through risk-sensitive regulation. Insurance insolvency law is conceptually similar: it too removes a class of firms from bankruptcy's standard process and protects a favored class of claimants through a special backstop. However, as the next Subpart shows, insurance does so through a quite different and weaker institutional structure.

B. The Insurance Insolvency Exception: Guaranty Funds

Like banks, insurers are excluded from ordinary bankruptcy, and their alternative insolvency law protects policyholders as a special type of claimant through a public backstop.[80] Unlike banks, failing insurers are not resolved through a federal receivership administered by a national deposit insurer. Insurance insolvency and receivership, like insurance regulation generally, rely on a state-by-state regulatory regime that is coordinated through the NAIC. In this Subpart, we explain the mechanics of state-based insurance guaranty funds.

Insurer insolvency proceeds through state-law receivership, and the formal transition from private distress to public loss allocation is controlled by the insurance regulator of the insurer's domiciliary state.[81]

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banks' deposit insurance premiums can be seen in Kenneth E. Scott & Thomas Mayer, *Risk and Regulation in Banking: Some Proposals for Federal Deposit Insurance Reform*, 23 STANFORD LAW REVIEW 857, 886-92 (1971).

[76] Scholars have argued that this distinction is more formal than real. *See, e.g,* Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677 (1988).

[77] In recent years, the FDIC's purview has been functionally extended to cover many uninsured depositors as well. *See generally* Michael Ohlrogge, *Why Have Uninsured Depositors Become De Facto Insured?*, 100 NYU L. REV. 345 (2025).

[78] 12 U.S.C. §§ 1, 93a, 1841-1852.

[79] At a very general level, banking supervision is an informal mechanism where the federal banking regulators (the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the FDIC) have tremendous power to approve or disapprove transactions, monitor banks, and impose remedies to bolster bank "safety and soundness." *See* Menand, *supra* note 59, at notes 4-6. *See generally* PETER CONTI-BROWN & SEAN H. VANATTA, PRIVATE FINANCE, PUBLIC POWER: A HISTORY OF BANK SUPERVISION IN AMERICA (2025). Bank capital requirements effectively penalize banks for holding assets the risk-based capital framework deems to be riskier. *See generally* Eric A. Posner, *How Do Bank Regulators Determine Capital-Adequacy Requirements?*, 82 U. CHI. L. REV. 1853 (2015). The effectiveness of these regulations is endlessly debatable, and in the late 20th century supervision and bank activity restrictions were loosened in favor of capital regulation. *See generally* Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the "Business of Banking,"* 63 U. MIAMI L. REV. 1041 (2009); Lev Menand, *Too Big to Supervise: The Rise of Financial Conglomerates and the Decline of Discretionary Oversight in Banking*, 103 CORNELL L. REV. 1527 (2019).

[80] 11 U.S.C. § 109(b)(2), (3)(A).

[81] The vast majority of states have adopted the NAIC's Model Insurers Rehabilitation and Liquidation Act, Uniform Insurers Liquidation Act, or Insurer Receivership Model Act, which articulate this mechanism. Daniel Hartley, *Insurance on*

A state's insurance commissioner petitions a state court to place a troubled insurer into receivership, which can take the form of conservation (a non-public, limited-duration state of heightened regulatory scrutiny), rehabilitation (commissioner direction of the insurer with the aim of reorganization, most analogous to bankruptcy's Chapter 11), or liquidation (commissioner-directed wind-down of the insurer, most analogous to bankruptcy's Chapter 7).[82] Once the receivership is in place in the domiciliary state, other states generally appoint ancillary receivers for their states and coordinate through the NAIC.

Life insurance policyholders do not hold fully money-like claims in the way that bank depositors do, but, as courts have reasoned, they are participants in the "quasi public nature" of insurance as a system of risk reduction.[83] The core problem is reliance: policyholders often pay premiums for years or decades before benefits become due, and a customer whose insurer fails late in life will almost certainly be unable to buy equivalent replacement coverage at the same price. If insurers were resolved through ordinary bankruptcy, life insurance policies would likely be considered "executory contracts" where the debtor firm would have power to attempt to cancel them.[84] Exposing policyholders to midstream cancellation through no fault of their own would undermine the basic consumer function of life insurance. Therefore, guaranty funds preserve covered benefits despite the insurer's failure and, in equilibrium, increase demand for life insurance products.

Against this backdrop, following a spate of insurer failures in the 1960s and Congressional consideration of a federal insurer backstop, states rapidly enacted insurance guaranty funds to reassure policyholders that insurer insolvency would not render their protection worthless.[85] Modern life-and-health insurance guaranty funds are structured through a set of state associations, the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA), and are modeled on the NAIC's relevant Model Act.[86] For efficiency, we describe their operations with reference to the Model Act.

An insurance guaranty fund and associated state law perform three functions. First, the fund protects in-state policyholders of liquidated insurers up to statutory caps. Second, the fund finances the protection by assessing the remaining, solvent in-state insurers in proportion to premium volume ex post. Third, in most states, tax law permits assessed insurers to then pass the cost of the rescue onto state taxpayers through premium tax credits. The system externalizes the costs of failure onto the failed insurer's competitors, and then likely to the public. We now describe each function in turn.

Insurers: How State Insurance Guaranty Funds Protect Policyholders, FED. RSRV. BANK CHI.: ECON. PERSPS. 3 (2024); Kent M Forney, *Insurer Insolvencies and Guaranty Associations*, 43 DRAKE L. REV. 813 (1995).

[82] BAIRD WEBEL, CONG. RSCH. SERV., RL32175, INSURANCE GUARANTY FUNDS 2 (2008); Hartley, *supra* note 82, at 3-4.

[83] Sims v. Fidelity Assurance Ass'n, 129 F.2d 442, 448 (4th Cir. 1942), aff'd, 318 U.S. 608 (1943).

[84] One influential definition of an executory contract is a contract "under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINNESOTA LAW REVIEW 439, 460 (1973). The bankruptcy trustee may "assume or reject any executory contract" with the bankruptcy court's approval. 11 U.S.C. § 365(a). Various courts have ruled in other contexts that insurance policies, including life insurance policies, constitute executory contracts. *See, e.g.,* LifeUSA, Ins. Co. v. Green (In re Green), 241 B.R. 187, 202-03 (Bankr. N.D. Ill. 1999) aff'd 259 B.R. 295 (N.D. Ill 2001) aff'd 42 Fed. Appx. 815 (7th Cir. 2002); In re Cmty. Mem'l Hosp., 2019 WL 7753754, at *5 (E.D. Mich. July 23, 2019).

[85] William M Foster, *The Federal Insurance Guaranty Corporation: A Proposal*, 22 S. C. L. REV. 788, 788-791 (1970). The NAIC, in response to Congressional proposals by Senators Thomas Dodd and Warren Magnuson in 1966 and 1969, respectively, for an automobile-insurer federal guaranty fund and a property-insurance guaranty corporation, acted swiftly to head off federal involvement in insurance insolvency and created a Model Act for guaranty funds. Between 1969 and 1974, 47 states adopted such funds, and the last three soon followed. U.S. GOV'T ACCOUNTABILITY OFF., GAO/GGD-87-100, INSURER FAILURES: PROPERTY/CASUALTY INSURER INSOLVENCIES AND STATE GUARANTY FUNDS (1987), at 26-27.

[86] Life and Health Insurance Guaranty Association Model Act (Nat'l Ass'n of Ins. Comm'rs 2018), https://content.naic.org/sites/default/files/model-law-520.pdf [hereinafter Life Guaranty Fund Model Act].

First, a state's guaranty fund protects in-state policyholders of a liquidated insurer by keeping their contracts in force, up to a threshold. Under the Model Act, up to $300,000 of life-insurance benefits with respect to an insured are covered[87] and up to $250,000 in present value of annuity benefits with respect to an insured are covered[88] (individual states may vary these amounts).[89] For example, if a policyholder had a term life policy that was supposed to pay out $400,000 in the event that an insured died and the insurer was liquidated, the Model Act would guarantee the first $300,000 of that contingent payment. Policyholders must continue paying premiums to maintain the coverage. Benefits above the cap may retain "priority claim" status against the insurer, but the fund is not legally obligated to make such claims whole.[90] This coverage enshrines policyholders as a privileged class of claimant against a liquidated insurer.

Second, the guaranty fund finances this protection by assessing surviving insurers. In essence, the remaining solvent insurers operating in states where the liquidated insurer was active must cover guaranty-fund obligations that cannot be satisfied from the liquidated insurer's remaining assets. Each assessed insurer's share of responsibility corresponds to its share of premium volume in the relevant state. There is a cap on the assessment of 2% of premium volume in any given year.[91] If assessments are insufficient to cover obligations, the fund may issue bonds that are typically secured by future insurer assessments[92] or, subject to approval by a state court, impose liens that temporarily or permanently limit policyholder claim payouts below the statutory threshold.[93] Thus, at least in the first instance, the cost of preserving the failed insurer's covered policyholder obligations shifts to the failed insurer's surviving competitors.

Third, in most states, assessed insurers may recoup much or effectively all of the cost of such assessments through tax credits against state premium taxes. States generally tax insurers on gross

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[87] Life Guaranty Fund Model Act § 3(C)(2)(a)(i), (d). Formally, $300,000 in life insurance death benefits is covered, with a maximum coverage of $100,000 of net cash surrender and withdrawal value with respect to an insured person, and $300,000 as a maximum of aggregate benefits with respect to an insured person. This structure applies without regard to the number of policies issued with respect to an insured person.

[88] Life Guaranty Fund Model Act § 3(C)(2)(a)(iii).

[89] As an example of state variation from the NAIC Model Act, New York's guaranty fund provides up to $500,000 in coverage relating to life insurance. N.Y. Ins. Law. § 7708(a)(2).

[90] *Guaranty Associations*, ACLI, https://www.acli.com/about-the-industry/guaranty-associations (last visited May 6, 2026).

[91] The precise formula for determining the assessment is somewhat complex. The Life Guaranty Fund Model Act splits life insurer contracts into subaccounts corresponding to three broad lines of business: life insurance, annuity accounts (including annuities owned by qualified retirement accounts like 401(k)s), and unallocated annuities. Life Guaranty Fund Model Act § 6(a)(1). Not all states actually cover unallocated annuities. Hartley, *supra* note 82, at 4. After a state court approves the insurer's liquidation, the insurer's receiver and the guaranty funds of states where the insurer operate must coordinate to calculate and levy assessments on the remaining solvent insurers in such states that operated in the same subaccounts as the liquidated insurer did. Life Guaranty Fund Model Act § 9(B)(2), (C)(2), (C)(4). For example, if the liquidated insurer sold only life insurance policies in Oregon but only annuity accounts in Michigan, insurers that sell life policies in Oregon and insurers that sell annuities in Michigan will be assessed. In each state, the insurers will be responsible for a percentage of the payment equal to their share of premium volume in that subaccount for the past three years. Life Guaranty Fund Model Act § 9(C)(4). So, if an insurer received 1% of the life insurance premiums paid in Oregon over the previous three years, that insurer would be liable for 1% of the amount calculated to meet the guaranty fund's obligations in Oregon. A 2% per year limitation is placed on this assessment so that a large insurer will never be responsible for more than 2% of the assessment with respect to a subaccount in a single year; if this maximum assessment for a subaccount means that the guaranty fund will be unable to make the guaranteed policy payouts, the fund will then conduct an assessment on the other subaccounts (up to a 2% per year cap). Life Guaranty Fund Model Act § 9(E)(1)(a), (3). All Model Act provisions may be modified in any individual state.

[92] Hartley, *supra* note 52, at 6.

[93] Life Guaranty Fund Model Act § 8(E).

premiums written on in-state residents and property in lieu of ordinary corporate income taxation.[94] The NAIC Model Act contains an optional provision permitting insurers to fully credit assessments against premium-tax liability over five years, with 20% of the assessment creditable each year.[95] 34 states have adopted this provision,[96] while ten states permit full or partial crediting on different timelines.[97] Only six states provide no tax credit against life-insurer assessments.[98] Additionally, while a reduction in state-premium-tax liability reduces the amount available for a deduction against federal-income-tax liability, insurers receive a current-year deduction against assessments when calculating taxable income for federal income tax purposes. Life insurers' federal tax liability is therefore mostly unaffected, or may become slightly more favorable in present value terms.[99]

In states that allow tax credits, the assessment looks like an industry-funded rescue, but is really an advance from surviving insurers that they recover through the tax system.[100] Suppose a guaranty association

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[94] The rates of such taxes, when placed on property & casualty insurers, are generally between one and four percent. Martin Grace, David L. Sjoquist & Laura Wheeler, *Insurance Premium Taxes*, 100 PROCEEDINGS. ANNUAL CONFERENCE ON TAXATION AND MINUTES OF THE ANNUAL MEETING OF THE NATIONAL TAX ASSOCIATION 34, 37 (2007).

[95] Life Guaranty Fund Model Act § 13(A).

[96] The states are Alabama, Arizona, Arkansas, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Texas, Utah, Vermont, Washington, and Wisconsin. Individual states may have additional provisions qualifying these rules, such as excluding administrative expenses. *GA Law Summaries*, NOLHGA, https://nolhga.com/the-guaranty-system/guaranty-association-laws/.

[97] The states are Florida (which permits full crediting of 5% per year over 20 years), Massachusetts (which permits full crediting of 10% per year over ten years), Michigan (which uses a formula to determine crediting), New Jersey (which permits a crediting of a maximum of 10% of the assessment each year for five years), New York (which uses a formula to determine crediting if the net assessment for New York companies exceeds $100 million over the previous 15 years), Pennsylvania (which uses a formula that permits a maximum crediting of 20% per year over five years), Rhode Island (which permits a crediting of a maximum of 10% of the assessment each year for five years), Tennessee (which permits full crediting using a formula), Virginia (which permits full crediting of 10% per year over ten years), and Wyoming (which permits full crediting of 10% per year over ten years). Washington, D.C. permits full crediting of 10% per year over ten years. Individual states may have additional provisions qualifying these rules, such as excluding administrative expenses. *Id.*

[98] The states are Alaska, California, Illinois, Maryland, New Mexico, and West Virginia. Puerto Rico also does not permit a tax credit. *Id.*

[99] A deduction for state and local taxes is available for life insurers against the federal income tax, including such state and local taxes "which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income)"; therefore, if a life insurer pays less in state taxes, it will have more federal "life insurance company taxable income." I.R.C. §§ 164(a), 801, 804, 805(a)(8); Treas. Reg. 1.164-1(a). However, the guaranty fund assessment is also deductible for federal income tax purposes in the year the assessment is levied. Treas. Reg. § 1.263(a)-4; T.D. 9107, 2004-1 C.B. 447. For an explanation of these provisions and why the deduction is available in the year the liability is incurred, see Peter H. Winslow & Lori J. Jones, *When Are Guaranty Association Assessments Deductible?*, 2 TAXING TIMES 24, 24 (2006). To see the net impact of an assessment on a life insurer's federal taxes, consider an example where a life insurer is liable for an assessment of $100 and faces its marginal income tax rate of 21%. I.R.C. §§ 11(b), 801(a). In the year the assessment is levied, the insurer's federal taxable income thus decreases by $100. However, if the insurer is in a state that permits a 100% state-tax credit where 20% of the credit is available each year for five years, then for five years, the insurer's state-tax liability is $20 lower than what it would have been otherwise. So, in year 1, the life insurer must reduce its deduction for state taxes by $20, and will do the same in years 2-5. Therefore, on net, the life insurer's federal taxable income will be -$80, +$20, +$20, +$20, and +$20 relative to baseline over that period, meaning that its federal tax liability will be -$16.8, +$4.2, +$4.2, $+4.2, +$4.2 using the 21% marginal tax rate. Because of the time value of money, the insurer on net comes out slightly ahead in terms of federal income tax liability.

[100] Interestingly, in both tax-credit-permitting and non-tax-credit-permitting states, a life insurer may consider "the amount reasonably necessary to meet its assessment obligations" when setting its "premium rates and policy owner dividends." Life Guaranty Fund Model Act § 9(G). The Drafting Note makes clear that the cost of an assessment "can be ultimately passed on to the policy owners, contract owners, certificate holders, or enrollees – i.e., to persons who enjoy the protection provided

assesses an insurer for $100. The insurer pays $100 now and reduces its premium-tax liability by $20 in each of the next five years (beginning in the current year). The insurer only bears the financing cost of waiting for reimbursement, but the state ultimately forgoes $100 in tax revenue. Under current interest rates, the tax credit shifts approximately 86.5% of the assessment's present-value cost to the state.[101]

The guaranty fund structure has meaningful virtues. It protects policyholders and arguably undergirds life insurance's long-duration contracts. However, it also generates a distinctive moral hazard problem: the guaranty-fund backstop is funded ex post, is not priced based on risk, and, in tax-credit states, shifts the cost of insurer failure onto the public through the ordinary mechanics of insolvency loss allocation rather than as a last-resort residual. Life insurers get to keep the upside if risky investments pay out, but taxpayers foot the bill if they do not. The next Subpart explains how the design choices of the NAIC and states in structuring guaranty funds make the insurance backstop particularly vulnerable to exploitation by sophisticated asset managers, even relative to federal deposit insurance.

C. Moral Hazard, Shock Amplification, and Crisis Risk

We argue that the current structure of guaranty funds (1) exhibits worse moral hazard issues than federal deposit insurance through four separate channels, (2) amplifies the cost of the insolvency shock to remaining competitors and taxpayers because of strategically timed insurer behavior, and (3) is underprepared for tail-risk events of large, national insurer insolvencies. Insurer regulation, relative to bank regulation, offers more occasion for opportunistic behavior that keeps the upside of investment risks private but socializes losses onto other firms and, in short order, taxpayers.

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by the Act." Life Guaranty Fund Model Act p. 28. However, a given life insurer's ability to set differential premiums state-by-state for the same type of policy is sharply limited due to regulatory processes and political backlash risk, with the result that an insurer's life insurance prices (though not quantities) for a given product line are effectively uniform across the U.S. *See* Johnny Tang, *Regulatory Competition in the US Life Insurance Industry*, J. POL. ECON. 89 (Forthcoming) (demonstrating lack of result change with and without a state fixed effect in Table A4); Derek Wenning, *National Pricing and the Geography of U.S. Life Insurers* 7-8 (SSRN, Working Paper No. 4745604, 2024), https://papers.ssrn.com/abstract=4745604. It is possible that life insurers are not effectively able to raise premium prices on policies in non-credit-permitting states, resulting in either a distribution of projected assessment costs to the insurer's policyholders nationally (as opposed to the insurance consumers of that state), or a forcing of the life insurer to eat the cost. We contacted the insurance guaranty funds of states that do not have tax credits; some did not reply and those that did said that they could not provide such information or did not know how assessments were built into life insurance premiums. Depending on the state, property & casualty insurers may receive a tax credit, the ability to charge rates with regard to prospective assessment costs, or the ability to levy a direct premium surcharge to recover assessment costs, enabling P&C insurers to consider the likelihood and magnitude of assessments in setting premium surcharges retrospectively rather than prospectively. Property and Casualty Insurance Guaranty Association Model Act § 17. (Nat'l Ass'n of Ins. Comm'rs 2023), https://content.naic.org/sites/default/files/model-law-540.pdf.

[101] Let us assume that the S&P 500 Investment Grade Corporate Index roughly equates to a traditionally operated life insurer's cost of capital. On May 6, 2026, the yield-to-maturity of the S&P 500 Investment Grade Corporate Bond Index was 5.05%. *S&P 500® Investment Grade Corporate Bond Index*, S&P DOW JONES INDICES, https://www.spglobal.com/spdji/enhttps://www.spglobal.com/spdji/en/indices/fixed-income/sp-500-investment-grade-corporate-bond-index/ (last visited May 7, 2026). The present value of an annuity stream equals the dollar amount of each annuity payment divided by the discount rate, times [1 – (1 / {1 + discount rate}^number of periods)]. Letting .2 be the dollar amount (e.g. normalizing the value of the assessment to 1), 5.05% be the discount rate, and 5 be the number of periods, the formula resolves to .865, or 86.5% of 1.

1. Guaranty Funds Exhibit Worse Moral Hazard Incentives Relative to Federal Deposit Insurance

Policymakers and scholars have offered several rationales for guaranty funds' post-insolvency assessment structure (as opposed to requiring pre-insolvency payments that are held for the purpose of insurer rescue). The current regime, it has been argued, incentivizes monitoring by other insurers,[102] reduces administrative costs to policyholders and other insurers (in the event there are no insolvencies),[103] avoids scenarios where state legislators may be tempted to use accrued funds for noninsurance purposes,[104] and increases confidence in the insurance industry.[105]

In contrast to these potential benefits, we illustrate that guaranty funds magnify the moral hazard problem of deposit insurance-like systems through to the public fisc via five channels.

First, guaranty fund payments are made post-insolvency rather than pre-insolvency, so the insolvent insurer never makes any payments into the fund that will rescue its policyholders. Pre-insolvency systems like deposit insurance require that all system members contribute.

Second, because the guaranty-fund assessments are priced on volume (up to a cap), not risk contribution, riskier insurers are not penalized relative to safer insurers. As discussed in Subpart III.A,[106] bank contributions to the Deposit Insurance Fund are risk-weighted, so banks that are more likely to need a rescue must contribute more to the fund as a mechanism for disciplining perilous behavior. A number of scholars have advocated for adding risk pricing to guaranty fund premiums, generally in conjunction with moving to pre-insolvency payments.[107] As a combination of the first and second channels, the riskiest insurers (those that are more likely to become insolvent) pay nothing at all on their way to imposing costs on others, while the share of the costs borne by relatively safe insurers is highly disproportionate compared to the expected value of the fund to their own policyholders.[108]

Third, while deposit insurance draws directly on bank-contributed funds with taxpayers serving as a last resort,[109] tax credits for guaranty-fund assessments provide immediate pass-through of insolvency costs to taxpayers in relevant states. In such credit-permitting states, taxpayers become the routine reimbursement mechanism for guaranty-fund assessments rather than a last resort. Banks, by contrast, must burn through the entire accumulated deposit insurance fund before taxpayers make a direct contribution; banks may at

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[102] Harold C. Krogh, *Insurer Post-Insolvency Guaranty Funds*, 39 J. RISK INS. 431, 437 (1972).

[103] *Id.* at 437; UNITED STATES GENERAL ACCOUNTING OFFICE, INSURER FAILURES: PROPERTY/CASUALTY INSURER INSOLVENCIES AND STATE GUARANTY FUNDS 35 (1987); OECD, POLICYHOLDER PROTECTION SCHEMES: SELECTED CONSIDERATIONS 33-34 (2013); Takahiro Yasui, *Policyholder Pension Funds: Rationale and Structure*, *in* INSURANCE AND PRIVATE PENSIONS: COMPENDIUM FOR EMERGING ECONOMIES, BOOK 1 1, 13 (2001).UNITED STATES GENERAL ACCOUNTING OFFICE, INSURER FAILURES: PROPERTY/CASUALTY INSURER INSOLVENCIES AND STATE GUARANTY FUNDS (1987); OECD, POLICYHOLDER PROTECTION SCHEMES: SELECTED CONSIDERATIONS (2013)

[104] UNITED STATES GENERAL ACCOUNTING OFFICE, *supra* note 74, at 35; Yasui, *supra* note 74, at 13; OECD, *supra* note 74, at 33-34.

[105] Yasui, *supra* note 104, at 13.

[106] See *supra* n. 49.

[107] J. David Cummins, *Risk-Based Premiums for Insurance Guaranty Funds*, 43 J. FIN. 823, 825 (1988); J. David Cummins, Scott E. Harrington & Robert Klein, *Insolvency experience, risk-based capital, and prompt corrective action in property-liability insurance*, 19 J. BANK. & FIN. 511, 527 (1995); Li-Ming Han, Gene C. Lai & Robert C. Witt, *A financial-economic evaluation of insurance guaranty fund system: An agency cost perspective*, 21 J. BANK. & FIN. 1107, 1126 (1997); William R. Feldhaus & Paul M. Kazenski, *Risk-Based Guaranty Fund Assessments*, 17 J. INS. REG. 42, 44 (1998); Jin-Chuan Duan & Min-Teh Yu, *Fair insurance guaranty premia in the presence of risk-based capital regulations, stochastic interest rate and catastrophe risk*, 29 J. BANK. & FIN. 2435, 2437 (2005).

[108] Bernard E. Epton & Roger A. Bixby, *Insurance Guaranty Funds: A Reassessment*, 25 DEPAUL L. REV. 227, 236.

[109] See *supra* n. 45-46.

most deduct FDIC assessments from their federal income taxes, and large banks cannot even do that.[110] Insurer tax pass-through of assessments also removes incentives for insurers to monitor each other,[111] and as the guaranty fund obviates the incentive for many policyholders to monitor their insurers, only the state is left to prospectively manage the risk.

Fourth, while federal deposit insurance in banking is paired with integrated backstop-and-resolution regulation to mitigate moral hazard,[112] insurance's accompanying regulation is relatively decentralized and focused on individual legal entities rather than systemwide risk mitigation. Insurers have no national guarantor, no single federal resolution authority, and no national supervisory entities for large and complex insurers. While many aspects of state-level insurer regulation are coordinated through the NAIC, every state's insurance regulator only has purview over insurance business that is contained within its boundaries, including insurance insolvency. State insurance commissioners are therefore hamstrung from looking at the industry systematically.[113] Insurer accounting data, the "sole source of data on which all of the core forms of U.S. solvency regulation are built," appears at this state level.[114] If a large, national insurer's business model were to become predicated on aggressively pushing RBC boundaries, the default insurer regulatory response could be highly fragmented and delayed. In an insolvency, though the insurer's home-state regulator would take the lead, each state would have to process the failure separately.

Fifth, there is substantial evidence that state regulators writ large, including in the insurance context, are simply more lenient than federal ones. State-level regulators assign more generous supervisory ratings in banking,[115] pursue less oversight of midsize investment advisers,[116] and pursue less oversight of insurance brokers who exit the federal investment advisor regime.[117] State insurance commissioners often angle to get jobs in the insurance industry afterwards; such commissioners rate insurer conduct more positively.[118]

The cumulative effect of these five channels of amplified moral hazard is that guaranty funds give insurers strong incentives to orient towards high-risk, high-return strategy (maximizing asset risk and minimizing balance sheet equity).[119]

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[110] See *supra* n. 49.

[111] Epton & Bixby, *supra* note 79, at 253; Elijah Brewer, Thomas S. Mondschean & Philip E. Strahan, *The Role of Monitoring in Reducing the Moral Hazard Problem Associated with Government Guarantees: Evidence from the Life Insurance Industry*, 64 J. RISK INS. 301, 301 (1997).

[112] See *supra* n. 50.

[113] Schwarcz, Critical Take on Group Regulation, *supra* note 25, at 541-43.

[114] *Id.* at 543.

[115] *See generally* Sumit Agarwal, David Lucca, Amit Seru & Francesco Trebbi, *Inconsistent Regulators: Evidence from Banking*, 129 Q. J. ECON. 889 (2014).

[116] *See generally* Ben Charoenwong, Alan Kwan & Tarik Umar, *Does Regulatory Jurisdiction Affect the Quality of Investment-Adviser Regulation?*, 109 AMERICAN ECONOMIC REVIEW 3681 (2019).

[117] *See generally* Colleen Honigsberg, Edwin Hu & Robert J. Jackson, *Regulatory Arbitrage and the Persistence of Financial Misconduct*, 74 STAN. L. REV. 737 (2022); Colleen Honigsberg, Edwin Hu & Robert J. Jackson, *Regulatory leakage among financial advisors: Evidence from FINRA regulation of "bad" brokers*, 174 J. FIN. ECON. 104170 (2025).

[118] *See generally* Ana-Maria Tenekedjieva, *The Revolving Door and Insurance Solvency Regulation* (SSRN, Working Paper No. 3762573, 2021), https://papers.ssrn.com/abstract=3762573.

[119] The economic literature in insurance sometimes also uses the terminology of agency problems. The common logic is that insurers act to increase the functional call option its equityholders have on the residual value of the firm at the expense of commitments to policyholders. *See generally* Cummins, *supra* note 108; Cummins, Harrington & Klein, *supra* note 108; Han, Lai & Witt, *supra* note 108; Soon-Jae Lee, David Mayers & Clifford W. Smith Jr., *Guaranty funds and risk-taking: evidence from the insurance industry*, 44 J. FIN. ECON. 3 (1997); Feldhaus & Kazenski, *supra* note 108; David H. Downs & David W. Sommer, *Monitoring, Ownership, and Risk-Taking: The Impact of Guaranty Funds*, 66 J. RISK INS. 477 (1999); Duan & Yu, *supra* note 108; Hato Schmeiser & Joël Wagner, *The Impact of Introducing Insurance Guaranty Schemes on Pricing and Capital Structure*, 80 J. RISK INS. 273 (2013); OECD, *supra* note 104.

2. Guaranty Funds Amplify Insolvency Shocks

The post-failure timing of assessments enables both distressed insurers and their solvent competitors to engage in strategic gaming that makes an insolvency even worse.

Distressed insurers, in the lead-up to likely insolvency, have incentive to expand rapidly.[120] An insurer may furiously sell more policies just before forced receivership because premiums provide cash immediately to use for Hail-Mary investments while financial obligations to those policyholders come later. (The insurer may, for example, massively increase hiring of brokers.) In so doing, the insurer effectively accesses a loan where the lender has little incentive to check if the borrower is in financial distress and will not insist on harsh covenant protections. This dynamic in turn increases the cost of subsequent insolvency to taxpayers because the insurer has grown so much just before going under.[121]

At the same time, surviving insurers face the opposite incentive: because surviving insurers' assessments depend on recent premium volume, they may reduce new sales in a state when a large failure appears likely, especially when states do not provide full tax-based pass-through.[122] A smaller premium base reduces the amount the association can collect quickly. Such exit reduces the assessment base at the moment when guaranty funds need high premium volume from surviving insurers the most.

And in situations where mass insolvencies occur in a poor macroeconomic environment, the balance sheets of even solvent insurers will be relatively fragile, so a large wave of insolvencies and assessments would land at the worst possible time. While insurers in tax-credit states will be able to recover the assessment costs over time, the poor macroeconomic environment will increase borrowing costs that make present-time access to the money more important. A tipping point of distress exists where each wave of insolvencies would trigger assessments, in turn triggering further financial distress and contagion, and therefore another wave of insolvencies, creating a vicious cycle.[123]

3. Guaranty Funds are Untested in True Crisis

Inadequate preparation for worst-case scenarios (correlated-risk left-tail events) highlights guaranty funds' relatively untested nature. Most life insurers that have been liquidated during the guaranty-fund era have been small. The largest such liquidation was Executive Life in 1991, but total assessments related to Executive Life totaled only $3.7 billion.[124] Immediately prior to its infamous role in the 2008 financial crisis, AIG had over $1 trillion in assets.[125] An AIG liquidation would have required assessments that were orders of magnitude larger than ever previously levied. The liquidation was only prevented because of a

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[120] This is a special case of the judgement-proof problem. *See generally* Steven Shavell, *The Judgment Proof Problem*, 6 INT'L REV. L. & ECON. 45 (1986) (judgment-proof parties are "unable to pay fully" for legally imposed liability). For a specific example of how firms in financial distress acquire liabilities to earn profits now and to delay insolvency, *see* Terra Baer, Pranjal Drall & Joshua Macey, *Too Liable To Regulate: The Hidden Costs of Fossil Fuel Decommissioning and Remediation*, 115 CAL. L. REV. (forthcoming 2027).

[121] *See generally* Brian J. Hall & James G. Bohn, *The Moral Hazard of Insuring the Insurers*, *in* THE FINANCING OF CATASTROPHE RISK (1999). Hall & Bohn are actually discussing property & casualty insurers, which are relatively short-term contracts, but note that this "excessive premium growth was more pronounced in long-tail lines than short-tail lines." This dynamic therefore appears even more strongly in life insurance, where contract duration can be decades long.

[122] *See generally* Boaz Abramson, Parinitha Sastry, Ishita Sen & Ana-Maria Tenekedjieva, *Insurance Guaranty Funds* (SSRN, Working Paper No. 5806662, 2026), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5806662.

[123] Gilles Bernier & Ridha M. Mahfoudhi, *On the Economics of Postassessments in Insurance Guaranty Funds: A Stakeholders' Perspective*, 77 J. RISK INS. 857, 837 (2010); OECD, *supra* note 74, at 33; Schwarcz & Schwarcz, *supra* note 25, at 1622.

[124] Hartley, *supra* note 82, at 6, 8.

[125] *See* William K. Sjostrum Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 946 (2009).

federal government bailout of over $100 billion channeled through the Troubled Asset Relief Program (TARP) and a full suite of credit facilities.[126] Some policyholders have had to face delays and logistical difficulties in getting relief from existing liquidations due to state court litigation.[127] A truly major life insurer insolvency, especially if it were taking place in all fifty states simultaneously, would be uncharted and potentially disastrous.

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To summarize Part III: banking and life insurance depart from the logic of ordinary bankruptcy, which directly allocates the costs of firm failure to the firm's investors, because of the distinctive attributes of a special class of claimant—depositors and policyholders. Both regimes protect the favored claimant class from the risk that there isn't enough money left in the firm to make them whole by shifting some losses of the firm beyond the firm's own capital structure. This protection predictably generates moral hazard because the protected claimant class has less reason to monitor risk-taking and firms have greater reason to increase risk when some downside losses will be borne by others.

However, banking law attempts to disincentivize risk-taking behavior by banks through a comprehensive, macro-prudential system of regulation that includes prefunding of the Deposit Insurance Fund on the basis of risk. Life insurers, by contrast, are subject to a multiplicity of state-level regulatory regimes that are structurally impaired from recognizing national risks. Their post-insolvency, non-risk-weighted-assessment guaranty funds entail greater moral hazard, augmented shocks, and more immediate pass-through of the cost to taxpayers in most states. And they have never been truly tested by the failure of a large, national insurer.

With these design features in mind, we turn to the last decade's transformation of the life insurance industry: the explosive growth of PE-controlled insurers that specialize in high-risk, high-return investment strategies in private credit.

IV. PRIVATE EQUITY, PRIVATE CREDIT, AND THE EXTRACTIVE TRANSFORMATION OF THE AMERICAN LIFE INSURANCE INDUSTRY

This Part explains how private equity's entry into life insurance transformed the insurer from a conservative financial institution into a source of permanentcapital vehicle for large asset managers that increasingly rely on private credit. We tell this story in three steps. First, private equity firms have gradually rebranded to "alternative asset managers" whose primary goal is to accumulate assets in order to earn a steady stream of assets under management (AUM) fee income. Second, life insurers have sticky liabilities and "permanent capital" that PE sponsors can deploy across business lines. And third, private credit supplied opaque, high-yield assets through which PE sponsors could earn fees *today* while shifting tail risk to policyholders, surviving insurers, and taxpayers.

A. Private Equity's Turn to Private Credit

This Part describes the rise of the PE and private-credit industries and how modern PE firms came to need private credit and, eventually, life insurance.

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[126] *Id.* at 975.
[127] Hartley, *supra* note 82, at 7-9.

1. From Buyout Funds to Asset-Management Platforms

A private equity firm raises capital from institutional investors and deploys it into private companies or other assets, and earns fees and a share of the upside. The firm operates through a series of "funds." Each fund is a closed-end limited partnership with a relatively standardized fixed life of about seven to ten years. Investors commit capital to the fund and the fund invests in assets ("draws it down") over a three- to five-year investment period, earns money ("harvests") on the back half, returns capital to investors, and eventually dissolves. The fund's general partner is the firm itself, which manages the fund, and the limited partners are outside investors, such as pension funds, endowments and sovereign wealth funds. The classical PE firm typically earns money through a "two-and-twenty" structure, which is a management fee of about two percent of committed capital and a carried interest of about twenty percent of profits above some profit threshold ("hurdle").[128]

When the industry took hold in the late 1980s and through the early 2000s, its dominant business model was the leveraged buyout.[129] The PE firm would acquire a target company using a combination of equity from the fund and substantial third-party debt, install new management, restructure the target's operations, and exit through a sale or initial public offering after a short period of three to five years.[130]

Beginning in the late 2000s, however, the largest private equity firms transformed themselves into multi-strategy asset-management platforms. This shift had several drivers. The 2008 financial crisis tightened bank lending and created openings for non-bank credit providers.[131] The biggest private equity firms went public in a wave between 2007 and 2014, which created pressure to grow assets under management (AUM) consistently since public market investors began rewarding diversified asset managers that had stable fee income over pure buyout firms which typically have lumpier returns.[132]

Firms like Apollo, Blackstone, KKR, Carlyle, and Ares have each built or acquired businesses in credit, real estate, and infrastructure. They now manage between over trillions of dollars in assets, with credit typically being the largest single segment.[133] Blackstone reported approximately $1.3 trillion in assets under management in the first quarter of 2026, of which roughly $457 billion was in credit and insurance while only about $165 billion in traditional ("corporate") private equity.[134] Therefore, the old mental model of a private equity firm, especially amongst the top asset managers, is increasingly outdated.

This business-model shift creates a problem that insurance helped to solve. A ten-year buyout fund produces episodic capital and episodic exits, which suits an investing strategy that produces natural ebbs and flows, like leveraged buyouts. A life insurer, by contrast, supplies a durable pool of assets that can be managed for recurring fees and reinvested across the sponsor's credit platform.

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[128] For an overview of the economics of private equity funds, see Andrew Metrick & Ayako Yasuda, *The Economics of Private Equity Funds*, 23 REV. FIN. STUD. 2303 (2010).

[129] Total U.S. private equity assets under management were measured in the low hundreds of billions of dollars, almost all of it in buyout funds from 1990-2000, *see* Committee on Capital Markets Regulation, *Expanding Opportunities for Investors and Retirees: Private Equity* 7 (Nov. 2018) (using Preqin data and reporting U.S. private-equity AUM of "$448 billion in 2000" and that 62% of U.S. PE AUM was in buyout funds).

[130] *See* generally Steven N. Kaplan & Per Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSPS. 121 (2009).

[131] This is the rise of private credit which we detail in the next Subpart. See *infra* II.A.2.

[132] XX.

[133] McKinsey & Co., Global Private Markets Report 2025 (2025); Bain & Co., Global Private Equity Report 2025.

[134] Blackstone, *First-Quarter 2026 Results* 2, 8 (Apr. 23, 2026), https://www.blackstone.com/wp-content/uploads/sites/2/2026/04/Blackstone1Q26EarningsPressRelease.pdf (reporting total AUM of $1.3 trillion and Credit & Insurance segment AUM of $457.5 billion); Blackstone Inc., Private Equity, https://www.blackstone.com/our-businesses/private-equity/ (last visited Apr. 29, 2026) (reporting $165 billion of Corporate Private Equity AUM as of Mar. 31, 2026).

2. The Rise of Private Credit

Private credit is the new asset engine for the modern private equity platform. The term refers to non-tradable firm loans that are originated and funded by an non-bank investment fund.[135] This type of lending has always served an important function in the debt markets, but the industry has grown tremendously over the past two decades. Total assets in private credit have increased from less than $200 billion prior to the Great Recession to over $1.6 trillion in the U.S. by 2024.[136]

We emphasize several important features of private credit. First, private debt is exempt from the registration and public-offering rules that govern corporate bonds. Public corporate bonds are registered under the Securities Act of 1933,[137] offered publicly,[138] and traded through broker-dealers in secondary markets.[139] Privately-placed debt, on the other hand, is not registered with the SEC, not publicly offered, and can only be sold only to a limited number of accredited investors.[140]

Second, private-credit loans are not intermediated by banks. Traditional corporate lending often placed banks between borrowers and end investors.[141] Private-credit loans, by contrast, are arranged and originated by private investment funds themselves and are generally held to maturity by the fund that makes the loan.[142]

Third, private-credit loans are typically more heavily negotiated than public corporate bonds and therefore tend to be more opaque, more complex, and more illiquid. Unlike public bonds, which are issued into broader markets on relatively standardized terms, private credit transactions are typically negotiated directly between borrower and lender in bespoke, arm's-length deals tailored to the borrower's particular financing needs.[143] That customization often includes individualized covenants, pricing terms, governance rights, and amendment or workout provisions, which can make private credit instruments harder to compare across borrowers. This makes it difficult to price.[144] At the same time, since such loans are unregistered with the SEC, the disclosure available to end-investors is less extensive and often remains confidential. Consequently, since private-credit loans are generally held by the originating funds through maturity and do not trade on exchanges which makes them substantially more illiquid than public corporate bonds.

These structural differences are easier to explain when the market is broken into its three principal actors. The lender is typically an alternative asset manager that makes loans through a private fund or a

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[135] For more detailed discussion, see Ellias & de Fontenay, *supra* note 2, at 805. Private credit is also refereed to as Direct Lending and Private Lending.

[136] Young Soo Jang, Dasol Kim & Amir Sufi, *The Lending Technology of Direct Lenders in Private Credit* (Working Paper No. 34500, 2025), https://www.nber.org/papers/w34500.

[137] Section 5 of the Securities Act of 1933 requires all nonexempt offerings to be registered. 15 U.S.C. § 77e(c).

[138] Securities and Exchange Commission, *What Are Corporate Bonds?*, https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/what-are (last visited Apr 21, 2026).

[139] Financial Industry Regulatory Authority, *Bonds*, https://www.finra.org/investors/investing/investment-products/bonds#buying-and-selling (last visited Apr 21, 2026).

[140] Anne Fournier, Ralf Meisenzahl & Andy Polacek, *Privately Placed Debt on Life Insurers' Balance Sheets: Part 1-A Primer*, FED. RSRV. BANK CHI. (2024).

[141] Ellias & de Fontenay, *supra* note 2, at 793 (describing the relationship-lending model of corporate debt).

[142] *Id.*, at 785.

[143] Fernando Avalos, Sebastian Doerr & Gabor Pinter, *The Global Drivers of Private Credit*, BIS Q. REV. 13, 14 (2025) ("Deals are usually directly negotiated between borrowers and lenders…").

[144] International Monetary Fund, *The Rise and Risks of Private Credit*, *in* GLOBAL FINANCIAL STABILITY REPORT: THE LAST MILE: FINANCIAL VULNERABILITIES AND RISKS TO GROWTH 53 (2024) (describing private credit loans as lacking standardized terms for contracts).

business development corporation (BDC).[145] Relative to banks, these lenders are much more active. They find borrowers, negotiate bespoke terms, value the loans over time, and monitor the debtor carefully.[146] The market is also closely tied to private equity.[147] Estimates suggest that about 70% of private credit borrowers are simultaneously backed by a private equity sponsor.[148]

The investors supply the capital for the loans. Historically, that capital has come from institutional investors such as pension funds, insurance companies, sovereign wealth funds, and family offices, usually through closed-end vehicles that can tolerate illiquidity.[149] But the investor base is widening. BDCs account for about 14 percent of the market and are often publicly traded and therefore open to retail investors.[150]

Private credit borrowers are typically middle-market companies that are smaller and more leveraged than firms that tap the leveraged loan or bond markets. IMF data place the median private credit borrower at about $0.5 billion in total assets, compared with roughly $4.5 to $4.6 billion for high-yield bond and leveraged-loan issuers.[151] This feature helps explain both why private credit appeals to borrowers that may lack ready access to bank or public market financing and why private credit loans generally carry higher rates and tighter lender protections.[152]

The question of why private credit has become an increasingly large part of the credit ecosystem is up for debate, but the recent literature points to several reinforcing explanations. The first part of the story is the change in bank lending. The share of private lending on bank balance sheets fell from 55 percent in the 1970s to 33 percent in 2023.[153] This can be attributed to a shift in borrower demand toward "informationally insensitive" lending and a shift in saver demand away from deposits.[154] At the same time, after the Great Financial Crisis, banks faced higher capital requirements and tighter supervision which meant that loans to smaller, levered, or harder-to-underwrite companies became unattractive.[155]

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[145] BDCs were created by an act of Congress in 1980. Although technically not registered funds, they are regulated as closed-end funds under the Investment Company Act of 1940 with the aim of providing access to capital to small and growing companies, *see* Benjamin C. Bates, *Retail Access to Private Markets: What Are the Risks?* 23 (February 18, 2026), https://ssrn.com/abstract=5381902.

[146] XX.

[147] International Monetary Fund, *supra* note 145 ("The growth in private credit has followed the rise in private equity, with which it is closely linked.").

[148] *Id.*

[149] International Monetary Fund, *supra* note 145, at 54, 56 (explaining that typical investors in private credit include "pension funds, insurance companies," sovereign wealth funds, and family offices).

[150] Bates, *supra* n. 121, at 6, 23-24, 28 (explaining that BDCs are a retail facing private-fund structure that are "accessible to individuals with modest wealth," and that public BDC shares can be bought through "personal brokerage accounts").

[151] International Monetary Fund, *supra* note 145, at 58 fig 2.3 (reporting median firm size of $0.5 billion for private-credit borrowers, $4.6 billion for leveraged-loan issuers, and $4.5 billion for high-yield bond issuers); Recently, a few large direct lenders have started to make loans to much larger and sometimes even publicly traded firms, *see* Ellias & de Fontenay, *supra* note 2, 813-15 (2025) (describing direct lending's expansion into "massive corporate transactions" and the largest funds' capacity to make "extraordinarily large loans").

[152] International Monetary Fund, *supra* note 145 at 54, 57-58 (explaining that private credit is usually more expensive than bank loans, uses "enhanced covenants," and carries rates that are "typically higher" than market-based debt yields); Ellias & de Fontenay, *supra* note 2 at 829-30 (discussing "stronger covenants" in private credit loans).

[153] Greg Buchak, Gregor Matvos, Tomasz Piskorski & Amit Seru, *The Secular Decline of Bank Balance Sheet Lending* 3 (February 2024), https://www.nber.org/papers/w32176.

[154] *Id.*

[155] *Id.* at 4-5 (finding that banks subject to heightened post-GFC regulation had lower loan shares and slower balance sheet lending growth); Greg Buchak, Gregor Matvos, Tomasz Piskorski & Amit Seru, *The Secular Decline of Bank Balance Sheet Lending* 1-3, 29-31 (February 2024), https://www.nber.org/papers/w32176 (explaining that banks may prefer lending to private credit fund special purpose vechicles (SPVs) because those exposures can receive a 20% risk weight, versus 100% for direct middle-market loans, and because leveraged-lending guidance and supervision impose bank compliance costs.

An alternative story suggests that private credit is a new "lending technology" for middle market firms. Unlike banks, direct lenders are able to structure loans around a company's specific cash flows and ownership structure which requires greater monitoring and knowledge of the underlying firm.[156] Private credit lenders are also much more likely to defer payments on loans during times of distress.[157] Banks are unable to do this kind of "informationally sensitive" lending, as noted above. This dynamic is an important feature for middle-market firms that are often too small or too opaque for easy access to public leveraged debt markets, but too complex or levered for traditional bank lending.

The rise of private equity has also increased demand for private credit loans. PE sponsors create a steady pipeline of leveraged buyouts, refinancings, and dividend recapitalizations. Those transactions often needed financing that can be negotiated quickly while having a high tolerance for leverage, complexity, and private information. Banks could provide some of that financing, but their appetite changed after the crisis, and syndicated markets were not always a good fit for smaller deals.[158]

Investor demand for high-yield assets has also increased due to the secular decline in interest rates. Private credit funds draw heavily from investors with long-dated liabilities, including pension funds and insurance companies. These investors can accept illiquidity in exchange for higher spreads, negotiated covenants, and exposure to loans that are not broadly traded. That funding model differs from the banking model because private credit funds rely less on runnable deposits and more on committed institutional capital.[159] This difference allowed private credit to grow without depending on the same deposit-funded structure that supports commercial banks.

Private credit also expanded because it provides borrowers with an alternative source of capital during times of economic stress. When syndicated loan markets become costly, slow, or unavailable, firms still need financing for acquisitions, refinancings, and other sponsor-backed transactions. Empirical evidence confirms that issuance is countercyclical to syndicated lending.[160]

Finally, private credit is now uniquely tied to private equity. This was not always the case as, for most of its history, direct lending grew up alongside the leveraged buyout industry but remained largely distinct from it, serving middle-market borrowers that banks and the public markets had passed over. That separation has since collapsed. Sponsors supply a steady pipeline of deals to lend against, and credit funds supply the debt that finances those deals. In 2023, private equity firms managed roughly 82 percent of

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The authors "conjecture" that "high capital requirements in combination with high supervision costs" discourage bank balance-sheet lending to risky middle-market firms).

[156] Jang, Kim & Sufi, *supra* note 137, at 4, 7 (describing direct lending as "cash-flow-based lending" to privately held middle-market firms and documenting the "heavy reliance" of direct lenders on "blanket liens" which are closely tied to the going-concern value of a company as opposed to tangible assets which is suited to intangible-heavy firms); Young Soo Jang, *Are Direct Lenders More Like Banks or Arm's-Length Investors?* (January 24, 2024), https://papers.ssrn.com/abstract=4529656 (finding direct lenders use financial covenants which borrowers often violate. Lenders are also more flexible in crisis times, relative to banks, and this is facilitated by relationsihps with PE sponsors.).

[157] XX good PIK bad PIK paper?

[158] Victoria Ivashina, *The Role of Private Debt in the Financial Ecosystem* 2-4, 10-13 (October 2025), https://www.nber.org/papers/w34426 (explaining that PE's move toward smaller companies created demand for loans too small to syndicate, while banks focused on larger clients and took only very senior buyout exposur and showing that roughly 60% of BDC investments support PE activity).

[159] *Id.* at 5-8, 20-22 (distinguishing bank deposits from private-debt funding: credit funds are closed-end limited partnerships funded mainly by institutions with long-term liabilities, including pension funds and insurers and capital is committed upfront, drawn down as deals arise, and is relatively more "locked in"); Joern Block, Young Soo Jang, Steven N Kaplan & Anna Schulze, *A Survey of Private Debt Funds* 2-3, 28-29 (noting that private debt funds operate without the short-term deposits emphasized in banking).

[160] Franz J. Hinzen, Giorgio Mondini, Paul Rintamäki & Sascha Steffen, *The Cyclicality of Direct Lending* 1-2 (March 29, 2026), https://papers.ssrn.com/abstract=6490423 ()

private-credit assets, even though they managed only about 42 percent of private-credit funds—a gap that reflects how heavily assets have pooled in the largest sponsor-affiliated platforms.[161]

In sum, private credit grew because it solved problems for several groups at once. Banks faced tighter lending constraints and different incentives. Private-equity sponsors needed flexible debt for middle-market transactions. Borrowers wanted certainty and speed. Long-horizon investors wanted yield and were willing to accept illiquidity. These mutually reinforcing trends have made private-debt funds the fastest-growing segment of private capital markets.

This growth of private credit raises the question of how good risk-adjusted returns have been? Since the loans do not trade on exchanges, investors earn a yield premium over comparably risky public credit. This is called an illiquidity premium. Whether that premium reflects genuine excess return is less clear. The apparent outperformance of private debt funds over liquid corporate bonds shrinks substantially once leverage and credit-risk exposures are accounted for. This makes the true risk-adjusted return difficult to measure and easy to overstate.[162]

The features of private credit described so far are important from a legal point of view because private credit assets are uniquely hard for regulators to monitor and risk-regulate once they show up on an insurer's point of view. The opacity, illiquidity, and bespoke contracts make valuation, credit-risk measurement, and capital treatment more contestable than for public, investment-grade bonds. We will discuss these problems in greater detail.[163]

B. The Life Insurer as Permanent Capital

The same characteristics that make life insurers natural holders of illiquid credit also make them unusually attractive to private equity sponsors because they increasingly prefer stable fee-paying assets under management.

1. Why Insurer Liabilities Fit Private Credit

Private-credit assets are well suited for life insurers because of the term structure of life insurers' liabilities.[164] Individual term-life policies run at least ten to thirty years, and whole-life and annuity contracts run for the policyholder's remaining life. The insurer therefore holds liabilities that are long, sticky, and often lacking demand-deposit features that are the classical source of bank runs. Private credit assets match this long-duration structure well. Typical private credit loans have maturities of five to seven years, and infrastructure and real-asset deals run ten to fifteen years and longer. Historically, insurers used investment-grade public corporate bonds to fund expected payouts and matched bond maturities to their liability schedule. Private credit fills the same asset-liability role, with a longer effective holding period.

The apparent yield premium that private credit pays over comparable public credit is another reason. Life insurers can earn higher yields at similar risk by capturing an illiquidity premium since their liabilities are relatively predictable and can hold up even in downturns.

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[161] International Monetary Fund, *supra* note 145, 67.
[162] Isil Erel, Thomas Flanagan & Michael S. Weisbach, *Risk-Adjusting the Returns to Private Debt Funds* 2 (Working Paper Series, March 2024), https://www.nber.org/papers/w32278.
[163] *See supra* XX.
[164] *See infra* II.A.2 for detailed discussion.

Insurers have have increasingly been holding privately-placed corporate debt even without PE involvement. From 2015 to 2022, life insurers sold roughly 4.1 percent of their private bond holdings annually, compared with 8.7 percent of their public bond holdings.[165]

Traditional insurers used their liability stability mainly to hold safe, investment-grade bonds and match expected payouts. PE-controlled insurers, we show in the next Subpart, use the same stability to support private-credit strategies that are more opaque, less liquid, and more closely tied to the sponsor's own origination platform.

2. Why Insurers Fit the PE Business Model

Having explained why life insurers suit private credit, we now turn to the other side of the convergence. The same long-dated, purportedly run-resistant liabilities that make an insurer a natural home for illiquid credit also make it an attractive asset for a firm that collects fees on assets under management. An ordinary private-equity fund must raise capital, deploy it, harvest it, and return it within about a decade. An insurer's general account is a pool of permanent capital the manager can charge against indefinitely. The purchase of an insurer converts the policyholder's premiums into a stable, fee-generating asset base that never has to go back to outside limited partners.

PE's move into life insurance has been a significant trend globally. Alternative asset managers have acquired close to a trillion dollars of life and annuity liabilities. By 2024 their insurance platforms made up roughly 35 percent of new sales of fixed and fixed-indexed annuities in the United States, up from about 7 percent in 2011. McKinsey calls the arrangement a "virtuous flywheel."[166] The insurer supplies so-called permanent capital, the affiliated manager earns recurring fees on that capital, and the manager's origination platforms supply the assets the insurer holds, with each turn of the wheel feeding the next. Apollo, KKR, and Brookfield have each built or bought a captive insurer, and Blackstone has become one of the largest third-party managers of insurance assets. However, the same mechanisms that generate recurring fees for the manager can also reshape the acquired insurer's portfolio in ways that serve the parent's fee interests more than the policyholder's or public's.

The mechanism is therefore simple. The sponsor can profit as owner, asset manager, and originator, while the insurer remains the legal entity that holds the assets and bears the balance-sheet risk. Policyholder premiums become permanent AUM, and the affiliated manager can use the AUM to buy or finance assets generated elsewhere in the sponsor's private-credit platform.

C. Extraction and Socialized Tail Risk

We descrive how a PE-owned sponsor may extract value through three linked steps, operating through different parts of the insurance balance sheet. First, they capture recurring fees by routing the insurer's asset management to an affiliated platform. Second, they reorient the asset side of the insurer's balance sheet toward private credit, reaching for yield which in turn funds more aggressive annuity sales. Third, they rely on the NAIC's ratings-based capital regime to hold those opaque assets without holding liability-side capital that tracks their economic risk. We then briefly discuss the ambiguous product-market consequences of these three steps.

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[165] Fournier, Meisenzahl & Polacek, *supra* note 141, at 1.

[166] Andrew Reich, Ramnath Balasubramanian, Henry Torbey, & Ying Zhao, *supra* note 7.

1. Fee Extraction Through Affiliation and Adversely Selected Asset Location

The first step is the move from outside management to affiliated management. Recent evidence on private equity acquisitions of life insurers suggests that the insurer significantly changes investment management and choice. Acquired insurers cut internal investment-staff salaries roughly in half and about one third drop their in-house investment teams altogether.[167] At the same time, total investment expense does not fall, because the salary savings are replaced by external asset-management fees, often paid to a manager affiliated with the private equity parent. The insurer's assets, in other words, remain on its own balance sheet but are managed by the parent's fee-earning platform.

Separate evidence for this trend leverages that insurers must list every asset manager they use in the General Interrogatories section of their statutory annual statements. The data is unstructured and needs heavy cleaning, but it can be cross-referenced against Schedule Y Part 1A and a 2016 disclosure update to tell whether a given manager is affiliated with the insurer or its PE parent.[168] About a quarter of PE-acquired insurers report using such an affiliated manager. These managers are also almost always a subsidiary of the parent and the contraction of internal investment staff is concentrated among those insurers. For instance, after Apollo acquired Athene in 2013, Athene disclosed an annual thirty-basis-point fee paid to an Apollo subsidiary for managing its assets. This type of arrangement is very common and is indeed one of the primary reasons insurers are increasingly owned by PE sponsors. Therefore, the PE sponsor occupies three roles at once: it owns the insurer, manages its assets, and often originates the very private credit those assets fund, so fee channels recur at each step.

In addition to collecting fees, the sponsor can utilize the insurer's balance sheet to benefit other parts of its business. We have already discussed how the sponsor uses annuity premiums to originate private credit loans that benefit other parts of the platform. Similarly, when the asset manager wants to achieve liquidity for one of its underperforming assets, validate its valuation marks for certain assets, or simply move certain loans out of a private credit fund, the insurer can become the convenient buyer. The insurer's balance sheet then takes on assets at prices and terms that may serve the platform more than the insurer's policyholders. This is enabled by the simple fact that policyholders are unlikely to be monitoring the sponsor's actions well. On the other hand, the investors in the sponsor's direct private credit funds are likely to be much more sophisticated. This creates an incentive to move negatively-selected assets onto the insurer balance sheet.

The recent Blue Owl fiasco illustrates the point well. Blue Owl, a large global alternative asset manager, had to sell assets of its private credit funds as it had promised certain amount of liquidity for its investors. It sold a $1.4 billion loan portfolio to four buyers: three were large North American pension funds and the fourth was Kuvare, the Chicago-based insurer whose assets Blue Owl managed. Blue Owl said it sold the loans at 99.7 percent of par even though these assets were trading at a significant discount to par on public exchanges.[169] This price helped justify Blue Owl's valuation marks and its liquidity plan, but the deal illustrated that the insurer can serve as a buyer-of-last-resort for underperforming assets generated elsewhere on a private credit platform.

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[167] Kyeonghee Kim, J. Tyler Leverty & Joan T. Schmit, *How Does Private Equity Impact Insurer Asset Management?* (April 2, 2026), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4981378.

[168] *Id.* at 8, 15-16.

[169] Laura Benitez, Paula Sambo and Olivia Fishlow, Blue Owl Sold Loans to Pensions, Own Insurance Asset Manager, BLOOMBERG, Feb. 19, 2026, https://www.bloomberg.com/news/articles/2026-02-20/blue-owl-sold-private-loans-to-pension-giants-and-own-insurer.

2. Increasing Share of Private Credit on Insurer Balance Sheets

The second step changes what the insurer holds. After acquisition by private equity, the insurer's portfolio tilt toward private credit. Privately-placed bond holdings rise by 6.4 percentage points and non-securitized private corporate debt by 1.8 percentage points relative to insurers never owned by a PE firm.[170] The share of private placement share of assets expanded by 7 percentage points more than non-PE-owned insurers between 2017 and 2024.[171]

These PE-owned life insurers are a significant driver of the industry-wide move into private credit. Although PE-owned life insurers accounted for only about 14 percent of life insurers' general account assets in 2024, they held more than 40 percent of financial and ABS private placements.[172] The private-placement share rose from 6 percent to 14 percent of general account assets between 2017 and 2024, with financial and ABS private placements accounting for roughly three quarters of that increase. After PE acquisition, the shift happens relatively quickly and is persistent. Much of the growth is in financial borrowers, asset managers, private direct-lending funds, privately placed ABS, CLOs, BDCs, and joint-venture loan funds which are structures that channel insurer premiums into loans originated, arranged, securitized, or managed by the alternative asset managers that own the insurer. In sum, the insurer's long-dated annuity liabilities become a stable funding base for the sponsor's private credit platform.

The economic payoff is the extra spread. As discussed earlier, private placements carry a premium over comparable public bonds. Privately placed debt is priced up to 40 basis points above comparable publicly traded corporate bonds and more recent issue-level evidence finds average spreads about 60 basis points higher for private placements generally, 78 basis points higher for financial private placements, and 156 basis points higher for privately placed ABS.

The insurer can use that additional yield to earn greater profits or compete more aggressively in the life-insurance product market. Approximately 61 percent of PE-owned insurers' annuity-market-share increase is associated with growth in financial and ABS private-placement investments.[173] The larger annuity book then supplies more investable premiums, which can again be deployed into private credit and affiliated structured vehicles. This dynamic is the flywheel: higher-yielding private credit supports more aggressive annuity pricing; more annuity sales produce more permanent capital; and the sponsor earns fees at multiple points—as originator, arranger, asset manager, and owner—while the illiquidity, valuation, and tail-credit risks remain inside an insurance balance sheet ultimately backing policyholder claims.

3. Ratings Arbitrage

The third step lets the insurer hold these privately placed assets without holding the requisite capital that tracks their economic risk. After a private-credit loan receives a rating that maps into a favorable NAIC designation, the statutory balance sheet can treat it as a relatively safe fixed-income asset. The rating mechanically dictates how much surplus the insurer must hold against it.

Formally, the NAIC defines a private-rating letter as a letter that an NAIC credit-rating provider issues to an issuer and that an insurer obtains as an investor in the issuance. A privately rated security is one for which the issuer has solicited a rating from an NAIC credit rating provider, but the rating goes only to the issuer and specified investors and never reaches the provider's public data feed or website. If such a security

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[170] Kim, Leverty & Schmit, *supra* note 171 at 3-4.
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[172] Ralf Meisenzahl, Jackson Overpeck & Andy Polacek, *Life Insurers' Private Credit Investments and Annuity Market Share Capture* (April 27, 2026) 2, https://papers.ssrn.com/abstract=5331817.
[173] *Id.* at 3.

has an eligible NAIC credit rating provider rating, the insurer verifies the rated status to the Securities Valuation Office. Once this occurs, the security can receive an NAIC designation based on that rating. The procedure assumes that private-letter securities usually carry a rating from only one provider. Therefore, a single private rating can become the gatekeeper between how an opaque asset is treated from a regulatory capital standpoint.

This design creates an incentive to shop for ratings. SEC staff describe private-basis ratings as increasingly common in the private-credit market and flag unpublished ratings as a place where weak transparency can sharpen conflict-of-interest risk.[174] The conflict is simple: a rating agency may know that the client plans to use the rating to set its own capital requirements, or those of its investors, and that the client would benefit from a higher rating. Rating shopping occurs when an issuer or user seeks the highest available rating from several agencies. These pressures run sharper for private ratings as the broader credit market cannot see the rating, test the rationale, or compare performance with the discipline available for public ratings.

Compare this race to the "Big Three" rating agencies. Public ratings by S&P, Moody's, and Fitch are hardly free of conflicts, as the issuer-pay model itself rewards landing the client (the issuer or borrower depending on circumstance). But public ratings at least leave a visible record and can be evaluated based on defaults. The rating is public and the market is able to observe whether the bond trades in line with its rating, and competitors, investors, journalists, academics, and regulators can compare rating behavior over time. A private letter rating lacks most of that discipline. It goes to a small audience, the underlying report is usually unavailable to the market, and the asset often does not trade at observable prices.

SEC staff has reported that insurers' use of private ratings has grown substantially and that approximtately 86 percent of private ratings on insurer investments come from small and medium NRSROs.[175] Moreover, their use is uniquely tied to PE. As of 2024, 23% of PE-linked insurer investments relied on private letter ratings compared to only 8% for other insurers.[176]

The asset mix of PE-owned insurers shows how even though the underlying asset mix of insurers has changed significantly, the ratings have barely changed. At year-end 2024, NAIC data identified 137 PE-owned U.S. insurers with $704.3 billion in cash and invested assets.[177] Their bond portfolios were far more concentrated in asset-backed and other structured securities than the industry as a whole. Yet more than 90% of PE-owned insurer bonds carried NAIC 1 or NAIC 2 designations, "implying high credit quality."[178] Without making wholesale judgements over the quality of the ratings, we want to highlight the their importance. A portfolio can grow more concentrated in complex and less transparent assets while still appearing, through the designation system, to consist almost entirely of high-quality bonds.

Recent evidence suggests that PE-owned insurers are also adept at rating arbitrage. The clearest evidence starts with the first wave of private-equity entry after the financial crisis. PE investments in life insurers

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[174] SEC Office of Credit Ratings, 2025 Staff Report on Nationally Recognized Statistical Rating Organizations 6 (Apr., 2026) ("The private credit market has experienced rapid growth and, with it, demand has significantly increased for credit ratings provided to ratings clients on a private basis. As discussed in Section IV.C., the lack of transparency with respect to these unpublished ratings has the potential to heighten the risk of them being affected by conflicts of interest."), https://www.sec.gov/files/2025-ocr-staff-report-compliant-4-24-26.pdf.

[175] Fitch Ratings, *US Insurers and Private Credit: Not All Private Ratings are the Same* (Dec. 2024), https://assets.ctfassets.net/03fbs7oah13w/3kYIW8MRhmfLZPOtmnB5dn/0005ebfc614eca3982959da63485a9b3/FR-NAIC-Whitepaper-December-2024.pdf.

[176] Matteo Aquilina et al., *The transformation of the life insurance industry: systemic risks and policy challenges*, 31-32 (2025).

[177] National Association of Insurance Comissioners, *Private Equity-Owned U.S. Insurer Investments Increased at Year-End 2024* (Aug. 2025), https://content.naic.org/sites/default/files/capital-markets-pe-owned-ye2024.pdf

[178] *Id.*

grew tenfold, from $23 billion in 2009 to $250 billion in 2014, after 57 acquisitions of life-insurance subsidiaries.[179] At the same time, PE-owned insurers' share of product rose from 3 percent to 20 percent of the market.[180] Kirti and Sarin present causal evidence that after acquisition, PE-owned insurers sold highly rated corporate bonds and bought poorly rated private-label asset-backed securities. This raised the private-label ABS holdings by about two-thirds of the industry average.[181] PE firms achieved these goals through regulatory artbitrartge. After year-end 2009, the NAIC decoupled capital charges for private-label ABS from credit ratings, so below-investment-grade ABS could qualify for NAIC-1 treatment if held at a steep enough discount.[182] In essence, this change allows PE-backed insurers to take on credit risk without holding more capital against it.

PE-backed insurers also extract value from the liability side of the balance sheet. The basic move is to transfer policyholder liabilities to affiliated entities that sit outside ordinary U.S. insurance supervision. This can reduce taxes, lower capital pressure, and make the true location of risk harder to see. Between 2011 and 2014, PE-backed insurers accounted for more than 90 percent of new shadow insurance for fixed annuities and nearly 60 percent of all new shadow insurance.[183] These shadow reinsurance contracts ran to affiliated entities that rating agencies did not rate and U.S. regulators did not authorize. One PE-backed insurer was domiciled in a jurisdiction with no income or capital gains taxes having secured tax exemptions through 2035.[184] This is essentially another form of arbitrarge: the sponsor uses the insurer's long-term liability base and affiliate network to increase returns while moving risk, tax exposure, and opacity away from the regulatory regime meant to protect policyholders.The sponsor uses the insurer's liability base and affiliate structure to raise returns while pushing risk and opacity away from the supervision that protects policyholders.

V. PRIVATE CONTROL, SOCIALIZED FAILURE: RESTRAINING PRIVATE EQUITY RECKLESSNESS IN LIFE INSURERS

We have established that (1) insurance law pairs insufficiently macro-level financial regulation with a guaranty-fund regime that socializes downside risk to competitor firms and taxpayers, and (2) PE firms have seized on life insurers as vehicles for private credit issuance in a manner that has significantly ratcheted up firm risk on regulators' watch. Insurance tax, insolvency, and financial regulation law has unacceptably subsidized this transformation.

This Part sketches a menu of reforms designed to realign insurance law's loss-allocation rules with their policyholder-protection function in the world of PE's new insurer business model. These reforms proceed in four steps. First, states should make private-credit and reinsurance risks more legible to regulators and the public before a failure occurs. Second, states should force insurers to internalize pre-failure risks by pricing them through guaranty-fund and solvency mechanisms. Third, when failure does occur, states should shift at least part of guaranty-fund-related losses upwards to corporate affiliates rather than outwards to competitors and taxpayers. Fourth, where state and NAIC coordination proves inadequate for nationally significant insurer groups, federal actors should supply minimum standards or revive existing systemic-risk authorities.

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[179] Divya Kirti & Natasha Sarin, *What Private Equity Does Differently: Evidence from Life Insurance*, 37 REV. FINAN. STUD. 201, at 202 (2024).
[180] *Id.* at 202.
[181] *Id*. at 206.
[182] Kirti & Sarin, *supra* note 183 at 203, 206.
[183] *Id.*, at 211.
[184] *Id*. at 211-12.

A. Make Insurance Risks Legible Before Failure

Two of PE's principal innovations are substantially expanded use of opaque private credit and reinsurers. As a basic matter of regulatory functionality, improved disclosure is necessary in order to make judgments about insurer health. To the extent that the cloudiness of PE's strategies makes it difficult for the NAIC to ensure credible reporting, the NAIC should impose procedural penalties on the opacity itself.

1. Reform Private-Credit Valuation Procedure to Penalize Opacity

The core problem with private-credit valuation is that, by definition, pricing data from liquid markets is not available to regulators or ratings agencies. This opacity enables greater discretion from ratings agencies, which PE-controlled insurers can deploy to generate favorable ratings treatment from agencies like Egan Jones. Such opacity cannot be "solved," only managed. We propose to reform the NAIC's valuation of private-credit assets by imposing system-wide procedural penalties on opaque and complex insurer balance sheets.

The NAIC has begun helpful efforts to apply additional scrutiny towards implausible private valuations, but some of its efforts are more oriented towards extremely effort-intensive asset-by-asset review. For example, the NAIC has developed a discretionary review process for its Securities Valuation Office (SVO) to "flag and pause" a rating where the NAIC's risk designation was originally made only using a private ratings agency's judgment, to use "only in very limited circumstances."[185] The NAIC has also imposed a "principles-based bond definition" requiring that debt instruments meet certain substantive criteria to be listed on the regulatory 'bonds and stocks' Schedule D form rather than the tougher 'other invested assets' Schedule BA. This reform impacts asset-backed-security subforms of private credit where the source of repayment employs underlying equity interests.[186] Schedule D and BA assets, including private credit and complex asset holdings, are accordingly now subject to more granular reporting requirements for individual holdings,[187] and securities rated by confidential private reports must now include accompanying "rationale

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[185] NAIC, *How Insurance Regulators Ensure Insurers Have Enough Money to Pay Claims: Leveraging Credit Ratings for Regulatory Use*, (Mar., 2026), https://content.naic.org/sites/default/files/svo-discretion-issue-brief.pdf [hereinafter SVO Review]. Previously, a rating from a Nationally Recognized Statistical Rating organization (NRSRO) was sufficient for direct mapping from a credit rating to an equivalent NAIC designation, a process called "filing exemption." (The NAIC designation converts the ratings made by different ratings agencies into a single 1-6 number to be used for RBC calculation purposes.) A NAIC working group has also proposed a Credit Rating Provider Due Diligence Framework for overseeing NAIC employment of ratings agency judgments in generating NAIC designations. *See generally* NAIC, *NAIC Credit Rating Provider (CRP) Due Diligence Framework - Whitepaper*, (2026), https://content.naic.org/sites/default/files/inline-files/NAIC%20-%20CRP%20Due%20DIligence%20Framework%20_%28For%205_4_2026Meeting%29_v4.pdf.

[186] Under the principles-based bond definition, a security will only qualify as a Schedule D "bond" if it represents a "creditor relationship" on the "substance, rather than the legal form of the document, as well as consideration of other investments owned in the investee and other contractual arrangements." Implementation documents note that securities that carry "equity-like characteristics," represent an "ownership interest in the issuer in substance," derive cash flow repayments from "an operating entity" rather than "the underlying defined collateral," or require cash flow generation from "the sale or refinancing of…non-financial assets" will not qualify. NAIC, PRINCIPLES-BASED BOND DEFINITION 4 (2024). Schedule D assets are "generally not subject to investment limitations" and have "the benefit of lower risk-based capital (RBC) charges based on NAIC designation." *Id.* at 43. The principles-based bond definition became effective on Jan 1, 2025.

[187] A major law firm highlights the new granularity for Schedule D and and Schedule BA in terms of "underlying collateral type, credit enhancement structures, affiliated party involvement and valuation methodology," and the new granularity for private credit in terms of "the identity and affiliation of the investment manager, the nature of any side letter or fee arrangement and the liquidity profile of individual holdings." The firm also emphasizes the increased importance of "look-through" reporting to underlying assets of pooled investment vehicles "rather than simply reporting the fund-level investment as a single line item." Marilyn A. Lion, Nicholas F. Potter, Megan K. Arrogante, & Matthew B. Parelman,

reports" to avoid SVO scrutiny.[188] In a more direct, systemic valuation challenge, the NAIC has also increased the RBC charge of lower tranches of collateralized loan obligations (CLOs) from 30% to 45%.[189]

The NAIC's address of private valuations and imposition of greater disclosure are welcome advances, but in the face of an entire PE business model devoted to embracing opacity, valuation procedure should respond in kind. Opacity and complexity in product structure should be treated as independent risk factors in their own right. Consider Michael Love's proposal for a Pigouvian "complexity fee" in tax,[190] where the IRS would impose a fee on highly-complex firms that scales with the cost of conducting an audit on them (which, he points out, operates similarly to fees levied on nuclear energy plants, securities, issuers, banks, and airline passengers).[191]

We offer several suggestions to operationalize the logic of the systemic Pigouvian tax in this context. The goal is to ensure that opacity itself no longer produces implicit regulatory subsidy through excessively favorable valuation.

First, insurers should pay a regulatory surcharge for overall balance sheet opacity. Currently, the NAIC, including its Securities Valuation Office, is funded in part through fees on insurers that are based on insurer premium volume.[192] Insurers should pay a surcharge, earmarked for the SVO's budget, if their balance sheet is more opaque/complex. This metric can be operationalized by factors such as the percentage of the insurer's balance sheet that is (on the asset side) reported on Schedule BA; lacking secondary-market pricing; reported using private, confidential letter ratings; intermediated through entities like Special-Purpose Vehicles (SPVs), CLOs, ABS, and feeder vehicles (with fee scaling for each additional layer of intermediaries); originated, managed, or valued by affiliates; or is missing data needed to make a determination about whether the asset falls into any of the above categories. On the liability side, complexity/opacity can be proxied using the percentage of liabilities that are ceded to reinsurers (with fee scaling for affiliated and offshore reinsurers).[193]

Second, if an insurer's balance sheet hits certain thresholds of being opaque/complex, a random sample of its private assets should be subject to an independent SVO valuation.

Third, private credit-rating providers who are systematically lenient should have their ratings penalized. The NAIC's current SVO discretionary review process only triggers a potential over-ride of a private rating provider's valuation when the rating provider's calculation is "at least three notches" more generous than SVO's, a tremendous gap. If that threshold is met, a regulator group is convened and the rating provider, insurer, and SVO petition their case, and the group votes on whether to use the private rating or the SVO rating.[194] Such a process imposes tremendous process costs for each individual security's review. Escalating penalties should be imposed if the regulator group repeatedly finds that a ratings provider's

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Private Credit Investments by Insurance Companies—an Overview of the Regulatory Landscape, DEBEVOISE & PLIMPTON (May 19, 2026), https://www.debevoise.com/insights/publications/2026/05/private-credit-investments-by-insurance-companies (last visited May 30, 2026).

188 NAIC, PURPOSES AND PROCEDURES MANUAL OF THE NAIC INVESTMENT ANALYSIS OFFICE AS OF DECEMBER 2025, 121 (2025).

189 NAIC, *Capital Adequacy (E) Task Force RBC Proposal Form: Agenda Item # 2023-09-IRE*, (Apr. 20, 2023), https://content.naic.org/sites/default/files/inline-files/2023-09-IRE%20webpost_0.pdf.

190 Michael Love, *Taxing Complexity* (SSRN, SSRN Scholarly Paper No. 6257838, 2026), https://papers.ssrn.com/abstract=6257838.

191 *Id.* at n. 9-10.

192 NAIC, *2026 NAIC Budget*, (Dec. 11, 2025), https://content.naic.org/sites/default/files/about-budget-approved-2026-budget.pdf, at 18.

193 Additionally, regulators may seek to penalize use of short-duration, market-sensitive liabilities like Funding Agreement-Backed Notes. *See generally* Nathan Foley-Fisher et al., *Funding Agreement-Backed Securities in the Enhanced Financial Accounts*, FEDS NOTES (2016).

194 SVO Review, *supra* n. 105.

analysis is off the mark, such as a lower threshold for process advancement (two notches, one notch). If a credit ratings agency is repeatedly over-ridden, it should lose the ability to challenge SVO's decision and eventually be banned.

2. Condition Shadow Reinsurance's Accounting Benefits on Look-Through Disclosure

After PE takes control of an insurer, it massively expands use of "shadow" (captive, non-rated, often offshore) reinsurers in tax-preferred jurisdictions where balance sheets are opaque and do not require standard insurance accounting.[195] When a life insurer employs reinsurance, it receives a "reserve credit" that permits it to reduce the reserves it must report on its statutory balance sheet on the theory that another insurer is bearing the risk of those liabilities and supporting them with its own assets. U.S. regulators do not have sufficient visibility into the investment activities of shadow reinsurers or whether the liabilities ceded to them are supported by meaningful assets.[196] A shadow reinsurance transaction may be well-capitalized and responsible, or may be wildly reckless.[197] Existing insurance regulation has unfortunately increased shadow insurance complexity by imposing new valuation frameworks on captive reinsurers.[198] Recent NAIC guidelines on captives have focused on requiring further asset adequacy testing.[199]

Our proposal sharpens existing regulatory efforts: the NAIC should condition reserve credit for shadow reinsurance on quarterly look-through disclosure of the assets supporting the ceded liabilities. If the assuming reinsurer does not prepare U.S. statutory accounting principles (SAP)-compliant financial statements, the ceding insurer should provide SAP-equivalent schedules held to the same standards as its own balance sheet. If the ceding insurer does not provide the disclosures, the insurer's reserve credit with respect to such ceded liabilities should be disallowed, and the cedent should be required to report reserves on its own balance sheet as if the reinsurance arrangement did not qualify for any statutory credit.

B. Force Risk-Internalization Before Failure

As discussed above, PE has shifted the business model of life insurers to make them a fulcrum of a broader asset-management firm.[200] This transformation carries two inherent risks: adverse selection by the PE firm in the assets that are forced onto the insurance subsidiary's balance sheet and extraction of insurer value via excessive fees that could have supported policyholders instead.[201] To force insurers to internalize the risks that they are imposing on competitors and the public, we advocate that affiliated transactions be subjected to elevated systemic (as opposed to transaction-by-transaction) review, that excessive affiliated-firm fees be treated as quasi-dividends for solvency regulation purposes, and that insurance guaranty funds finally shift to a ex-ante assessment system funded by risk-calibrated premiums.

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[195] *See* Divya Kirti & Natasha Sarin, *What Private Equity Does Differently: Evidence from Life Insurance*, 37 RE. FIN. STUD. 201 (2024), at 221-222; *see generally* Ralph S. J. Koijen & Motohiro Yogo, *Shadow Insurance*, 84 ECONOMETRICA 1265 (2016).

[196] Offshore captive affiliates are a subject of particular interest to Tom Gober, a former Mississippi Insurance Department examiner turned investigative forensic accountant. Tom Gober, *The Great Insurance "Sleight of Hand": How Policy Reserves Vanish into a Black Hole*, (Feb. 16, 2026), https://deepdiveanalytics.biz/blog/the-great-insurance-sleight-of-hand (last visited May 31, 2026).

[197] Daniel Schwarcz, *The Risks of Shadow Insurance*, 50 GA. L. REV. 163, 206 (2015).

[198] *Id.* at 209-211 (describing the 2014 "XXX/AXXX Reinsurance Framework").

[199] NAIC, ACTUARIAL GUIDELINE 55: APPLICATION OF THE VALUATION MANUAL FOR TESTING THE ADEQUACY OF RESERVES RELATED TO CERTAIN LIFE REINSURANCE TREATIES (2025).

[200] *See supra* Subpart IV.A.1.

[201] *See supra* Subpart III.C.

1. Subject Affiliated Transactions and Sponsor Exposure to Elevated Systemic Review

Similarly to the situation in private-credit valuation, the NAIC has made several welcome moves towards increased scrutiny of affiliated transactions. However, existing law remains poorly matched to the private-equity insurance model because it is organized around transaction-by-transaction review. This structure centers the question of whether a particular transaction between an insurer and an affiliate is reasonable and adequately disclosed. PE-owned life insurers present a different problem: that the subsidiary insurer may become a permanent forced customer of the sponsor's private-credit origination pipeline and asset-management business. In that setting, even a series of individually defensible transactions may cumulatively transform the insurer into a holding pen for sponsor-controlled risk. Therefore, only systemic review can adequately guard against a sponsor's adverse selection in asset location.

The NAIC's relevant Model Law, which imposes discretionary standards for individual affiliated transactions, is the Model Insurance Holding Company System Regulatory Act.[202] Under the Model Law, "transactions within an insurance company system" must have "reasonable" "terms" and "charges or fees for services performed."[203] If the insurer's domiciliary state commissioner deems an insurer to be in "hazardous financial condition," then the commissioner has discretion to require a "deposit" or "bond" against an affiliated transaction.[204] Finally, if an insurer enters into an affiliate transaction that exceeds 3% of the insurer's "admitted assets," the insurer must provide notice to its domiciliary commissioner 30 days in advance and the commissioner must not affirmatively issue a disapproval.[205] The same applies to "management agreements, service contracts, tax allocation agreements, guarantees, and all cost-sharing arrangements."[206] All such provisions rely on regulators to make transaction-by-transaction determinations, which becomes impractical if insurers conduct waves of affiliated deals. These provisions do not require regulators to aggregate formally distinct exposures or impose automatic consequences when an insurer pursues a sequence of formally distinct transactions. Additionally, the definition of "affiliate" for purposes of insurance accounting logs if an insurer invests in a firm that is also under the formal or effective control of the PE sponsor,[207] but does not take into account assets originated, structured, arranged, managed, serviced, valued, or financed by the sponsor or its affiliates.

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[202] Insurance Holding Company System Regulatory Act § 5(A) (2021). As of 2023, most states had not yet adopted the newest version, but prior law is sufficiently similar that we will use the 2021 Model Law as a benchmark. Jennifer Neuerberg, *Insurance Holding Company System Regulatory Act*, https://content.naic.org/sites/default/files/model-law-state-page-440.pdf. As an example of a state statute that is not fully aligned with the Model Act, consider IOWA CODE §§ 521A.1-13 (1970/2018).

[203] Insurance Holding Company System Regulatory Act § 5(A)(1)(a), (c) (2021).

[204] Insurance Holding Company System Regulatory Act § 5(A)(1)(g) (2021).

[205] Insurance Holding Company System Regulatory Act § 5(A)(2), (2)(a)(ii) (2021). As an anti-avoidance mechanism, the same standard applies to an insurer's extension of credit to a non-affiliate with the understanding that the proceeds of the loan will be used to make an affiliated transaction of the same magnitude. Insurance Holding Company System Regulatory Act § 5(A)(2)(b), (b)(ii) (2021). If an insurer attempts to split up a transaction into smaller transactions where each one lies below the reporting threshold, the commissioner may impose sanctions. Insurance Holding Company System Regulatory Act § 5(A)(3) (2021). Note that though the wording of the Model Act may slip into the plural, the reporting requirement does not apply to affiliated transactions cumulatively. Related provisions in § 5(A)(2)(f) and § 5(B) contain explicitly cumulative language. It is perfectly legal for an insurer to conduct separate affiliated deals where each non-step-transaction arrangement consists of 2.9% of the insurer's admitted assets without triggering the reporting requirement. The Model Act contains various other related provisions; we have presented what we consider to be the most important.

[206] Insurance Holding Company System Regulatory Act § 5(A)(1)(d) (2021).

[207] NAIC, ACCOUNTING FOR AND DISCLOSURES ABOUT TRANSACTIONS WITH AFFILIATES AND OTHER RELATED PARTIES 2 (1998). The full definition is "an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An

Our reform proposals for affiliated transactions focus on principles that steer away from draining scarce state-regulator resources through fact-intensive individual adjudications and towards addressing cumulative, systemic exposure to a sponsor. Recall that the principal scenario we are trying to prevent is one in which a sponsor drains an insurer of resources in order to offload a larger bill onto taxpayers. The sponsor can accomplish this maneuver by imposing large fees or making an insurer buy a poorly-performing investment from an affiliate at an excessive price. Not every sponsor-linked asset is the result of an abusive transaction, but concentrated dependence on a sponsor cannot be addressed through transaction-by-transaction review. We offer three proposals in this vein.

First, if an insurer's total affiliated assets exceed certain aggregate thresholds, the insurer's RBC ratio should receive a cumulative exposure charge. It is not feasible for regulators to keep consistent watch over every affiliated transaction, so cumulative such deals should receive a risk-designation penalty. The charge should be calculated on a look-through basis to prevent avoidance through affiliated reinsurers or other intermediaries. A reserve-credit transaction with an affiliated reinsurer should count for this calculation to the extent that the assets supporting the ceded liabilities are sponsor-linked.

Second, regulators should measure insurers' operational dependence on affiliates. A PE-conrolled insurer may be heavily exposed to its sponsor even when it holds few formally affiliated assets on its balance sheet. For example, the insurer may rely on affiliates for critical business services like valuation modeling, investment management, reinsurance administration, data systems, or accounting. Insurers in holding companies should be required to report an operation-dependence schedule measuring the percentage of assets managed, originated, or valued by affiliates; the percentage of liabilities reinsured to captives; whether asset-level data and loan files are held by sponsor affiliates; and related metrics. The more an insurer cedes management responsibility to its affiliates, the more opportunity the parent organization has to exploit the insurer. A high operational-dependence score should trigger enhanced examination and, at higher thresholds, an additional RBC surcharge.

Third, new affiliated transactions should be presumptively frozen when an insurer approaches financial distress. As an insurer's financial condition deteriorates, it becomes progressively more tempting for the PE sponsor to load up an insurer with the "worst" assets held across its aggregate portfolio because of the higher chance the sponsor has of sticking taxpayers with the bill.[208] Existing law recognizes this dynamic, to some degree, by giving insurance commissioners discretion to require bonds for new affiliate deals when an insurer experiences a downturn.[209] We propose that when an insurer's RBC ratio falls below certain thresholds, all new affiliated transactions should be presumptively barred unless explicitly permitted by the domiciliary commissioner.[210]

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affiliate includes a parent or subsidiary and partnerships, joint ventures, and limited liability companies. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, indirectly or indirectly, own or control the reporting entity." The Model Act employs a similar definition: "an 'affiliate' or, or person 'affiliated' with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." Insurance Holding Company System Regulatory Act § 1(A) (2021).

[208] If the transfer occurs after the insurer ceases to be "solvent," an insurance receiver may pursue an unwinding of the transaction, but this tool does not reach transfers performed while the insurer is still technically solvent. Insurer Receivership Model Act § 602(B)(1) (2007). A transfer, reinsurance transaction, or incurred obligation by the insurer made within two years of a receivership filing may be voided if the insurer conducted the act "with actual intent to hinder, delay or defraud any person to which it was or became indebted on or after the date that the transfer was made or the obligation was incurred; or received less than a reasonably equivalent value in exchange for the transfer or obligation. Insurer Receivership Model Act § 605(A) (2007).

[209] See *supra* n. 114.

[210] Commissioners may choose to give insurers the opportunity to rebut the freeze through a structured safe harbor. For example, the insurer could be required to provide independent valuation, approval by an independent conflicts committee,

Existing review would remain in place for discrete affiliate transactions, but our reforms would shift the principal regulatory object to cumulative dependence by an insurer on its holding company (e.g. the PE sponsor).

2. Subject Affiliated-Firm Fees to Dividend-Like Solvency Review

To reiterate, PE-controlled insurers may be pushed to rely on a PE sponsor's affiliates for a whole host of business services, including valuation, asset management, and reinsurance. In doing so, the insurer must pay substantial fees to the PE sponsor directly or indirectly, and these fees provide additional opportunity for an unscrupulous controller to siphon away insurer assets. The NAIC acknowledges the danger that capital-draining transfers pose to solvency, but the same rules do not apply to fees for services. Excessive fees to affiliated firms are tantamount to disguised dividends to shareholders, so we recommend implementation of systematic anti-disguised dividend rules.

As discussed in Subpart V.B.1, the NAIC Model Law subjects affiliated-firm fees to the same default structure as general affiliated transactions: they must be "reasonable," as determined by the domiciliary state's insurance commissioner.[211] Large dividends to shareholders, by contrast, are subject to a heighted scrutiny. While the default rule is also that insurer surplus must be "reasonable" after a dividend to affiliates is paid,[212] an "extraordinary dividend" entails the type of cumulative analysis we endorse in the affiliated-transaction review context. An extraordinary dividend occurs when the sum of *all* dividends and distributions made to shareholders over the course of twelve months exceeds the lesser of (1) 10% of the insurer's surplus and (2) the "net gain from operations of the insurer."[213] Insurers may not pay extraordinary dividends unless they provide notice to their domiciliary commissioner 30 days in advance and the commissioner must not issue a disapproval.[214] While this system does entail discretionary review, it acknowledges that the cumulative nature of capital-draining corporate finance manuevers matters rather than going dividend-by-dividend.

We propose reforms in this area that mirror the logic of our proposals for affiliate transactions.

First, regulators should create an "extraordinary affiliate fee" review process analogous to that of extraordinary dividends. Insurers are required to maintain data on their affiliated-firm fees to facilitate reasonableness review.[215] Insurance commissioners should use that data to generate an appropriate Affiliate Compensation Ratio of fees (and all other compensation paid to affiliates) relative to the volume of insurer assets subject to affiliated-firm services, paid over a rolling twelve-month period, with applicable controls for the nature of the work performed. If an insurer exceeds a threshold on such a scale, it should have to go through "extraordinary affiliate fee" review where fees would have to be justified to the domiciliary insurance commissioner.

Second, affiliated-firm fee hikes should be presumptively frozen when an insurer approaches financial distress. Analogously to the reasoning in the affiliated transactions context, a PE sponsor's incentives to extract sharply more fees from an affiliated insurer increase as the insurer's financial health deteriorates. We propose above that new affiliated transactions be presumptively frozen as an insurer's RBC declines below a threshold, which also has the effect of presumptively freezing affiliate-firm fees from those deals.

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disclosure of all direct and indirect PE-sponsor compensation tied to the transaction, and evidence of unaffiliated market participation or other third-party pricing support where reasonably available.

[211] Insurance Holding Company System Regulatory Act § 5(A)(1)(c) (2021).

[212] Insurance Holding Company System Regulatory Act § 5(A)(1)(f) (2021).

[213] Insurance Holding Company System Regulatory Act § 5(B) (2021).

[214] *Id.*

[215] Insurance Holding Company System Regulatory Act § 5(A)(1(d), (e) (2021).

To guard against the possibility that a sponsor will attempt to loot an insurer through sharply increasing fees on already-existing asset transactions, the presumptive freeze should be extended to fee hikes as well.[216]

3. Capitalize Guaranty Funds Ex Ante and Implement Risk-Based Pricing for Guaranty-Fund Premiums

Finally, like banking's Deposit Insurance Fund, guaranty funds should be funded through quarterly assessments on all insurers that are calculated through risk contribution, not just premium volume. We have detailed above our synthesis of critiques of ex-post, non-risk-based guaranty-fund assessments,[217] and only note here that the urgency of guaranty-fund reform is far greater today with the rise of PE sponsors that are very comfortable managing insurers aggressively. Guaranty funds were spared from navigating the collapse of AIG in 2008 by TARP; we should not wait to find out if they will be even logistically able to process the insolvency of a large PE insurer.

C. Make Sponsors Bear Losses After Failure

Having proposed mechanisms to make concretely identify and price pre-failure insurer risk, we now turn to mechanisms that force sponsors to share in the financial losses that they have imposed onto others. We urge states to end tax credits for guaranty-fund assessments and to make insurance holding companies guarantors for at least part of the assessments caused by the insolvencies of their insurance subsidiaries.

1. End Tax Credits for Guaranty-Fund Assessments

States should eliminate premium-tax credits for guaranty-fund assessments. These credits convert an ostensibly industry-funded policyholder-protection regime into yet another public backstop. A tax-credit-based structure means that taxpayers are routinely on the hook for guaranty-fund costs, while the industry only bears the time value of delayed recovery.[218]

This structure is even worse than an explicit public guarantee because it is submerged in the tax system. The Deposit Insurance Fund is acknowledged as a state backstop, but its standard payout structure actually comes from the banking industry's (non-tax-creditable) assessments.[219] Guaranty-fund credits, by contrast, shift insolvency costs to the public through an obscure tax expenditure unlikely to receive the political scrutiny that would accompany a direct appropriation. Political scientists have found that, across surveys, many Americans do not understand that tax expenditures are the fiscal equivalent of government spending, a phenomenon known as the "submerged state."[220] So while the public at large does not monitor insurers, neither do their policyholders, and neither do their competitors, who lack the incentive to do so in tax-credit

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[216] If the fee hike occurs within two years of the insurer's receivership filing, fraudulent transfer law may be able to void the fee hike, but that will require proving "actual intent to hinder, delay or defraud" or that the insurer "received less than a reasonably equivalent value." Insurer Receivership Model Act § 605(A) (2007). This clawback mechanism is helpful, but is retrospectively, costly, and uncertain. The "extraordinary affiliate fee" responds to the same concern as fraudulent transfers, but creates a stronger pre-insolvency mechanism to guard against it.

[217] See *supra* Subpart III.C.

[218] See *supra* n. 79.

[219] See *supra* n. 47.

[220] *See generally* SUZANNE METTLER, THE SUBMERGED STATE: HOW INVISIBLE GOVERNMENT POLICIES UNDERMINE AMERICAN DEMOCRACY (2011).

states.[221] The system therefore also undermines the monitoring incentives that assessments are supposed to create.

2. Give Guaranty Funds a First-Priority Claim Against Controlling Insurance Holding Companies

The core incentive alignment problem that generates moral hazard, at root, is that limited liability curtails equityholders' downside risk. Banking's federal deposit insurance and insurance's guaranty funds amplify this problem by weakening the incentive of these firms' primary creditors (depositors and policyholders, respectively) to monitor the firm by socializing downside risk outwards. We have covered the financial solvency regulations that banking and insurance law employ to dissuade such firms from undertaking excessively risky activity, at least in theory. However, banking law has (again, in theory) one more arrow in its quiver: a targeted veil-piercing doctrine that purportedly ends limited liability for bank holding companies called the "source of strength" doctrine.

The actually-existing source-of-strength doctrine in banking is considered to be ineffectual at forcing the rest of a bank holding company to contribute resources to resolving a subsidiary failed bank.[222] Only once have regulators actually pressured a bank holding company into making a contribution to an ailing bank.[223] The source-of-strength doctrine was technically codified into statute in Dodd-Frank, but merely as a directive for regulators to implement the doctrine without explicitly stating that a bank holding company could be held liable for a capital shortfall at an affiliated bank.[224] A properly functioning, statutorily codified source-of-strength doctrine would shift a bank holding company's incentives to act towards bank preservation.

For this reason, we advocate for a statutory codification of a modified source-of-strength doctrine in the insurance context. The principle remains the same: if the public is expected to safeguard an institution, the holding company that ran the institution into insolvency should be expected to contribute instead of just washing its hands of the situation. One implementation mechanism would be to make insurance holding companies at least partial first-lien guarantors for assessments caused by affiliate-insurer insolvencies. Liability could attach jointly and severally to all affiliates under common control, as is the case for Employment Retirement Income Security Act (ERISA) liability for unfunded defined-benefit-pension obligations.[225] The higher the percentage of responsibility allocated to the holding company, the more the holding company's incentive becomes aligned with the downside residual claimant (in this case, generally taxpayers).

D. Pressure NAIC & State Action Through Federal Action and Reviving SIFI Authority

Throughout our previous recommendations, we have taken the role of the NAIC and state regulation as given. Because insurance remains deeply embedded in state law and NAIC coordination, we believe federal intervention is politically unlikely absent a highly salient insurer failure that triggers broader financial instability. However, we note that Congress has the power to implement most of the above suggestions at the federal level. A federal law could implement minimum standards that also leave states free to adopt

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[221] See *supra* n. 89.
[222] *See generally* Adam J. Levitin, *Samson's Toupeé: Banking Law's Source-of-Strength Doctrine*, 41 YALE J. REGUL. 1078 (2024).
[223] *Id.* at n. 9.
[224] *Id.* at 1113.
[225] *Id.* at n. 44. 29 U.S.C. §§ 1301(a)(14), (b)(1), 1362(a)-(b).

stronger rules. A more targeted federal pathway would be for the Financial Stability Oversight Council (FSOC) to revive its Systemically Important Financial Institution (SIFI) authority for nonbanks.[226] FSOC designation cannot overwrite state statutes like the design of state guaranty funds, but it could impose a federal prudential overlay on designated insurer groups or apply pressure to firms and state regulators to act through recently adopted guidelines for a "pre-designation 'off-ramp.'"[227]

CONCLUSION

Life insurance was a sleepy industry, where conventionally-managed firms administered low-risk portfolios of AAA-rated corporate bonds and collected a small spread. The industry benefited from a lack of federal interest in regulation and favorable treatment under NAIC-coordinated law. State guaranty funds for policyholders generated perverse incentives for excess risk, but they helped keep customers interested in life insurance and annuity products, and major insurer insolvencies were rare.

PE firms noticed life insurers' economics and regulatory treatment and saw opportunity. PE was growing beyond its pure buyout model into investment-management platforms eager to expand into investment areas where incumbents had not pushed regulatory limits. In life insurers, PE has found an ideal host body from which to issue illiquid, risky, and opaque private-credit investments. Substantial media commentary has focused on how long-duration life insurance contracts generate "permanent capital" for PE firms to deploy, but we emphasize another feature of life insurance: the guaranty-fund insolvency allocation system that permits PE firms to socialize the downside risk of their private-credit portfolios without a sufficient financial-regulation regime to stop them. Publicly-traded private-credit institutions like BDCs may experience sharp volatility, but when they go down, the losses are borne by their investors who accepted that they were taking on risk. When a private credit-loaded life insurer becomes insolvent, it is mostly taxpayers who must pay for it.

On top of their opaque private-credit strategy, PE sponsors of life insurers have strong opportunity and incentive to siphon money out of life insurers through adversely selected asset location and excessive fees. Guaranty funds destroy the incentives to policyholders to monitor insurers, and tax credits for guaranty-fund assessments destroy the incentives for insurers to monitor each other. even though surviving insurers are nominally the first line of defense to protect policyholders of a failed insurer. The NAIC and state regulators have so far refused to price guaranty-fund contributions, implicitly subsidizing PE's aggressive strategies even further. The astonishing growth of PE's insurer-centered asset-management business model may reflect success in servicing customers, but it has been aided at every turn by insurance tax, insolvency, and financial regulatory law's subsidies for that transformation.

We propose a raft of reforms to end these subsidies. The NAIC has shown an admirable willingness to take first steps, but bolder ideas are needed. Regulators should make private-credit and reinsurance risks more clear to themselves and the public by imposing procedural penalties on private-credit valuation opacity and "shadow" reinsurance. They should force insurers to internalize more risk pre-insolvency by creating systemic review of affiliated transactions, treating excessive affiliate-firm fees as quasi-dividends, and moving insurance guaranty fund premiums to an ex-ante, risk-calibrated system a la the Deposit Insurance Fund. They should force insurers to bear losses post-insolvency by ending tax credits for guaranty-fund premiums and making insurance holding companies liable for at least some of the guaranty-fund costs of affiliated insurer insolvencies. And if the NAIC and state regulators are unwilling to act, the

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[226] For a history of this authority, see Kress, *supra* note 43.

[227] *Financial Stability Oversight Council Issues Proposed Guidance on Nonbank Financial Company Designations*, U.S. DEPARTMENT OF THE TREASURY (Feb. 13, 2026), https://home.treasury.gov/news/press-releases/sb0422 (last visited May 31, 2026).

federal government should pressure them with nationwide minimum legislative standards or use of systemic-risk authority.