

# Insurance companies use rate shopping to boost returns from private credit

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One of the triggers of the global financial crisis of 2008 was the way in which bankers and others used inflated credit ratings supplied by some of the major agencies to boost the value of the assets they held, particularly those based on subprime mortgages, many of which were essentially worthless.

The value of shopping around for a higher credit rating, so-called regulatory arbitrage, is that it enables the asset holder to reduce the capital reserve held in case of a default, freeing up more money for profitable investment.

In a recent comment piece, *Financial Times* columnist Gillian Tett drew attention to the return of this practice in the relationship between insurance companies and the private credit market which has grown by leaps and bounds since the 2008 crisis.

Describing what took place leading into the 2008 crash she wrote that the “game of regulatory arbitrage turned bankers into financial chefs: they sliced up risky loans (like meat scraps), remixed them into new products (like fancy sausages), which got seals of approval from rating agencies (like food critics.) And it worked well until rotten meat entered the sausage mix and investors panicked in a financial food poisoning scare.”

Tett reassured her readers that the subprime mortgages bubble is now in the past.

But as always happens in the financial world because of its relentless drive for profit a practice which has been shut down in one area will often make its reappearance in another, albeit in a new form.

And as Tett duly noted “regulatory arbitrage has not disappeared but has emerged in the private credit and insurance world.”

“Until recently, insurance groups were (in)famous for mostly just investing in boring, safe assets. But recently

they have moved into private credit to boost returns,” she wrote.

Calculations by Moody’s, which Tett cited, showed US insurance groups now hold \$807 billion of illiquid and opaque assets, that is, 20 percent of their holdings of \$4 trillion at the end of 2025, up from 18 percent the year before.

According to Bloomberg, reporting on the Moody’s analysis: “The securities used for those calculations bore private-letter ratings, didn’t carry a form rating assigned by a third-party firm or couldn’t be valued with observable market prices.”

The Moody’s report, issued earlier this month, said the increase in private ratings was “driven by both structural and cyclical factors, including increased demand for higher risk-adjusted yields amid elevated but volatile interest rates, and the expanding availability of privately originated private credit.” In short, as market turmoil has increased so has the turn to private rating for riskier assets.

Last October, the Bank for International Settlements, the umbrella organisation for central banks providing information to them, warned that credit ratings for loans held by US insurers may have been systematically inflated and there was a growing risk of “fire sales” in conditions of financial turbulence, when market conditions would establish they were not the safe asset the private rating said they were.

The warning was made in the wake of the bankruptcy of two auto-connected companies, First Brands and Tricolor, which had complex and opaque connections with private credit and through them connections to banks that were obscure.

The BIS noted that insurers with links to private equity groups had been heavy users of private letter ratings—outside of those provided by the major

agencies, Fitch, S&P and Moody's—and that a quarter of these insurers' investments relied on such ratings in 2024. It did not escape attention that some of debt of Tricolor had received a triple-A rating before its collapse.

In her comment piece Tett pointed to what she called “startling” research recently carried out by three Columbia University economists—Xuelin Li, Sangmin Ok and Giacomo Riccardi.

They reported that the “rise of private markets has placed a growing volume of opaque debt securities onto the balance sheets of regulated financial institutions” and that the “risk assessment of these investments is increasingly outsourced through private ratings, which are disclosed only to the issuer and select investors rather than disseminated publicly.”

The analysis of the three researchers found that there had been a “10-fold increase in the use of private ratings since 2018, predominantly in “opaque securities” and concentrated in private equity-owned insurance firms.

They noted that measuring any deterioration in the value of the loans and investments made by insurance companies was “challenging because privately rated bonds are often illiquid and infrequently traded.”

The reason private rating agencies are used is to provide elevated ratings on loans which enables the insurance companies which have made them to cut the reserves they must hold to cover any potential defaults and losses. This frees up capital which can then be used to make further investments and increase returns. The Columbia analysis found that on what they called a “conservative” estimate, the additional amount of capital made available was \$4.5 billion a year.

The report noted that “life insurers rank among the largest holders of corporate bonds and structured credit, so their portfolios are large enough for private ratings to matter economically.”

It found that insurers use private ratings “strategically” to minimise the capital they just hold and to avoid downgrades of their debt.

The analysis of the use of private ratings to boost the value of risky assets might be dismissed as being of marginal significance in and of itself because the amount of undercapitalisation of \$4.5 billion a year is not a large amount in relation to the overall market. The same thing, it should be recalled, was said of the

subprime market before the crash.

And like the subprime situation, the increased use of private rating must be placed in its broader context—one of increasing instability in the global financial system.

This was pointed to by US president Trump in remarks to reporters at the G7 meetings in France last week. He said that he had pushed for an agreement with Iran because the alternative—a resumption of the military onslaught which he has threatened and may well carry out—would have crashed the market.

If military action had resumed the market “would go down to levels that nobody ever saw before, maybe except for 1929,” he said. The alternative to the deal would be “a world-wide depression” and the one president he did not want to be was Herbert Hoover.

Trump is given to daily bluster, bluff and a continuous stream of lies and falsification with his eye firmly fixed on Wall Street. But his words, on this occasion, should be taken seriously because they indicate the extreme fragility of the stock market boom and the financial system more broadly, based on speculation and the accumulation of vast quantities of debt and the existence of a number of potential triggers for a crisis.

Elevated ratings of highly dubious financial assets were one of the triggers for the 2008 crash and may well be so again.



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