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Insurance Investment Management

A New Era for Insurer Investments: Navigating NAIC's Regulatory Overhaul

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The National Association of Insurance Commissioners (NAIC) is currently executing a fundamental multi-year modernization of the investment regulatory framework. These changes, primarily driven by the Statutory Accounting Principles (E) Working Group and the Valuation of Securities (E) Task Force, emphasize a regulatory focus on treating securities based on underlying economic substance rather than legal form. The primary implications for insurers include potential Risk-Based Capital (RBC) volatility, reporting reclassifications for structured products, and new operational requirements for admitting realized losses into IMR.

Principles-Based Bond Definition Implementation

This long-awaited update to the presentation and treatment of insurer bond portfolios has technically been in effect since the start of 2025, but its first major road test has occurred with year-end 2025 reporting. The PBBD has split Schedule D into 2 sections, one covering Issuer Credit Obligations, and the other including Asset-Backed Securities. Bond sectors are now broken out with more granularity than before, and the process includes detailed flowcharts governing what characteristics assets need to qualify for Schedule D treatment. Asset that lack these qualifications (including equity-linked notes, residual tranches of structured bonds, and asset-backed notes lacking sufficient underlying cash flows to meet interest obligations) must now be reported on Schedule BA, typically with substantially higher capital charges.

This transition has gone smoothly for the most part. A review of Life industry holdings reflects just a 0.1% YoY increase in total Schedule BA exposure, suggesting no mass reclassification of newly-ineligible securities has occurred. However anecdotal evidence suggests that many insurers have been closely

engaged with their auditors this spring, clarifying details around the classifications of specific holdings, reviewing the flowcharts mentioned above, and ensuring adequate supporting documentation exists to justify reporting treatments. Overall this change should significantly improve the clarity and utility of Schedule D going forward, and incentivize genuinely innovative financial structures while discouraging regulatory arbitrage.

IMR and Proof of Reinvestment

The large rise in interest rates in 2022 caused many insurer bond portfolios to fall into a net unrealized loss position that persists to this day. The NAIC responded by allowing Life companies to admit a net negative Interest Maintenance Reserve (IMR) asset, incentivizing companies to realize losses and reinvest at higher rates when it made economic sense to do so. However, the NAIC is seeking to clarify the intent of this new practice by instituting a Proof of Reinvestment requirement, necessitating that insurers show that the proceeds of a realized loss sale were 1) reinvested, 2) into fixed income securities, 3) at a higher yield than the bonds sold, in order for the resulting IMR to qualify as an admitted asset. To implement this a template is being designed to compare average yields on bonds bought and sold within a given accounting period. This template focuses on an overall “big picture” view of investment activity, rather than assigning the proceeds of specific trades to specific reinvestment activity. While this new requirement is unlikely to be an issue for most Life companies given continued strong reinvestment rates, any who might be directing investment purchases into lower-yielding sectors may want to investigate the potential impact on the admissibility of their negative IMR before proceeding.

Model-Based CLO Ratings

The NAIC continues to move forward with its project to shift to CLO ratings (and RBC charges) determined by annual modeling rather than CRP ratings, analogous to how non-agency RMBS have been rated for many years. The expected implementation date of 12/31/26 looks attainable, with factors close to finalization and plans already in place to design necessary alterations to reporting templates. The key takeaway for insurers is that while AAA-rated CLOs will see little impact on RBC charges, lower-rated tranches (especially sub-IG) are likely to see significantly higher charges going forward, potentially reducing their capital efficiency as sources of supplemental yield.

Residential Mortgage Loan Treatment

In a win for many life insurers seeking yield in residential mortgage loans, the NAIC has clarified the treatment of these loans when held through Delaware Statutory Trusts (DSTs). Historically, there was ambiguity as to whether these should be treated as “other invested assets” (Schedule BA) due to the trust structure. The new guidance (effective at the start of 2026) allows them to be reported as Mortgage Loans on Schedule B, provided the DST is structured such that the insurer has a direct pro-rata interest in the underlying loans. This allows for a more favorable RBC treatment compared to the equity-heavy charges of Schedule BA, while still enjoying the reduced administrative burden of the DST structure.

Bond Fund Treatment

In recent years Bond ETF's have enjoyed eligibility for bond-like RBC treatment and inclusion on Schedule D Part 1, but other fund types (mutual funds, LP funds) have not. In keeping with the NAIC's overarching "substance over form" philosophy, they've instituted an "SVO Fund Alignment Project" with a 12/31/26 target implementation date, and a goal of creating guidelines for funds to qualify for Weighted Average Rating Factor (WARF) treatment (essentially a look-through to the average ratings on underlying holdings), and then applying that approach to determine RBC charges regardless of fund type. This would ensure similar holdings get similar treatment regardless of the vehicle they're held in, and end the penalties currently applied to non-ETF fund structures.

Conclusion

The NAIC is moving rapidly across multiple workstreams, with particular focus on improving transparency around private and illiquid securities, and aligning capital charges based on economic substance rather than legal forms or fund structures. With the shift to PBBD now successfully achieved, expect these other projects to benefit from the increased transparency (e.g. into CLO and private placement holdings) and granularity of Schedule D. As always we will continue to monitor regulatory developments as they arise and provide regular updates and supporting analysis for affected clients.

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