Discussion of Gschossman, Li, Uppal, and Wenning (2026)

"Giving Life to Private (Rated) Credit"

Discussant: Sangmin Simon Oh (Columbia Business School)

Chicago Fed Inaugural Annual Conference on Insurance 2026

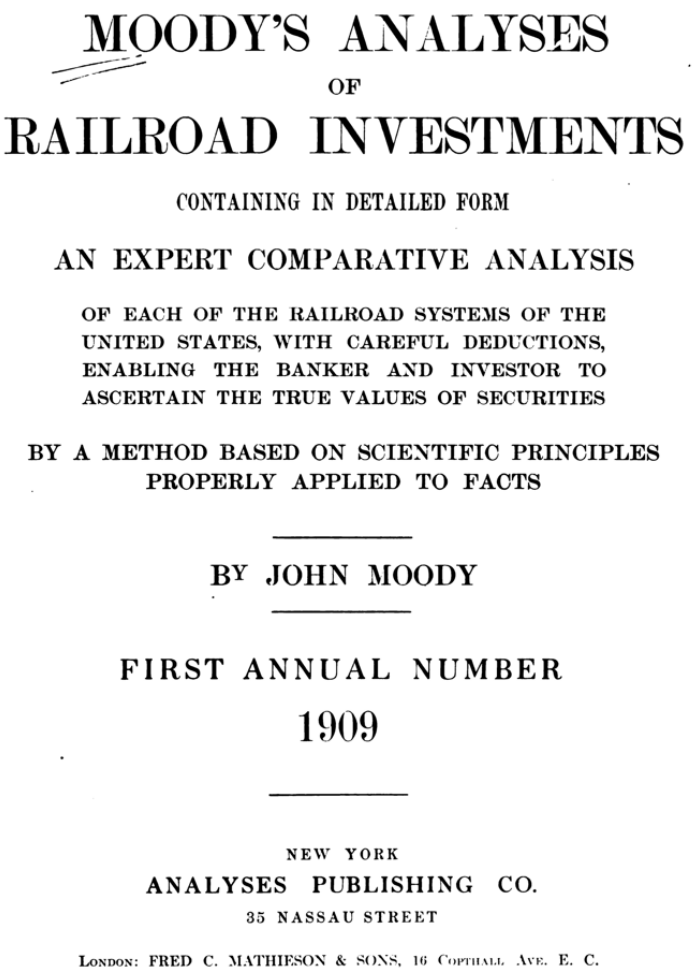
Background #1: Credit Ratings

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MOODY'S ANALYSES
OF
RAILROAD INVESTMENTS

CONTAINING IN DETAILED FORM

AN EXPERT COMPARATIVE ANALYSIS

OF EACH OF THE RAILROAD SYSTEMS OF THE UNITED STATES, WITH CAREFUL DEDUCTIONS, ENABLING THE BANKER AND INVESTOR TO ASCERTAIN THE TRUE VALUES OF SECURITIES

BY A METHOD BASED ON SCIENTIFIC PRINCIPLES PROPERLY APPLIED TO FACTS

BY JOHN MOODY

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Role 2. Regulatory: Ratings set capital and eligibility

Partnoy (1999); Kisgen and Strahan (2010); Becker and Ivashina (2015)

- Since 1936, rules for banks, broker-dealers, money funds, and insurers have used ratings
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- **After the GFC, the US takes ratings out (2010–2015)**
  - Dodd-Frank §939A (2010): each federal agency must "remove any reference to or requirement of reliance on credit ratings"
  - OCC (2012): "investment grade" = "adequate capacity to meet financial commitments"
  - SEC (2015): ratings removed from money market fund Rule 2a-7

Background #2: Regulatory Arbitrage

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1. **Hold the riskiest asset that carries the same charge**
   Becker and Ivashina (2015)

2. **Report lower risk when you can measure it yourself**
   Behn, Haselmann, and Vig (2022)

3. **Move the risk outside the regulated balance sheet**
   Acharya, Schnabl, and Suarez (2013); Koijen and Yogo (2016)

4. **Use accounting values to preserve reported capital**
   Huizinga and Laeven (2012); Koijen and Yogo (2015)

5. **Move to a more lenient regulator or jurisdiction**
   Agarwal, Lucca, Seru, and Trebbi (2014)

6. **Obtain a better regulatory label for the same asset**
   Bongaerts, Cremers, and Goetzmann (2012); Opp, Opp, and Harris (2013)

7. **Build the asset to earn a better label**
   Coval, Jurek, and Stafford (2009); Griffin and Nickerson (2023)

... and probably more!

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1. **Demand for private credit ⟹ Demand for private ratings**
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   True if the deal is designed around the rating
   - Insurer sources deal from an affiliated originator, which orders the rating
   - Bespoke structures get rated by an agency that builds criteria for them
   - Structure exists to earn the label (rated note feeders)

Recap

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2. Insurers hit harder by the reform subsequently buy more privately rated bonds.
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Plan for Discussion

1. What would it mean to "inadvertently" fuel private credit
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1. What would it mean to “inadvertently” fuel private credit?

A Simple Framework (1/2)

Insurer j maximizes mean-variance return subject to a risk-based capital constraint

$$\max_x \sum_n \alpha_n x_n - \frac{\gamma}{2} \sum_n \sigma_n^2 x_n^2 \quad \text{s.t.} \sum_n \ell_n x_n \leq K_j$$

- x_n: dollars in bond n (j omitted); α_n, σ_n^2: return net of funding cost, and variance
- $\ell_n = f(r_n - \delta_n)$: capital charge, set by the bond's **rating label**; f: NAIC schedule
- r_n: true risk in notches; δ_n: notches of generosity (0 if public, ≥ 0 if PL)
  - $s_n = f(r_n) - f(r_n - \delta_n)$: capital saved by the PL label
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Takeaway: Need variation in μ_j to distinguish label vs. asset motive! (Table 7 of Paper)

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Separate Point: For some assets, the only rating available is a private one.

- In this case, it's difficult to distinguish the rating (δ_n) from the asset (α_n)

Implications for “Inadvertently”

Reminder: insurer demand

$$x_{jn} = \frac{\alpha_{jn} - \mu_j f(r_n - \delta_n)}{\gamma \sigma_n^2}$$

What the reform did

- Exposure $\Delta\overline{f}_j$ raised required capital on the old portfolio ⇒ shadow cost rose: $\Delta\mu_j > 0$
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DID Estimate:

- The regression coefficient can be expressed as:

$$\beta = \underbrace{\bar{s} \cdot \frac{\mathrm{Cov}(\Delta\bar{f}_j, \Delta\mu_j)}{\mathrm{Var}(\Delta\bar{f}_j)}}_{\text{label channel}} + \underbrace{\frac{\mathrm{Cov}(\Delta\bar{f}_j, \Delta\alpha_{jn})}{\mathrm{Var}(\Delta\bar{f}_j)}}_{\text{asset channel}}$$

- Asset channel: exposed insurers would have bought more private credit anyway

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Suggestion #1a. Show directly that exposure is unrelated to changes in α_{jn}

- α_{jn} proxies × Post: pre-reform private credit share, affiliated originator, annuity share
- In addition to pre-trends (Figure 5), direct evidence will pin down "inadvertently"

2. What would it mean to inadvertently “fuel” private credit?

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Clearing the market for issuer i's bond:

$$X_i + D_i = B_i$$

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- Other investors: $D_i = d_i y_i$; issuer: $B_i = \bar{B} + B' y_i$ with $B' < 0$

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Equilibrium Yield: Capital charge works like a tax on insurers' holdings

$$y_i = y_i^0 + \pi_i \bar{\mu}_i f_i, \qquad \pi_i = \frac{b_i}{b_i + d_i - B'}$$

- y_i^0: yield with no capital charge ($f_i = 0$)
- π_i measures the passthrough of insurer's capital cost into issuer's yield
  - Numerator: only insurers pay the charge
  - Denominator: everyone in the market absorbs the yield change

A Simple Framework (Continued, 2/2)

Issuer i can borrow through two routes (cost of borrowing per dollar per year)

$$\text{Public:} \quad C_i^{\text{Pub}} = y_i^0 + \pi_i \bar{\mu}_i f(r_i)$$

$$\text{PL:} \quad C_i^{\text{PL}} = y_i^0 + \pi_i \bar{\mu}_i f(r_i - \delta_i) + c_i$$

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Channel (composition of credit): choose PL if

$$C_i^{\text{Pub}} - C_i^{\text{PL}} = \pi_i \bar{\mu}_i (f(r_i) - f(r_i - \delta_i)) - c_i > 0,$$

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Quantity of credit:

$$B_i = B(\min\{C_i^{\text{Pub}}, C_i^{\text{PL}}\})$$

Takeaway: Composition shift needs $\pi_i \bar{\mu}_i s_i > c_i$; quantity increase needs $B' \pi_i < 0$

Implications: “Fuel” (1/2)

Would be useful to distinguish the following three scenarios:

B_i: Outstanding private credit; C_i: Cost of new borrowing

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#3: Expansion through lower borrowing costs: $\Delta B_i > 0, \Delta C_i < 0$ $(\pi_i > 0)$

- Lower financing costs induce additional borrowing (Coppola 2025; Kubitza 2026; Li 2026)

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- Insurers buy existing bonds from other investors, or issuers swap other debt for PL bonds. Yields may still change.

#2: Expansion with little pass-through: $\Delta B_i > 0, \Delta C_i \approx 0$ ($\pi_i \approx 0$)

- Elastic issuers expand debt at similar financing costs.

#3: Expansion through lower borrowing costs: $\Delta B_i > 0, \Delta C_i < 0$ ($\pi_i > 0$)

- Lower financing costs induce additional borrowing (Coppola 2025; Kubitza 2026; Li 2026)

Why This Matters:

- #1 vs. #2 & #3: Did the reform grow private credit or only move it?

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- #1 vs. #2 vs. #3: What is the cost of closing the loophole?
  - #1: firms lose nothing, because holdings just move back to other investors.
  - #2: firms lose credit; #3: firms lose credit and also pay more

Implications: “Fuel” (2/2)

Table 8: Insurer demand Δx_{ji} relative across insurers

$$\text{SharePL}_{jt} = \beta\, \Delta\overline{f}_j \times \text{Post}_t + \boldsymbol{\gamma}'\mathbf{X}_{jt} + \alpha_j + \delta_t + \varepsilon_{jt},$$

Figure 11: $\sum_j \Delta x_{ji}$ minus what zero-exposure insurers did (i.e. the FE terms)

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Suggestion #2a. Measure ΔB_i

- Net borrowing in dollars by issuer exposure, across all debt (which extends Table 9)

Suggestion #2b. Measure ΔC_i

- Offering spreads on new issues by issuer exposure

Hopefully, both are feasible with the issuance data behind Table 9 (Refinitiv, Mergent FISD), which record offering amounts, maturities, and yields

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  - Further work on separating the label from the asset
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- **Very much looking forward to the next version!**