The NAIC Capital Markets Bureau monitors global capital market developments and analyzes their potential impact on the investment portfolios of U.S. insurance companies. Previously published NAIC Capital Markets Special Reports and Primers are available via the Capital Markets Bureau web page and the NAIC archives (for reports published prior to 2016).

Funding Agreement-Backed Notes

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Executive Summary

- Funding agreement-backed notes (FABNs) are securities backed by funding agreements issued by life insurers.
- U.S. insurers use FABN programs as an extension of their spread business as well as to diversify funding sources.
- FABN programs provide insurers with stable revenue due mainly to their more predictable liabilities than traditional life insurance products that contain mortality and policyholder behavior risk.
- Robust asset-liability management by the insurer is essential to how the funding agreement-backed structures perform.
- According to Federal Reserve data, overall issuance of FABNs has increased significantly over time.
- Growth in the FABN market has contributed to an evolving product landscape beyond traditional structures, with some transactions incorporating a broader range of securities backed by funding agreements.
- State insurance regulators have proposed disclosure requirements to improve transparency around insurers' funding agreements and FABN programs.

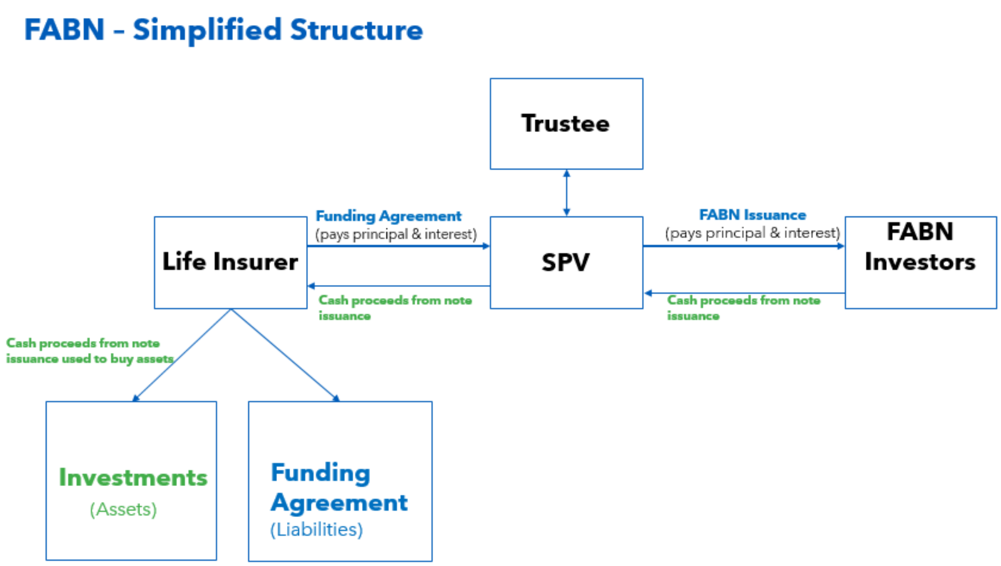
Over the last few years, U.S. life insurance companies have increasingly issued funding agreement-backed notes (FABNs) for spread-based income and funding source diversification. FABNs have been a focal point of the NAIC's Macroprudential (E) Working Group (under the Financial Stability (E) Task Force) to better understand risks, mitigants, and data availability relative to U.S. insurers' exposure. The Working Group's discussion topics are included in the July 2025 publication of its FABN analysis.

How Do FABNs Work?

Funding agreements are deposit-type contracts that are the source of principal and interest payments on the FABNs. In a typical structure, insurers issue funding agreements to a special purpose vehicle (SPV), which is a separate, legal, bankruptcy-remote entity established by the insurer as a financing conduit. The funding agreement is the SPV's only asset. The SPV then issues FABNs to investors, the majority of which are fixed-rate.[1] A few of the most common institutional investors in FABNs are money market funds, pension funds, and asset managers. FABNs are attractive to investors as they are backed by an insurance product (the funding agreement) that ranks pari passu with other insurance products in the event of an insurer insolvency. Additionally, FABN ratings are generally the same as the issuing insurance company's financial strength rating or the equivalent rating of the insurer's debt.

Insurers aim to invest proceeds from the FABN issuance in assets that generate yields in excess of the interest paid on the FABN, thereby producing positive spread income. However, the insurer is required to pay principal and interest under the terms of the funding agreement regardless of how the invested assets perform. According to Fitch Ratings, the invested assets usually consist of corporate bonds, mortgages, and private credit.[2] The spread-generating assets are recorded as such on the balance sheet of the insurer's legal operating entity, and the funding agreement is reported as a liability. Robust asset-liability management by the insurer is essential to how these structures perform. Chart 1 illustrates a basic FABN structure.

Chart 1:



[1] Fitch Ratings, *U.S. Life Insurers' Increasing Reliance on Funding Agreement-Backed Notes Creates Risk*, October 2025.
[2] Fitch Ratings, *North American Funding Agreement-Backed Note Market – YE 2025 Review*, February 2026.

A trustee is assigned fiduciary responsibility of the funding agreement to protect the interests of the noteholders. The trustee pays principal and interest on the FABNs to investors on payment dates based on the funding agreement terms, from income earned on the assets that collateralize the funding agreement.

Growth of the FABN Market

Although the FABN market has existed since the 1990s, according to research by S&P Global,[3] U.S. life insurers did not issue FABNs to U.S. investors until the spring of 2000. Prior to this, life insurers issued FABNs to European and other global markets. For U.S. insurers, funding agreements have been considered general account liabilities (i.e., not debt) and operational leverage (as opposed to financial leverage) because they are issued for the purpose of generating spread income rather than for corporate purposes.

According to analysis by the Macroprudential (E) Working Group, there are differences in the total volume and types of FABNs outstanding, depending on the data source. In 2025, FABNs experienced record issuance, due in part to favorable market conditions.[4] There was not only an increase in issuer participation, but also in investor demand. The FABN market has also been cited as an area of growth for U.S. life insurers. Investor interest in FABNs depends in part on the direction of interest rates. That is, as rates decrease, bonds with fixed rates become more attractive, as they offer a higher yield. While there has been a rising percentage of floating-rate FABNs, the majority of the notes are issued as fixed-rate. Lower rates also mean that issuers receive more cost-effective funding (i.e., lower rate on the FABNs), an incentive to increase issuance.

Why Are FABNs Appealing to U.S. Insurers?

FABN programs are an attractive extension of life insurers' spread-based business, and they represent an additional, diversifying funding source. Insurers invest proceeds received from the FABN issuance in assets that typically have higher yields than the interest rate on the FABN. These spread-generating assets are held in the insurer's general account. Advances from Federal Home Loan Bank (FHLB) programs, repurchase agreements, and securities lending can also, at times, be used by insurers as part of their spread-based business activities.

The FABN structure also allows investors access to notes backed by insurance contracts that otherwise do not generally exist in the fixed-income market, thereby expanding the investor base. By issuing notes through an SPV, investors only have recourse to the SPV. That is, investors do not have recourse to the insurer, but they do have recourse to the funding agreement, which is assigned to the trustee for the noteholders' benefit. The FABN noteholders, through the SPV, would rank pari passu with other insurance product policyholders and have priority over general creditors in an insurer insolvency.

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[3] S&P Global, *Funding Agreement Backed-Notes: What, When, How?*, December 2025.
[4] Fitch Ratings, *U.S. Life Insurers' Increasing Reliance on Funding Agreement-Backed Notes Creates Risk*, October 2025.

FABNs are viewed as a stable funding source because they are typically not puttable, meaning that investors cannot demand cash back prior to maturity. In addition, funding agreement maturities and liability duration are more predictable than other types of life insurance liabilities, as they do not contain mortality or behavior risk.

What Are the Risks and Mitigants?

FABNs offer insurers an efficient funding tool but also introduce several key risks, including credit risk, the potential for operational leverage, liquidity risk, asset-liability mismatches, and transparency risk.

General credit risk, or the risk that sufficient income will not be available to pay FABN investors, is minimized by appropriate cash-flow matching between the funding agreement and the FABNs. Funding agreements are generally 'match-funded' with FABNs in terms of interest rate, maturity, and principal amount to eliminate the risk of mismatches in those areas. However, for any FABN programs where interest rate mismatches exist between the funding agreement and issued notes, insurers may enter into interest rate swaps with counterparties to mitigate or prevent a disruption in cash flows. The same is true relative to currency risk: insurers may enter into currency swaps with a counterparty if there are any mismatches between the currency of the funding agreement and the FABNs. Consequently, engaging in swaps results in exposure to counterparty credit risk.

FABNs may be viewed as non-traditional liabilities because they are not categorized as debt by U.S insurers. The size of an insurer's FABN program relative to its total liabilities is a factor to be considered when identifying the potential impact on operational leverage. While FABN programs represent an additional funding source, the size of the program as a percentage of an insurer's total spread-lending business is also a key factor in assessing potential operational risk. As the FABN market continues to expand, increased insurer reliance on these programs as a funding source, along with a greater concentration in spread-based income, could raise additional risk considerations.

Most FABNs are structured with a bullet maturity (i.e., total principal amount of the notes is paid in full at maturity) and typically do not have the option to be redeemed by the investor prior to maturity (also known as optionality). In fact, according to Federal Reserve data, there are no FABNs outstanding in the market with optionality. Therefore, liquidity risk is mitigated that otherwise could arise if the insurer were not able to liquidate the corresponding investment to raise sufficient cash to pay investors in full, or if the insurer were to liquidate the investment at a loss.

Asset-liability management risk is addressed through insurers investing FABN proceeds in assets whose durations are appropriately matched with that of the funding agreement, which, in turn, mirrors the terms of the FABN. Typically, life insurers invest in longer-dated assets to meet their long-term life policies' liabilities, but with FABNs, maturities generally range between three and five years (but can be longer in some instances).

Statutory reporting of FABNs by insurers does not exist, making it difficult to accurately assess overall exposure levels and the appropriate matching of assets to liabilities (i.e., whether the duration of the funding agreement matches that of the FABNs issued). To address this transparency risk, the NAIC has proposed standards for additional disclosures in insurer annual statement filings for funding agreements that back FABNs. Currently, the only required reporting is the amount of funding agreements issued in aggregate for all purposes, with disclosure of funding agreements issued in connection with FHLB advances.

Evolving FABN Structures

Growth in the FABN market has contributed to the product landscape evolving beyond traditional structures, with some transactions incorporating a broader range of securities backed by funding agreements. Brief descriptions of some of the observed structures are provided below.

Foreign Currency Funding Agreement-Backed Notes

In a foreign currency FABN (FXFABN), the SPV issues a FABN denominated in a foreign currency, and the funding agreement issued by the insurer is likewise denominated in the same currency. Insurers may use derivatives, such as currency swaps, to hedge foreign exchange exposure. However, these hedging strategies can introduce basis risk as well as counterparty credit risk.

Funding Agreement-Backed Commercial Paper

Under funding agreement-backed commercial paper (FABCP) structures, the insurer issues a master funding agreement to an SPV. The assets backing the master funding agreement consist of commercial paper with maturities of 360 days or less that are purchased by the insurer with the FABCP investors' cash proceeds. The principal and interest payments on FABCPs are generally structured to align with the dollar amount of commercial paper backing the transaction. However, the insurer may not always be able to fully invest the proceeds due to the short maturities and frequent rollovers of commercial paper, which can create a duration mismatch. The short-term nature and high liquidity of the underlying commercial paper partially mitigate this ALM mismatch.

Funding Agreement-Backed Repurchase Agreements

In a funding agreement-backed repurchase (FABR) agreement transaction, an SPV purchases a funding agreement issued by an insurer and then uses that funding agreement to enter into a repurchase agreement (repo) with a bank counterparty. In addition, the insurer pledges collateral into an account controlled by the SPV to support the repurchase transaction. The bank counterparty may rehypothecate, or repledge, all or a portion of the collateral pool. This FABN structure expands repurchase capacity and balance sheet flexibility for the insurer while reducing the bank counterparty's regulatory capital charge.

Funding Agreement-Backed Loans

Funding agreement-backed loan (FABL) structures work similarly to FABNs, except the SPV is established by the bank counterparty, not the insurer. Another key difference from FABNs is that the FABL SPV enters into a loan directly with a bank instead of issuing notes. Effectively, though, the cash flows of the loan and notes operate similarly. Additionally, with FABLs, the insurer pledges securities to a collateral account, for which the bank counterparty has a security interest pursuant to an account control agreement.

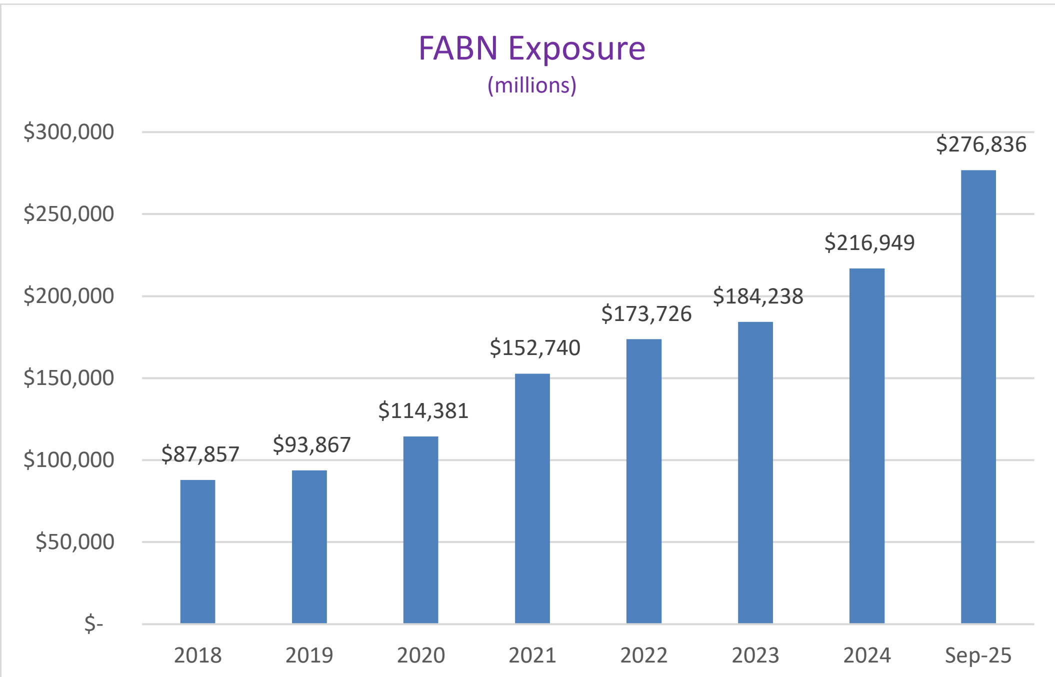
Funding Agreement-Backed Municipal Pre-Pay/Energy Bonds

Funding agreement-backed municipal gas and electric prepayment bonds (FABMBs) are a specialized segment of the municipal bond market that allows municipalities to secure a long-term, discounted supply of energy from a utility company. The municipality issues a tax-exempt bond to investors and uses the proceeds to prepay for typically 20 to 30 years of energy delivery. The SPV is a single-purpose entity whose sole purpose is to execute the prepayment with the commodity supplier, which is typically the commodity-trading entity of an investment bank. The insurer's funding agreement provides interest payments on the bonds until such payments are recouped from consumers paying their utility bills.

Appendix:

FABN Issuance, 2018-3Q2025

According to Fitch Ratings' aforementioned October 2025 publication, record issuance occurred in 2025 due in part to "positive market conditions, expanding issuer participation and increased investor demand." Issuance going forward will depend on Federal Reserve decisions about interest rates, the trend with credit spreads, and the status of geopolitical issues.



Source: https://www.federalreserve.gov/releases/efa/efa-project-funding-agreement-backed-securities.htm

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