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A Compelling Opportunity for Tax-Efficient Growth: Private Credit in Insurance-Dedicated Portfolios

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INVESTMENTS & WEALTH INSTITUTE®

A Compelling Opportunity for Tax-Efficient Growth

PRIVATE CREDIT IN INSURANCE-DEDICATED PORTFOLIOS

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SOME INVESTMENT STRATEGIES combine particularly well with certain investment vehicles. Our analysis shows that private credit may be the optimal asset for inclusion in tax-efficient insurance-oriented vehicles.

The Growth of Insurance-Dedicated Funds

Taxable investors and their advisors know it's what you keep, not what you make, that matters. In some cases, tax-smart investing can deliver a degree of alpha to client portfolios that can dwarf the benefits accruing from more traditional areas of financial advice.

One example is the use of tax-advantaged insurance-dedicated fund (IDF) exposure for

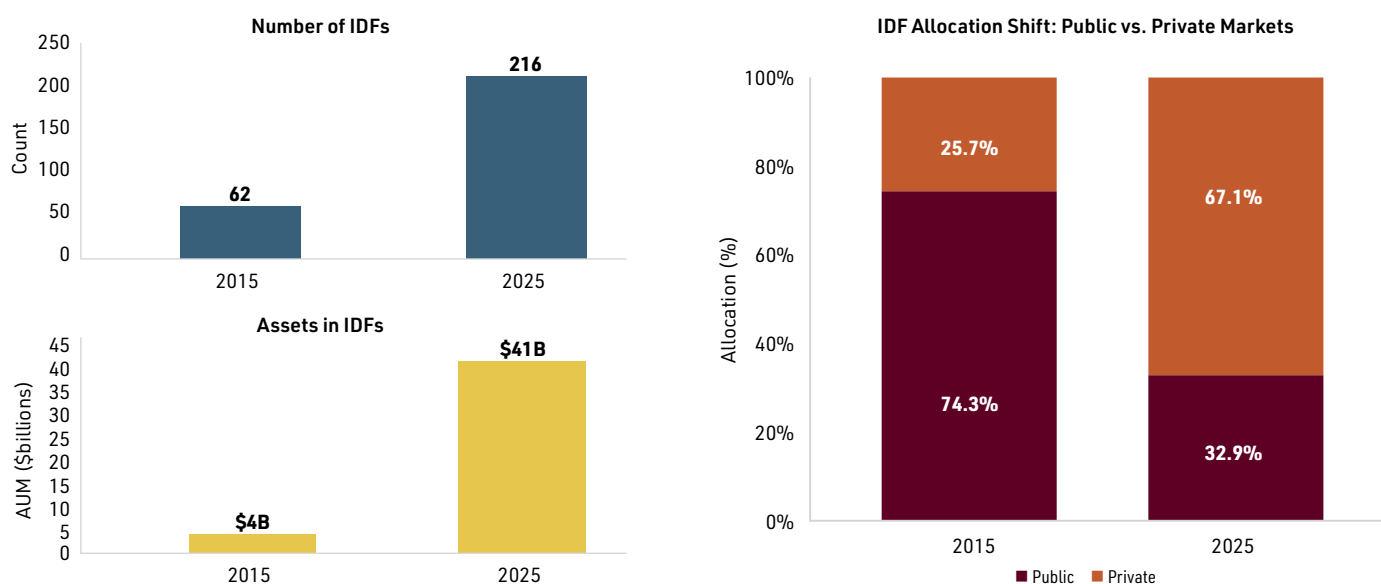
certain high-net-worth client portfolios. IDF investments—structured as private placement life insurance or private placement variable annuities—can help clients defer or eliminate income taxes on investment gains. These insurance vehicles also may provide an effective way to achieve tax-efficient multigenerational wealth transfer.

The growth in the number of insurance-dedicated funds over the past 10 years has been impressive (see figure 1). The chief industry source on the topic, SALI Fund Management, indicates the number of IDFs in market has grown from 62 to 216 over the past 10 years. Assets invested in an IDF structure have grown 10X over the same

period, from just under \$4 billion (in 2015) to more than \$40 billion (year-end 2025).¹ Much of the recent growth has been driven by institutional allocators, especially insurance companies.

At the same time, asset allocation for policy-holders over this period has shifted away from public markets toward private market strategies. Exposure to private market investments in IDF vehicles grew to 67 percent in 2025 from 26 percent in 2015, alongside a concomitant drop in public. Investors appear to have increasingly recognized the value of tax-deferred compounding that less-liquid (and potentially higher-returning) private strategies can offer.²

FIGURE 1 IDFs Evolve: Rising Allocations and a Shift to Private Markets



Source: SALI Fund Management.

Optimizing the IDF Allocation

Advisors can help their clients make the most of the IDF opportunity by identifying specific investments that are particularly advantageous to shield from taxation. In our experience, the tax advantages of IDF exposure are greatest for assets with consistently strong returns that also are subject to high marginal tax rates.

We use a five-part framework to gauge asset suitability, looking at elements ranging from tax inefficiency to tax waste, to determine which asset may be best suited to an IDF vehicle. We find that private credit, and specifically direct lending, is among the most attractive assets to include in a new IDF—or add to an existing one. The IDF can help transform an otherwise yield-centric lending strategy into a tax-efficient growth engine for clients.

Winning the (Tax) Drag Race

Tax drag is a reality for most individual investors, but there’s a relatively clear framework for understanding and managing it. Marginal tax rates generally are highest—potentially exceeding 40 percent at the federal level—for

assets with returns derived primarily from interest income (such as leveraged loans or direct lending) or short-term capital gains from trading (a characteristic of certain equity and hedge funds).

Next in order of tax-inefficiency are assets whose returns are derived primarily from long-term capital gains and qualified dividends. These typically benefit from more-favorable tax treatment. Several examples include passive long-only equity portfolios and private market investments such as venture capital and private equity.

And, of course, some assets have built-in tax advantages, such as municipal bonds, that generally do not belong in a tax-efficient structure (see figure 2).

Illiquidity

The holding period for IDFs, which can extend to decades to maximize the tax-deferral benefit or facilitate multigenerational transfer, should favor longer-duration assets. This would encourage greater use of alternative or private market investments with less underlying liquidity and, in turn, an illiquidity premium as part of the return profile.

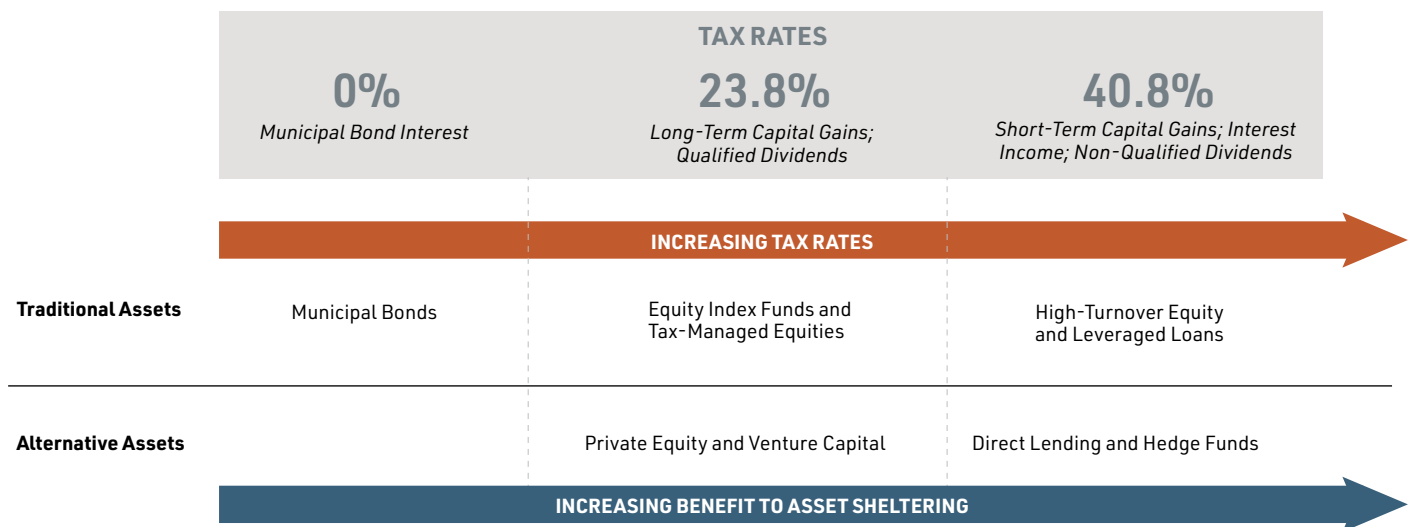
ADVISORS KNOW THAT PORTFOLIOS WITH HIGHER RETURNS AND LESS VOLATILITY—AND THUS MORE CONSISTENT COMPOUNDING—WILL BUILD GREATER WEALTH FOR THEIR CLIENTS OVER TIME.

Premium Returns

Advisors know that portfolios with higher returns and less volatility—and thus more consistent compounding—will build greater wealth for their clients over time. Looking at projected returns and risk across asset classes, several strategies stand out.

Private equity is appealing intuitively thanks to its projected return potential (10.5 percent), but it has about three times the volatility of direct lending (with a standard deviation of ~20 percent versus ~7 percent). Mean-while, hedge funds may be attractive from a risk perspective, but they are projected to return only about two-thirds as much as

FIGURE 2 It’s a Drag: Tax Inefficiency in Context



Source: U.S. Internal Revenue Service and Golub Capital internal analysis. For illustrative purposes only.

FIGURE 3 Great Taste and Less Filling? Premium Returns and Lower Volatility

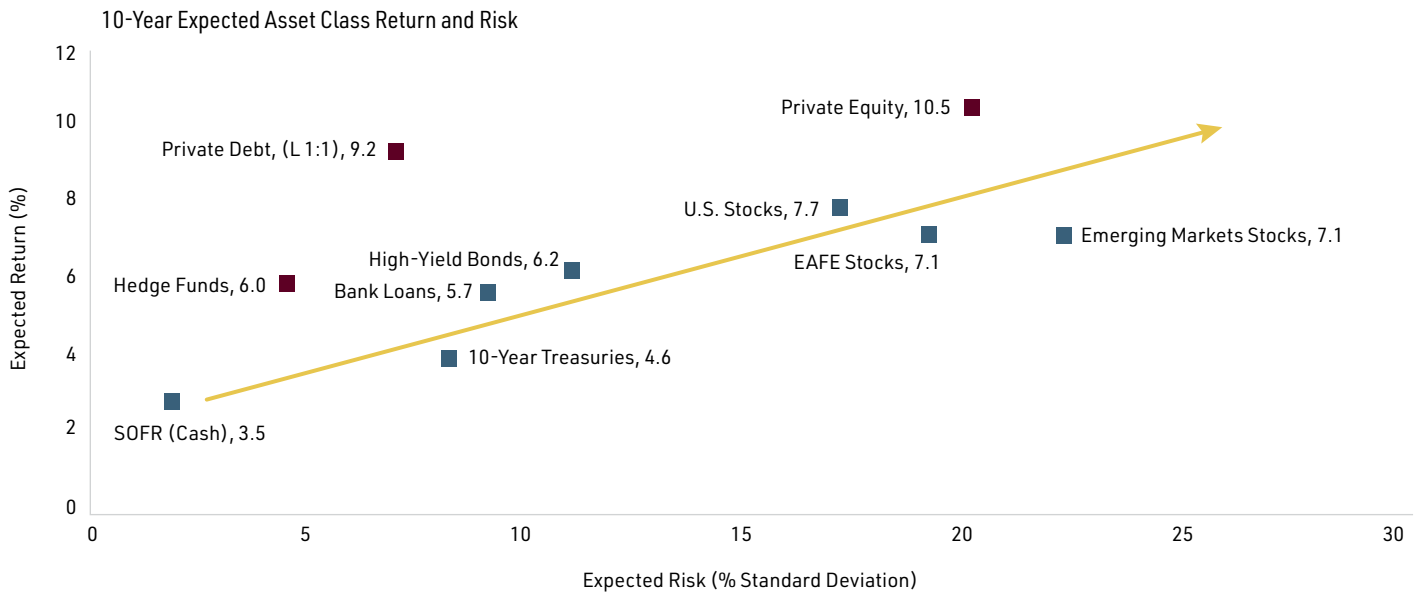
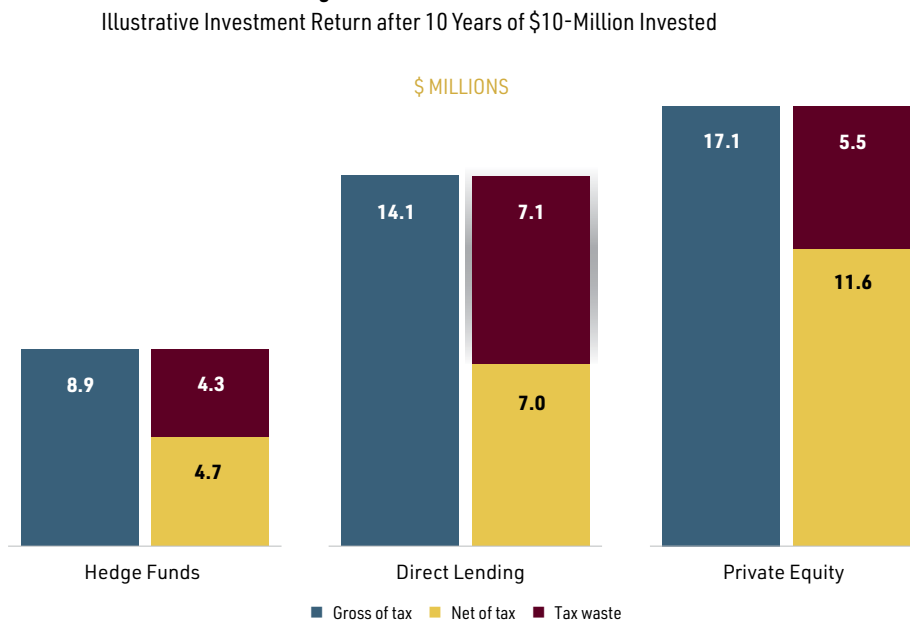


FIGURE 4 Waste Not: Measuring the Relative Erosion of Returns Due to Taxes



▲ Source: Cliffwater 2025 Asset Allocation Report, January 29, 2025 (the “Cliffwater Report”), page 4, Exhibit 2. 10-year expected asset class return and risk. For illustrative purposes only. Golub Capital makes no representations or warranties about the accuracy or appropriateness of third-party data sources used in this analysis. All third-party data sources are the property of their respective owners and such owners, have not endorsed the contents of this article.

Note: Private debt or private credit may refer to a number of non-public credit strategies, from distressed debt to mezzanine finance to direct lending. In this article, as in most discussions, private credit is synonymous with direct lending.

◀ Source: Golub Capital internal analysis and the Cliffwater Report. For illustrative purposes only. The analysis uses projected 10-year returns for private equity, direct lending, and hedge funds, based on a composite of third-party forecasts shown in the Cliffwater Report. The analysis calculates forward gross and net returns on each asset over 10 years, applying estimated tax rates for each asset based on return composition and trading. Private equity is taxed annually at long-term capital gains tax rate; hedge funds and direct lending are taxed annually at highest federal income tax rate (short-term capital gains tax rate in the case of hedge funds; interest income tax rate in the case of direct lending). Gross of tax is compounded at the gross-of-tax return rate, and net of tax is compounded at net-of-tax return rate $((1 - \text{tax rate}) \times \text{gross-of-tax return})$. Tax waste is the amount of gross-of-tax returns eroded by taxes over the 10-year period.

direct lending over the next 10 years (6.0 percent versus 9.2 percent), as shown in figure 3.

Return Consistency and Early Return of Capital

Direct lending strategies tend to deliver steady and highly consistent returns in the form of quarterly distributions, which can drive better compounding. It’s also worth

noting that the absence of regular returns early in the life of an IDF to cover the vehicle’s costs could threaten its tax-shielding character. Private equity typically involves a delayed harvest period on investments and a slower and chunkier return of capital. Direct lending offers quicker and more reliable returns in the form of quarterly interest income on privately negotiated loans.

Tax Waste

Assets with high returns and high tax rates generally experience the most tax waste in terms of actual dollars lost to taxes. Looking at projected net-of-tax investment gains over the next 10 years, we see that direct lending outside an IDF suffers two-thirds more tax waste over this projected 10-year period in absolute dollar terms (\$7.1 million versus

FIGURE 5 Fit for Purpose: A Framework for Optimal Asset Allocation in IDFs

Asset Class	Tax Inefficiency	Illiquidity	Premium Return	Return Consistency (esp. early)	Tax Waste	Overall
Direct Lending						
Hedge Funds						
Private Equity						

Source: Golub Capital internal analysis. For illustrative purposes only.

\$4.3 million), relative to hedge funds, and one-third more relative to private equity (see figure 4).

Location, Location: Optimizing for Tax-Efficient Growth

Combining the five elements of our framework, direct lending investments appear to be the optimal asset to shelter (see figure 5). Freed of taxes with a longer period of consistent compounding of interest income, direct lending can achieve net-of-tax wealth outcomes on par with higher returning private market growth strategies—and with lower volatility.

From Asset Location to Asset Allocation

Although direct lending may be the best single asset to hold in an IDF, clients still may prefer a more diversified portfolio. They might look to combine the two most tax-inefficient private strategies (hedge funds and direct lending) in a single fund or include other asset classes, such as private equity, in a more broadly diversified portfolio. Using our framework for IDF allocations, advisors can guide clients to consider an asset mix that offers the right blend of tax benefits, reduced risk and projected wealth. ●

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group. He is responsible for managing existing and new client relationships across all investment offerings for the firm. He earned an MBA from the Columbia Business School and a JD from American University's Washington College of Law. Contact him at rjacobson@golubcapital.com.

ENDNOTES

1. Source: SALI Fund Management, as of March 31, 2026.
2. SALI data: "Private markets" includes private equity, private real estate, private credit/direct lending, secondaries, and diversified private markets.

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