BARINGS

PRIVATE CREDIT

The Growing Opportunity in Private Placements

INSIGHTS

Private placements have become an established source of funding for borrowers. Given the potential for incremental returns, diversification, and downside protection, investors are increasingly turning to this asset class too.

Ernesto Chesculescu
Head of European Private Placements Origination

Ben Jones
Head of Corporate Private Placements

Given the relatively higher yields on offer, institutional investors are increasingly considering investments in illiquid private markets—including private placements. For insurance companies and pension funds, in particular, these markets can offer a number of potential advantages, ranging from an illiquidity premium over public markets to enhanced diversification, risk protection, and positive asset-liability matching attributes.

What are Private Placements?

Private placements are essentially notes and loans sold only to qualified institutional buyers (QIBS). Historically an investment grade (IG) market, private placements tend to have intermediate to long-term maturities, and are mostly fixed rate **(Figure 1)**. For issuers, financing via the private market has potential advantages. These range from confidentiality considerations to the flexibility of issuing debt across a wide range of sizes, maturities, and currencies.

The market also spans a range of geographies, credits and sectors—from universities, sports-related transactions and financials to more esoteric products such as structured finance, credit-tenant lease transactions and aviation deals.

Figure 1: Key Characteristics of Private Placements

	Private Placements	Public Investment Grade Debt
Credit Quality	BBB- and above	BBB- and above
Tenor	Flexible, 2–50-year	2-year to perpetual
Income	Primarily fixed	Fixed or floating
Structure	Flexible structuring with delayed draw and bespoke maturities	Bullet maturities or scheduled amortization
Prepayment	Make-whole provisions for prepayment	Make whole provisions or call structures
Security	Primarily senior unsecured or senior secured	Senior unsecured through junior subordinated
Key Features	Engaged working relationship with borrowers, strong covenants, historically low net losses, stable cash flows	Engaged relationship with borrowers, flexibility of tenor and unsecured

Source: Barings. As of February 29, 2024.

"The opportunity to earn a premium in exchange for giving up public liquidity can be particularly attractive to investors with long-term liabilities that do not need all of their portfolio in liquid assets."

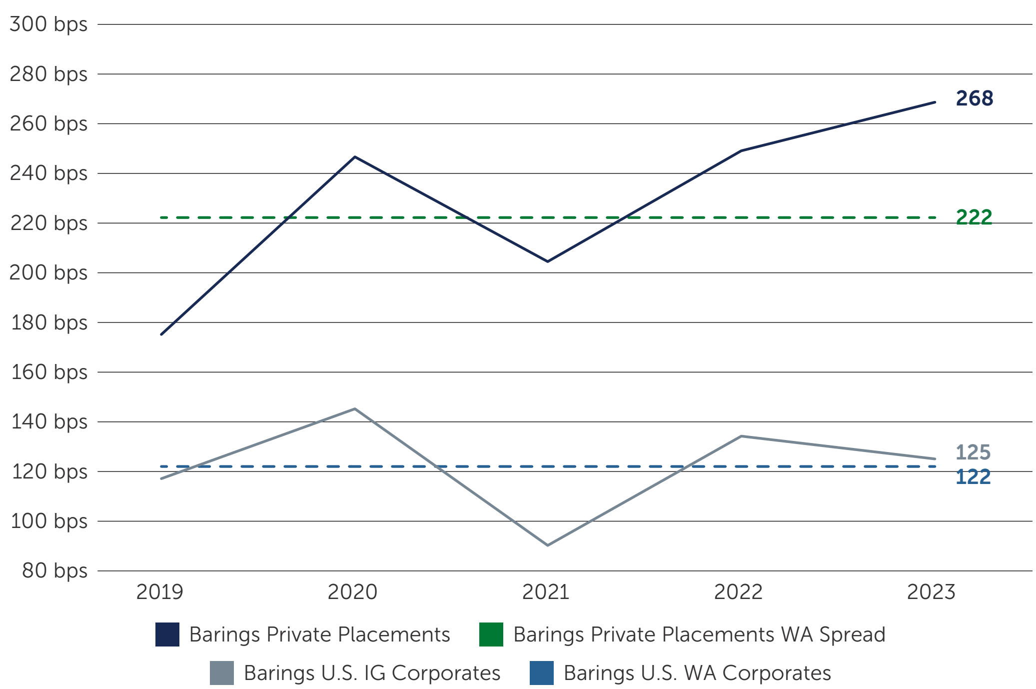
Key Benefits for Investors

As the market has evolved, institutional interest in private placements has grown. Insurance companies have traditionally been the most active investors in the market, attracted to the liability matching characteristics, such as longer tenors and prepayment protection. Investors seeking to enhance yield and portfolio return, such as pension funds, have turned their attention to the asset class more recently. At the same time, the investor base for private placements has become more global, with demand from both Europe and Asia growing as investors continue their respective searches for attractive yields and greater diversification.

PREMIUM TO PUBLIC MARKETS

Private placements are less liquid than public bonds and have historically offered enhanced yields vs. IG credit to compensate for that illiquidity, as well as for the complexity inherent in underwriting the credits **(Figure 2)**. The opportunity to earn a premium in exchange for giving up public liquidity can be particularly attractive to investors with long-term liabilities that do not need all of their portfolio in liquid assets. Over the past five years, Barings' private placement strategies have offered a weighted average spread premium of 100 basis points (bps) over the Barclays IG Corporate Index.

Figure 2: Private Placements Debt Spreads vs. A/BBB Public Corporate Bonds



Sources: Barings market observations. As of February 29, 2024.

DIVERSIFICATION BENEFITS & UNIQUE EXPOSURES

Private placements is a global asset class, and it can be an effective diversifier in a portfolio that already includes more traditional, long-term fixed income assets such as sovereign and public corporate bonds. Whereas public debt is heavily concentrated in the industrial, financial and utility sectors, **private placements span rated and unrated public and private debt, as well as a wide range of industry sectors and sub-sectors—all of which exhibit unique return profiles.** Private placements, relative to public corporate bonds, can provide additional exposure to consumer sectors, social housing, sports, real estate and a wide range of industries.

DOWNSIDE PROTECTIONS

Private debt investments have a potential advantage over public bonds given the **strong negotiated covenant structures unique to each deal**, which help ensure that investors will be properly compensated and protected for the risks they assume. Often, the agreements also include make-whole provisions that will compensate investors if borrowers decide to prepay their debt. Private placements are also **typically senior in an issuer's capital structure**. In times of stress, the combination of strong covenants and capital structure seniority gives the holders of private investments a seat at the table, enabling them to reprice or renegotiate a deal to compensate for higher risk and/or receive partial or full prepayment offers.

LOW LOSSES/HIGH RECOVERIES

Given the strong downside protections, private debt assets have exhibited resilience over time, including through periods of market volatility and economic downturns. While the costs associated with managing private assets can be higher relative to public bonds, **losses for private placements have historically been lower relative to public corporates of similar credit quality.** More specifically, the historical recovery rate for senior unsecured private placements is 62.2%, versus 47.9% for senior unsecured public debt.[1]

DURATION/LIABILITY MATCHING

The long maturities of private placements can also potentially benefit institutional investors. **Private placements have long tenors, typically five to 30 years**. The long-dated debt is supported by **steady, and highly predictable, cash flows**. The ability to establish different maturities, backstopped by prepayment protections, makes these private markets particularly effective for asset-liability matching relative to public debt. In particular, this often requires long-duration investors to use derivatives, which can be both expensive and volatile, to ensure their liabilities will be met.

1. Source: Society of Actuaries 2003–2015 Credit Risk loss Experience Study: Private Placement Bonds. As of April 2019.

What to Look for in a Manager

For investors interested in gaining exposure to the asset class, there are a number of ways to access the opportunities on offer. Historically, large institutional investors have accessed this market primarily through separately managed accounts, but more funds have emerged in recent years, allowing smaller investors to participate. That said, given that many deals in the private placement market are directly originated and privately negotiated, selecting the right manager is critical to accessing the opportunity.

Key characteristics to look for in a manager include:

STRONG ORIGINATION PLATFORM

Access to deal supply is without a doubt the 'secret sauce' to outperforming in the private market. A proven origination strategy to underwrite deals seamlessly from the broadly syndicated market as well as more proprietary deal sources is key to achieving growth, name diversification and spread outperformance. While private markets have grown considerably in recent years, they are still relatively small in comparison to public markets—meaning managers that have strong, established partnerships with market participants are often better positioned to find the best pipeline of opportunities and source the highest-quality deals for investors.

THE ABILITY TO STRUCTURE & PRICE DEALS PROPERLY

An experienced team knows how to structure deals with covenants that will provide optimal protections for investors, and an experienced manager will bring a better understanding of where the market may be currently moving in terms of pricing.

GLOBAL PRESENCE

More opportunities are emerging around the world, and it is important to work with a manager who has a foothold in and experience across different countries and regions. That will enable the manager to identify the best opportunities for each client given their particular investment criteria at any point in time.

Key Takeaway

Private placements can offer access to high-quality assets that may provide incremental, risk-adjusted cash returns, particularly for investors able to allocate to illiquid private debt assets. In order to access the broadest selection of investment opportunities, investors can benefit from partnering with experienced managers who have longstanding relationships with key market participants, access to a large and diverse pipeline of opportunities, and the ability to appropriately structure, price and monitor the investments. This access is critical for investors seeking to deploy long-term capital and positions them to capitalize on both opportunistic and fundamental investment opportunities in the growing asset class.

Barings' Private Placement Debt Capabilities

39	$45+ B	30+	100 bps
Professionals Dedicated to Private Corporate & Structured IG Strategies	of IG Private Debt Investments	Years Experience in Private Debt Investing	Average Spread Generated Over U.S. Public Corporates

Source: Barings. As of December 31, 2023.

Barings is a $381+ billion global investment manager sourcing differentiated opportunities and building long-term portfolios across public and private fixed income, real estate and specialist equity markets. With investment professionals based in North America, Europe and Asia Pacific, the firm, a subsidiary of MassMutual, aims to serve its clients, communities and employees, and is committed to sustainable practices and responsible investment.*

LEARN MORE AT BARINGS.COM

**As of December 31, 2023*

24-3425363