The changing face of the private placement marketplace

INSURANCE ASSET RISK

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In this *Insurance Asset Risk* / Loomis Sayles roundtable, insurers discuss the benefits of investing in private placements, the evolving nature of the marketplace, market volatility and opportunities ahead

Part I: Defining private placement in the context of insurers' investments

Vincent Huck: What is the advantage for insurers to invest in private placements?

Sean Collins: Private placements are a core allocation in our portfolio and that will be the case regardless of market conditions. We use privates to fill in portfolios with specific asset classes we cannot get on the public side. Privates also provide diversification, higher yields than publics though less liquidity, and better downside protection.

From an insurance portfolio perspective, privates are a capital-efficient and defensive asset class, which makes them attractive as a core allocation.

Chris Gudmastad: One of the key attributes of private placements in addition to the spread over publics, is with the recent introduction of esoteric credit to the asset class, where there is the potential opportunity to get a complexity premium in addition to illiquidity.

In addition, the covenants and structural protection can be key as a buy and hold investor, as it seeks to minimize downside risk throughout the cycle.

Andrew Hanson: Probably worth highlighting too, diversification is a big deal in privates. Because the kind of companies we do debt private placements for are often not going to come to the public debt markets. They are brand new names for insurance company investors in an environment where a lot of public-only bond investors have trouble diversifying because of the concentration of large public borrowers.

Sean Collins: About the downside protection. Strong covenants are going to allow you as a lender to get invoice quicker and work directly with the company to navigate any short-term challenges. This provides better downside risk protection compared to the public high-yield market.

Mary Beth Cadle: And we clearly saw that during the GFC, when we held a stressed credit which had issued in both the private and public markets. Private investors were able to negotiate security, coupon bumps and forced prepayments with make-whole fees at a time when the public bonds were marked at 40-cents. It was a great outcome and return, versus the public bond equivalent.

Colin Dowdall: It's important also to define the terms. When you say "private placements" to an insurance company often times they think: corporates, sleepy market. And when you talk about some of the evolution of the market, things like project finance and the structured area, specialty finance, [that] is when they start to understand the full universe of it.

It is, frankly, something that the industry now is grappling with, because how do you underwrite investment managers that are in this market when everybody defines it differently. We are also seeing that with third-party consultants that they themselves are taking a step back and are trying to create a definition so that they can look at the market apples to apples. However, this is not the 20-30 over a public investment grade BBB corporate bond, there is so much more to this market.

At Loomis Sayles, we have defined it as "private fixed income," and as simple as it is, that little nuance means you do not get that immediate reaction and you get an interest in really digging in and understanding why do we call it private fixed income instead of private placements, and how do we define that universe more broadly.

Chris Gudmastad: It is a more accepted term and we are starting to see non-insurance investors investing in the asset class as well – pension funds, endowments, infrastructure funds, and sovereign wealth funds. As these investors invest in the asset class, I think private fixed income is a better way to define it. I would also say the quality spectrum is not just investment-grade anymore. We are certainly seeing non-rated and high-yield issuance and will likely see more as the market evolves.

Dmitry Baron: Aflac has an interesting relationship with private placements going back 10/15 years. One of the reasons why Global Investments in New York was created is private placements. Aflac

Attendees (L-R): **Colin Dowdall**, VP and director of insurance solutions, Loomis Sayles; **Dmitry Baron**, structured finance – senior portfolio manager, Aflac; **Andrew Hanson**, senior advisor in private capital markets, Moelis & Co; **Chris Gudmastad**, managing director for private credit, Loomis Sayles; **Mary Beth Cadle**, head of private placement debt, Nationwide; **Nakul Nayyar**, head of investment risk, Guardian Life; **Sean Collins**, VP investment, Prudential; Chaired by **Vincent Huck**, editor, *Insurance Asset Risk*

had traditionally a fairly large portfolio of private placements, very concentrated, so during the global financial crisis it did not necessarily do that well. Thus, to diversify away from private placements the platform in New York was created.

However, now, going back to a couple of years ago, we saw an opportunity to go back into private placements but we define it slightly differently. We do need to have structure on top of just being private for us to qualify as an investment opportunity. Having said that, we have a very strong Yen-denominated private placement book, which works very well for us, because Aflac has significant part of its business in Japan.

Mary Beth Cadle: So when you say you need structure on top of it being private, is it an asset-backed structure or are you referring to structure as defined in a project finance deal or a transaction that involves a more complex organizational structure and covenants?

Dmitry Baron: I guess an easy definition for us is whatever doesn't fit anywhere else. However, we view it as private ABS and corporates with a twist, private corporates with some kind of special purpose vehicle, receivables-based financing, maybe an insurance wrapper, something like that.

Chris Gudmastad: As you look at why these opportunities exist, taking a step back, we believe it is because the banks stepped away from the markets – our industry is replacing banks. We are focusing on infrastructure, as well as specialty finance, which could also be defined as esoteric private credit or private ABS. And we are seeing an increasing issuance in our market. It is not just pure corporate. It is not a multi-tranche ABS; it combines the structural aspects of both ABS and corporate credit. That just shows the flexibility of structures in our market and we believe it is also a result of new investors in the market, mainly alternative and non-insurance institutional asset managers.

Nakul Nayyar: Insurers are long-term investors and so well placed to capture the illiquidity premium across private placements. After the global financial crisis and certainly during COVID panic, there was an emphasis placed on liquidity. While we still need to manage for things like outflows, surrenders and other liquidity events, there is more comfort looking at illiquidity in the portfolio than there was perhaps five or ten years ago.

Mary Beth Cadle: I would challenge a view that private securities are inherently illiquid. In my view, liquidity is a continuum with some off-the-run public bonds less liquid than well-known, high quality private placement issues. Furthermore, public markets are liquid only until one really needs liquidity during a market downturn or in times of volatility.

Illiquidity in the public market can also be priced a bit differently than in the private markets. Sometimes you can get a higher premium for illiquidity in the public market versus privates, depending on where you are in the cycle, and in a particular sector.

Andrew Hanson: I agree with you. When we talk to issuers about doing private versus public, or private versus 144A versus Agented 144A versus 4a2 private, there are so many nuances of the legal form of issuance. And theoretically in the textbook that has something to do with liquidity; but what has more to do with liquidity is the name, access to information, credit quality, deal size, and number of investors in the deal. If you do a supposedly illiquid private placement for a single-A corporate with 25 investors in it, I would say that is going to be a lot more liquid than many off-the-run BBB public deals issued once every ten years that don't have a strong following on the street's trading desks.

It is more of a name by name thing. We know it when we see it but it is hard to define what is liquid versus illiquid.

Vincent Huck: How have you seen this space evolve over the last few years and how has it impacted the way you think about those investments?

Mary Beth Cadle: When I started in privates, the market consisted of a very small group of investment bankers and US insurance companies, with issuers often privately held and typically more mid-cap in size. We then saw the advent of commercial banks where they leveraged their lending book to drive supply. As a result, larger, often publicly-traded credits began to issue private placements. The next driver of growth were cross-border companies, which opened up the UK, Europe, Australia and New Zealand as new geographic jurisdictions.

The point seems to be that whenever investors question how to deal with supply-demand imbalance, our market creatively develops other sources of supply. I give private capital markets a lot of credit for being innovative.

Andrew Hanson: The early wave of market growth in the 2000's was international and then probably ten years ago, the project finance growth wave started really taking off. I actually think that is what has helped lead to this earlier discussion about the breadth of private fixed income. It started with project finance and all of a sudden there wasn't a clear definition of who is buying these deals, and whether they were considered a "traditional" private placement buyer or not; but they are structured deals that are illiquid and add value. The asset class started to be defined a little bit more broadly. And now that has just accelerated private fixed income and what you were talking about earlier regarding esoteric assets.

Colin Dowdall: It is not a coincidence that it coincides with the entrance of private equity capital into the insurance market, which is 12 years when it formally began as a risk transfer strategy, and has accelerated. And we are seeing in the last 18-24 months there have been more changes in the life insurance market than there were in the prior 30 years, because you just had such a dramatic re-shifting of assets to different forms of ownership and, frankly, different philosophies around investments and how to potentially optimize yield per unit of capital consumption.

> "In the low-rate playbook, you saw a lot of insurers going down in quality, taking on more illiquidity, or extending duration to pick up yield"
> **Sean Collins**

Chris Gudmastad: That has brought a lot more sophistication to the market. It began with project finance, as banks stepped away from the asset class shortly after the global financial crisis. The recent wave the last 2-3 years is private ABS, which can be also called private structure fixed income or esoteric credit. And the way I would describe the market today is when the transaction comes to an analyst, it is like a lump of clay. You do not know what the final form is going to be. You do not know if it is going to be corporate or structured, bond format or loan format, but individuals and firms need flexibility to offer solutions and have the expertise necessary to structure, underwrite and price the risk.

Dmitry Baron: We definitely see a lot of new players in this space. We are now competing with hedge funds, asset managers. And they are yieldy deals – rated closer to investment grade, but paying like high yield, because of the supply on one hand and yield requirements from non-traditional players.

Sean Collins: There is also a natural fit for insurance portfolios, where you have a need for high-quality, long duration assets. Managers can help fill the gaps in insurance portfolio with higher yielding, short-term assets. These can be opportunities such as esoteric ABS or below investment grade that offer a yield pick-up with some level of downside protection. Private Equity firms have driven some of the evolution we've been discussing, but insurance company specific needs are also helping to drive the shifting opportunity set as well.

We were in this low-rate environment for a very long time, and in the low-rate playbook, you saw a lot of insurers going down in quality, taking on more illiquidity, or extending duration to pick up yield. As we go through the next downturn, there will be assets that come out of that period will a lot more attractive valuation. Additionally, managers are increasingly focused on finding opportunities that are structured in a capital efficient manner for insurance portfolios.

Vincent Huck: Protection was mentioned earlier, have you seen that evolve over the years?

Mary Beth Cadle: I think protection evolves more over market cycles. Depending on where you are in the market cycle and the resulting supply/demand imbalance, covenant protection can become competitive. Then just when you think covenant packages can't become any less meaningful, there is a downturn and everybody tightens up the covenant requirements. That said, the private placement market tends to have stronger covenant terms compared to other participants.

Chris Gudmastad: As a buy-and-hold investor, covenant packages are important, considering we are going to most likely hold through the cycle.

That is why we believe it is important to have a highly selective process. That being said, considering the investor base, covenants are not going to go away from the private investor market.

Andrew Hanson: I agree with Mary Beth [that] it ebbs and flows. I don't think it is dramatic ebbs and flows, but you can definitely feel it on the margin even year-to-year. However, I would be hesitant to say there is some long-term trend for looser or tighter covenants.

Sean Collins: You still have stronger covenants in the private placement market than you do in broadly syndicated loan markets.

Mary Beth Cadle: However, do you think with new entrants into our space their covenant requirements will be different or be perceived as being different? Recently, when we aren't able to get the documentation points required with our deal bid, there are questions as to who is willing to do weaker terms.

Nakul Nayyar: Investment committees and organizations are generally cognizant of the risks of covenant-lite packages. There are plenty of conversations, particularly in the CLO and Broadly Syndicated Loan market, and its effect on recoveries going forward.

Andrew Hanson: Every investor thinks differently on a particular deal about covenants, just like you guys think differently about credit. And sometimes, we see an investor who might be more lenient on covenants, but in our opinion their credit selection is good. Covenants are not necessarily the most important thing, just seeing it from the sell-side perspective. However, I have seen newer players who do want tighter covenants, whereas, other do not. I am not sure I could generalize if newer players are coming in with less covenants; and if they are coming in with less covenants, I do not necessarily think they are making a mistake. They may be picking the deals that are better from a risk-reward standpoint even if they are more lenient on covenants. It's just the flip side of that argument.

Dmitry Baron: Coming from the bank loan side, that is absolutely right. Like, over the last 3-4 years, you might have ended up with negative selection. If you wanted to focus on the deals with covenants, those would be the weaker credits.

Having said that, in private placements, because we are married to the deal for long time, we want to make sure the covenants are there to protect us. You do want credit quality, obviously, but also covenants; otherwise, during the next cycle you might not do well; you might not be able to exit if you need to. Thus, covenants will be there to get you a sit at the table to negotiate the deal, to get screws tightened, to make sure that the recovery is there.

Sean Collins: It feels like it could be a risk. However, there is still a tremendous amount of insurance money out there that outweighs the new entrants into the market. And we keep saying a buy-maintain is a conservative approach to portfolio management and asset allocation, so it feels like that is still an overwhelming factor. And on the covenants, that is the value of also having a direct origination platform. If you have the direct relationship with the borrower, then you are going to have a greater say over the covenant package.

Chris Gudmastad: Speaking on behalf of the new entrant in the marketplace, Loomis Sayles has a deep value credit culture and that is not going to change. One of the keys for us is to not just slap a covenant package on a transaction, but one that matters. One that helps minimize the idiosyncratic risks, gets you a seat at the table to re-price the risk and potentially get taken out of a transaction.

Part II: Addressing volatility

Vincent Huck: If we look at today's environment. We have high inflation, volatility, rising interest rates and a potential recession in the mid- to long-term. How does this impact your decisions and do you see opportunities in that environment or do you see more risks?

Mary Beth Cadle: It is tough because the future is so uncertain, at this point: do we prepare for a recession? Do we prepare for stagflation?

You have got market volatility, geopolitical uncertainty, supply chain COVID-related issues – it sometimes feels overwhelming.

From our perspective, the key is to stay focused, ensure that we understand the credit/portfolio risks and that the risk is adequately priced. We run base case and downside scenarios concentrating on ratings migration. That then leads to honing in on obtaining strong covenant terms as downside protection. I think the next few years are going to be a tough environment.

Chris Gudmastad: I am curious, Nakul and Sean, considering your positions as allocators with higher rates, how are you doing with the asset allocation balance of publics and privates?

Nakul Nayyar: Generally speaking, public corporate assets are a core investment for an insurer and if spreads were to widen, can represent an opportunity. Public Corporates provide quick access to a diversified source of liquid securities with various duration profiles. From a risk perspective, there is a lot of historical data to leverage on migration and default, research and underwriting, deeper markets, and operationally easier asset class to deal with versus privates. This is again on a high level.

So, spread widening in Publics is then an attractive development. Public spreads today are in this midpoint area, not at historical tights but not 2008 like levels either. Additionally, insurers generally have large portfolios of legacy assets at often high yields so incremental purchases this year may not have a huge impact on overall NII. A short term spread widening event is not going to cause a dramatic movement or shift in allocation at this point in my opinion. If spreads blow out for example or continue to be elevated while Private spreads react in a slow fashion, then of course allocators would look closely at moving back into Publics or slowing Private purchases.

Chris Gudmastad: What is interesting in a higher yielding environment is it is hard to be tactical managing a buy-and-maintain portfolio in our view. You are not going to make dramatic shifts. However, the growth in private credit was in part due to low yields as you saw investors allocate more to this asset class to take advantage of the illiquidity premium.

However, if you look at the recent rise in yields and volatility, we believe there are increased opportunities in the public market. That being said you can still have negative real yields so the illiquidity premium offered by private credit is still important. The private markets might not look attractive right now -there is generally a lag as the private market is less quick to adjust to market volatility. And I do think once the private market adjusts, it should continue to be attractive to investors. We believe the train has left the station on private fixed income and it is going to continue to be a core asset for institutional investors.

Sean Collins: That echoes some of the opening comments I made. We have a core allocation to private credit and that is not going to change in any market scenario. However, as an insurance company you consistently have cash that you need to invest. So rising rates are not necessarily a bad thing for insurers, because you are dollar-cost averaging into higher yields. Which is something we have been able to do. You can be a little tactical and if you think a recession is on the horizon then maybe you want to go up in quality a little bit in on the public side.

However, there are going to be opportunities in private credit and, yes, the low-yield environment brought investors into private credit, but there are going to be a lot of opportunities through these market dislocations. Some of that will come when companies need capital quickly in a downturn. As a borrower, if you have a relationship with a lender, you can get that capital through the private markets potentially faster than the public markets. As an investor, this may provide some extra yield, whether it is a premium for speed or complexity, which is very attractive for an insurer. These opportunities can be in that solid BB, low BBB range. Those are potentially attractive credits that generate a lot of free cash flow, but you are getting a nice yield given challenged market conditions.

So, market dislocations, as long as you are sticking to your fundamental tenets of credit investing, are generally good for insurance portfolios.

Andrew Hanson: When we talk to issuers, we explain that the investment-grade private placement market has always been a much more reliable, stable source of capital for borrowers than the public markets. Going all the way back to 9/11, we were doing new issue privates shortly after that when the IG market was effectively still closed. The rising interest rate environment that we are in right now is causing a lot of volatility in the US capital markets which, in a way, makes all of our lives more challenging, and should have a dampening effect on new issue markets, both debt and equity.

However, in a way, it kind of helps private markets. Whether it is private equity or private credit, the more volatile the public capital markets are, the more things shift over to private execution, because it is more reliable. You can have a dialogue directly with borrowers and investors, because the investors who are investing in these asset classes are not as worried about things like "I committed at a rate today, and tomorrow the market changes". That is okay, because we are not trading oriented market. And my personal opinion is this volatility is going to continue for a while, because interest rates are high, and they are going to go higher. I am not in the camp of recession, but I just think the volatility is something we are all going to have to manage for a while.

Colin Dowdall: Compared to the end of the year, we see a lot of insurance companies that are sitting on large unrealized losses whereas, previously, they were sitting on large unrealized gains and that has really changed the tone of the conversations that we are having with these companies. There is a concern about loss realization in the portfolio. So what you owned at year-end largely is what you own today, for the most part, in talking to insurance companies. However, I will say it is about, like you talked about, Sean, cash coming in and where does the next dollar go? First of all, some of the private commitments are made months or years in advance, so that money is going where it is going, but we believe the public markets are becoming a beneficiary just due to ease of execution and that you can get yields that you could not have dreamed of, even four months ago. However, I do not think it changes any of the discussion that we have had around the secular trends of public to private, this is just the short-term where do you put the next dollar – and insurance companies think of things in terms of decades instead of where do I go for the next month or so with my dollar.

So it has been very interesting outside of purely the life insurance market. We have seen companies that historically were total return oriented that have really changed their tune and have been thinking a little bit more on book yield orientation or buy and hold, because any relative value trades could result in a realized loss through the P&L.

Nakul Nayyar: One other element of this conversation is related to the competition. Whether it's in participating whole life or spread based product, you compete on dividend levels or pricing which is ultimately a reflection of your portfolio spread. So, when you look at asset allocation it also matters to a degree what your competition is doing.

Sean Collins: That is a great point, that comes down to how do you fill the gaps in your portfolio to make up a few basis points of competition? You are talking about very small margin for error here in these products. So, in the private credit markets, you are thinking about something like esoteric ABS. You are using these products to fill that gap to get that extra couple of basis points. And then it comes down to does your manager have the capabilities and the deep expertise in some of these asset classes, particularly some of the asset classes that are new without a lot of history through multiple downturns.

You can get a huge advantage if you have a manager that really understands the market, and has a large platform from which they can go out and source deals. If you are competing over basis points, you need to be able to get significant deal flow. One-off deals are not really going to help you compete on those products. You need volume.

Dmitry Baron: Since we are still in the early build up of our private structured group for us volatility represents an opportunity. There are some deals which are getting pulled from the market but also some deals getting priced more attractively, so, overall, we are seeing yield pick up versus publics compared to just five months ago. Obviously, on a net basis with inflation it still does not look as attractive but still better than publics in our view. And also – talking about uncertainty of the future – private ABS market provides good diversification. Some deals like, let us say, music or film royalties are kind of recession-proof, because people do listen to music in good and bad times. If a deal is well structured this provides additional protection versus downside.

Mary Beth Cadle: Have any of you thought about investing in real assets in the context of inflation? I am starting to hear initial conversations that investing in real assets, such as timber, could offer protection. Perhaps real asset financing could be another way to bring further issuance into the private market?

Chris Gudmastad: Honestly, I have not heard that but where you could tie the private fixed income market with inflation is in some of the infrastructure investments that have revenue tied to CPI, where you can seek to minimize risk.

Going back to your comment, Nakul, on the yields, do you think that is driving the interest with smaller insurers just re-insuring portions of the portfolio to the competition?

Nakul Nayyar: Re-insurance is an interesting development. There are lots of reasons why reinsurers are becoming a bigger part of the marketplace. Many insurers have legacy liabilities written decades ago utilizing assumptions that may have been too optimistic and need to deal with these. Insurers are looking at their balance sheet, at their capital usage, and saying is this optimal? Do I want to have this balance sheet volatility? Reinsurers can provide solutions. They can leverage greater risk appetite or other capital optimization strategies and can price those solutions where it makes sense to the insurance companies.

Chris Gudmastad: We believe the investor landscape is certainly changing given the involvement of reinsurance and maybe for some smaller and medium-size insurers you could potentially see lower levels of assets over time managed in-house. From Loomis Sayles' perspective, as we build out our platform, as a firm that has the breadth across the structured asset class where we can leverage a structured team, our credit research team, and our emerging markets team, that should help us in terms of participating on the reinsurance side and improve portfolio yield potential.

Sean Collins: You are going to continue to see the reinsurers participate because large traditional insurers want to clean up their liabilities from products underwritten 10 or 15 years ago and focus on their core competencies. So, you may have liabilities that do not fit your overall business strategy now – and reinsurers play a role in helping insurers clean that up. That is a natural fit to the ecosystem and we will probably continue to see that happen.

Chris Gudmastad: What are the core companies?

Sean Collins: We had very big variable annuity book with a lot of interest rate sensitivity. We decided to reduce some of our interest rate and market sensitivity, and reinsure some of our legacy variable annuities business — that happened this year. We just did a large deal. That has been a theme in the insurance space where there are these large blocks of business going to reinsurers to help insurers refocus their business mix.

Nakul Nayyar: There is likely bifurcation when talking about reinsurance. The large institutions may be looking for reinsurance from a balance sheet optimization lens. However, from a mid-sized to small insurer it can offer an opportunity to essentially outsource the portfolio and leave the company to focus on core competencies like sales or distribution. Do they build an internal investment team, do they have the talent, the resources, the capital? What is the cost compared to an external manager? And so, a lot of insurers are asking themselves those questions.

Colin Dowdall: One of the things with that, that is interesting, as you look under the hood of the reinsurance companies, is the underinvestment in technology and data. The costs are high to be at the cutting edge and we believe scale is critical to be able to keep up with that. We have seen it as an interesting opportunity share our proprietary technology with insurance companies. But my sense is you are going to see this convergence of asset management and technology and the bar continues to get higher each day to be successful with that, as you think of risk analytics and making sure you understand what is under the hood within your portfolio.

Chris Gudmastad: I absolutely agree. If you look at the increased complexity that has come to our market like in the case private ABS. These are assets that are harder to source and originate. They are also more difficult to structure in our view. You need special skills to do that. And then on the operational side they can be more difficult to manage operationally as well.

As I see the market evolving, we will likely see more floating-rate investments and potentially more complicated transactions that involve revolvers or involve multiple fundings, which is typically more complex. That is going to be more difficult for insurers that do not have access to strong technology or operations to invest in those asset classes.

Andrew Hanson: That is driving consolidation on the buy side.

Colin Dowdall: On both sides, insurers and asset managers. The bar continues to get higher and higher, specifically around technology.

Sean Collins: If you are an asset manager you are going to think 'is there a way to bring some of these technology capabilities in-house, rather than trying to build them from scratch?'. Insurance can be seen as a sleepy industry to some extent historically, so, do you have the ability and culture to make those changes in-house? I do not know the answer, but I think that is a question that is certainly in the market.

Dmitry Baron: Technology definitely is a low-hanging fruit I believe and fixed income in general, insurance in particular, is so much behind the curve in terms of technology. And there are so many different opportunities, not just in the back office, not just in middle office, front office should be moving away from the Excel spreadsheets into more sophisticated tools. Right now, we have many analysts scrubbing through indentures, 10-Ks, 10-Qs. It takes technology seconds to come up with an analysis of what is important for you, and analysts can spend time thinking about the direction the company is going, the portfolio construction, things like that, rather than spending days reading through the hundreds of pages of sometimes not very useful text. So solutions are out there, just the insurance world is not using it as much as it could for now. However, I think it is going to change.

PART III: Opportunities going forward

Vincent Huck: Let us talk about opportunities going forward and where you see the market going. Chris, what are the emerging areas or opportunities in private placement?

Chris Gudmastad: Going back to Andrew's earlier comments on what fueled growth the past decade, it was project finance and recently private ABS, specialty finance and esoteric even more recently. As I look forward, I believe there are a couple of important changes. One, is regulatory and capital changes, where there is less of a cliff for life insurance companies in the US going from BBB to BB. For well-capitalized insurance companies, you will see more interest investing in BB potentially in this space. We are seeing that the quality continuum is getting filled in.

Number two, I have been talking to individuals like Andrew and other bankers about what is the next, let us call it private ABS. Esoteric private ABS may have some time to grow and mature. The next private ABS, if you will, are likely new geographies that you did not typically historically see in the private placement or private equity asset class. I am thinking more frontier and emerging markets and investments that are structured appropriately for the risk. The logical place to start is project finance and infrastructure.

Mary Beth Cadle: What we are hearing about is LATAM, specifically for infrastructure project finance.

Historically, certain geographical regions did not meet our requirements. But some of those countries now seeking capital have stabilized politically, demonstrated strong economic growth and legal protections for creditors have improved. There is a need for infrastructure, and we prefer that sector which has strong government interest. At this point, infra is a more natural place for us to invest than, for instance, a domestic REIT where our knowledge base is more limited.

Nakul Nayyar: What is your historical experience generally in that area in terms of credit performance?

Chris Gudmastad: It really differs by country. Like look at Chile vs Argentina, for example. If you look at investors in the private markets, the natural place to start is Mexico first. Chile and Mexico are generally creditor friendly jurisdictions. Or it is going to be a transaction that is infrastructure-related, or it might be a multinational where jurisdiction may be less important and you are confident that you will not going to have to go through the courts.

From my standpoint, working for multiple insurance companies, there is really no interest in going outside Europe, US, Canada. However, as I look at more sophisticated investors coming into the marketplace, that have an emerging markets team, they can provide the expertise to help underwrite those transactions.

Mary Beth Cadle: And that is what Nationwide Insurance is doing. Over the last 3-4 years, we built a sovereign desk that is

investing in emerging markets. We then leverage their country expertise combined with the privates' ability to underwrite the project itself. We couldn't invest in non-traditional jurisdictions without the collaboration.

Sean Collins: We have talked about complexity premium for ABS. There has got to be a complexity premium for going into some of these markets that are maybe less credit-friendly or maybe more uncertain – and if you have expertise in those areas, you can take advantage of that complexity.

Chris Gudmastad: Yes, generally you are getting paid in part because there is a lack investor of demand, so there is a supply-demand imbalance, and that is typically how a new asset class starts within private fixed income. There is an opportunity to generate alpha, at least early on, if you are one of the first investors coming in to, let say, private ABS, and you have that capability.

Same with REITs. There was a time with REITs – it is hard to believe – but the private placement market was not really open to REITs shortly after the crisis. And there was a time where the illiquidity premium on REITs was dramatic and we believe that is now starting to come in.

Mary Beth Cadle: I think you could say the same with the asset manager sector. Because not everyone was comfortable investing in that space, deals were smaller and spreads wider. We still like investing in asset managers but spread compression has definitely occurred over the last year.

Chris Gudmastad: I remember doing one of the first unsecured BDCs (Business Development Companies) post-crisis, and we were probably one of two investors in that transaction, and that is probably five or six years ago. Now, you have 20-plus investors investing in BDCs.

Andrew Hanson: I look back more than a decade ago, where it was not unusual for a private placement insurance investor to say they do not invest in other financial institutions (as well as a few other industries like technology, tobacco, etc). But how has the world changed. Today, if you combine REITs and all financial institutions, it is nearly half of our market. So that has been a huge boom for the issuance statistics – that willingness on the buy side to entertain these new credits.

Public markets think of financial institutions mainly as banks. However, in private placements we see traditional asset managers, alternative asset managers, BDCs, closed end funds, private credit funds, finance companies, leasing companies, brokers, and community banks. It is so broad, which has been great for our marketplace. Some of the buy-side is a little concerned that we are doing a lot in this sector, but our market shifts where the opportunity is, and it does add some new diversification to investment portfolios.

Mary Beth Cadle: In many ways, the asset managers and BDCs, are a diversifier to the availability of banks in the public markets. While issuance has been high, if one looks at a broader corporate credit book, the percentage of total exposure to asset managers and BDCs is less meaningful. Of course, in a downturn, should one be working on stressed credits, the combined book doesn't feel quite so comfortable as in a more benign environment.

Chris Gudmastad: I think you also need to look across alternatives too, because a lot of these assets are typically correlated.

Colin Dowdall: The banks have retrenched to create this opportunity, and we call this large swath of the market fixed income placement, and we believe the next natural place to look for supply – given new entrants, you see asset managers, private equity-backed insurers entering the market, as well as existing participants, is, frankly, taking issuance from the public bond market. It is very logical that you have a significant amount of issuance in that space, and you have ease of execution in the private market, which is potentially more cost effective and easier to match up buyers or investors with issuers. However, even prior to COVID, you were starting to see some large issuers coming to the private market that just were bypassing the public market. That is, frankly, why we are here, as Loomis Sayles approximately $300 billion manager of credit, we believe it is critically important to look at the credit as this continuum because that represents the evolution.

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