EXPERT Q&A

A broader opportunity set and higher yields are attracting a wider range of investors to private investment grade credit, says Jim Moore, head of private placements at Barings



What's driving the growth of private investment grade credit?

Q How do you define the private investment grade (IG) credit opportunity?

The core private IG verticals are corporate private placements, infrastructure debt, fund finance and consumer and commercial asset finance. These verticals have different duration profiles, collateral structures and risk characteristics, ranging from traditional corporate credit to more asset-specific forms of lending.

Insurance investors may also include IG-adjacent asset classes such as residential whole loans and commercial real estate debt, which receive similar regulatory capital treatment as comparable rated private investment grade credit.

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Q Private IG has been around for a long time, so why is it grabbing headlines today?

Private IG has been an important component of insurance investors' portfolios for decades, given its ability to generate excess spread over comparable public credit in a capital efficient way. Prior to 2015, the private IG market was dominated by corporate private placements with a limited number of structured deals, which today we'd label as infrastructure, fund finance or private asset-based finance (ABF) transactions. The market was largely driven by life insurance, with dealflow sourced by in-house expertise or affiliated managers. As a result, private IG often ended up overshadowed by higher-profile (and higher-returning) areas of private markets, such as direct lending and private equity. Today, that dynamic has shifted.

Private IG's growing profile reflects the convergence of three key developments. The first is a significant expansion of the opportunity set. Infrastructure debt, fund finance and asset-based finance are not new markets, but each has ballooned in size over the past decade. Increased privatisation and sponsor ownership

of infrastructure assets, overall alternative fundraising, and the financing gap opportunity created for non-bank lenders amid bank retrenchment in certain segments of ABF have served as tailwinds to growth. This expansion has given investors access to a broader opportunity set beyond traditional corporate risk, as well as potential spread premiums.

When private IG consisted primarily of corporate private placements, its value proposition was generally around 50-100 basis points over comparable public IG fixed income. The addition of more specialised verticals has expanded that range, with some opportunities offering spreads up to 250bps or more.

The second development has been the increase in base rates. Combined with the broader opportunity set, higher rates have resulted in potential private IG yields of 6-8 percent. This has attracted interest from pension funds and other non-insurance investors seeking a complement to their public IG allocations.

The third theme is the rapid growth in the annuities market and pension risk transfer transactions. The insurance market has seen significant M&A activity between alternative managers and insurance companies in recent years, and as base rates popped higher in 2022-23, growth in these products exploded, as did the need for private IG raw material assets.

Q What is the appeal for prospective borrowers?

Public markets are highly efficient for borrowers that check all the boxes in terms of issuance, size, ratings, disclosure and structure. For those borrowers, public bonds are typically the most attractive source of financing in normalised credit markets.

However, many borrowers do not fit neatly within those parameters. They may not meet size benchmarks, or they may only have one rating (or a private rating), or require delayed funding or a more bespoke structure. Sponsor-owned companies may also prefer terms that are difficult to achieve through a standard public market transaction. In these situations, private markets can provide greater flexibility and certainty of execution.

We've recently seen borrowers in capital-intensive sectors such as digital infrastructure or certain parts of consumer and commercial asset finance increasingly use multiple public and private financing channels to diversify funding sources, given large capital requirements.

Q How are investors using private IG to solve for different outcomes and what are the challenges they face?

The role of private IG varies by investor type. For insurance companies and pension investors primarily focused on asset-liability matching, private IG offers an efficient matching menu for liability profiles, given the breadth of products and typical call protection.

For example, private ABF and fund finance align well with shorter-duration liability products such as annuities, while corporate private placements and infrastructure debt can provide intermediate or longer-duration cashflows, allowing investors to create stronger hedging and better duration matching.

For many corporate pension plans that have seen considerable improvement in their funded status, we have seen a willingness to consider less liquid, long-term assets that match their duration profile but do not introduce unnecessary risk into the portfolio.

For public pensions with public core or core-plus fixed income allocations, private IG can provide an alternative source of 'up-credit' excess return. In a traditional public core-plus allocation, the 'plus' typically comes from some element of securitised product, high yield or emerging market debt exposure.

With private IG now offering 6-8 percent yields, these investors are positioned to achieve additional yield and diversification across asset and credit risk profiles, while maintaining an IG credit rating.

The two main challenges, which are really considerations, are investors' appetite for illiquidity and need for deployment. Investors have to decide whether amortising private IG assets – such as private ABF or infrastructure – can provide enough liquidity, or whether there are other areas within the broader portfolio that provide the liquidity they require.

A challenge unique to insurers, and annuity providers in particular, is maintaining a consistent origination pipeline, which is essential to manufacturing and selling products.

Q For investors looking to invest in private IG, what manager capabilities are most important to consider?

Private IG is not a homogeneous market. It consists of a core set of highly specialised verticals with different collateral, structures and risk characteristics. It's important that investors understand the breadth and experience of a manager's platform.

Track record, and experience through multiple market cycles, is a key consideration. Private IG is typically focused more on capital preservation and consistent income than on achieving outsized returns, making underwriting discipline and downside management particularly important.

Origination is also important. Investors should really peel back the onion to evaluate whether a manager can consistently source differentiated assets beyond those available in broadly syndicated or large club markets.

Finally, it's important for investors to consider a manager's breadth. Having capabilities across a broad menu of specialised private IG verticals provides an important relative value lens across a wider opportunity set, and best positions a manager to tailor solutions to meet clients' varying objectives. ■