A Guide to Investment Grade Private Credit

With attractive yields, robust covenant protection, and a surprising amount of liquidity, investment grade private credit is a growing favorite of both investors and borrowers.

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VOYA INVESTMENT MANAGEMENT

Executive summary

Insurance companies, pension funds and other large institutional investors allocate a sizable portion of their total assets to fixed income due to its consistent income and lower volatility than equity. These investors seek assets that provide both long duration and potentially lower losses than other investment choices. Investment grade private credit offers a natural fit to these objectives and, as the #1 private placement manager for external clients in this fast-growing asset class, Voya is highly experienced in helping new clients navigate it successfully.[1] This paper offers an introduction to investment grade private credit; explains its nature, characteristics and distinctions; and explores some of its advantages and risks.

Average deal size
$300 mn

Average # of deal participants
12

Weighted average life
7–10 years

Maturity range
5–30 years

Weighted average quality
BBB+

As of 09/30/2023. Source: Voya IM, Bank of America.

The market

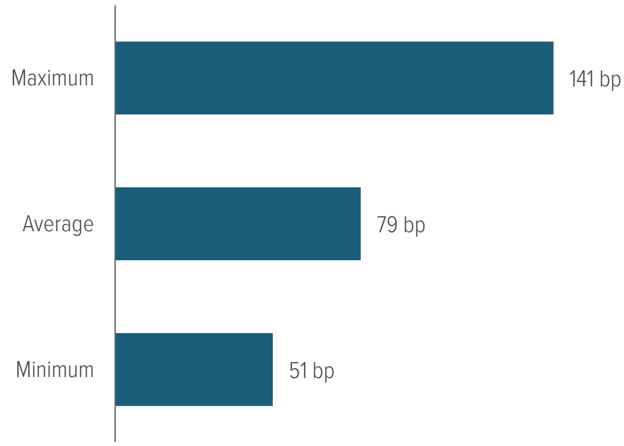
- Although private credit is often associated with below investment grade offerings due to its role as a funding source for mid-sized companies, Voya estimates that **90% of private placements are investment grade.**[2]
- Investment grade private credit is a **$1 trillion market** with issuance of $100-110 billion per year.[3]
- **The average deal is $300 million in size,** is offered and priced by intermediaries, and has 12 participants.[4] Direct deals are rare due to the large transaction sizes involved.
- Borrowers utilize the private placement market due to needs for **greater flexibility, complexity, and/or confidentiality** than the public market allows, or so large non-U.S. companies can raise money without SEC registration.
- The market's **move to daily pricing** is likely to enhance available portfolio data and enlarge its pool of potential investors.

Investment factors

- Investment grade private credit trades at a long-term historical average **40–50 basis point yield premium** to equivalent public bonds, although top-tier investors such as Voya have consistently been able to achieve higher premiums.[5]
- Compared with equivalent public bonds, investment grade private credit offers **far more comprehensive covenants** and capital protection.
- As an asset class, **investment grade private credit exists outside the efficient frontier,** historically delivering higher yields and lower actual credit losses, resulting in higher absolute and risk-adjusted returns compared with public corporate bonds of similar credit quality and duration.[6]
- While purchasing liquidity is tight due to the asset class being in high demand, limiting trading in and out of different sectors, there is **an active, liquid secondary market** to sell out of positions.

[1] Clearwater Analytics, Annual Insurance Investment Outsourcing Report 2023, released 09/2023.
[2] Voya IM estimates, based on Regulation D filings.
[3] Voya IM estimates, based on Regulation D filings and Bank of America U.S. Private Placement Market Snapshot.
[4] Bank of America U.S Private Placement Market Snapshot.
[5] See Exhibit 1.
[6] Ibid; also Society of Actuaries, 2003-2015 Credit Risk Loss Experience Study: Private Placement Bonds, released 04/2019.

Exhibit 1: Since 2001, Voya's private credit team has averaged a 79 bp premium to equivalent public bonds



As of 09/30/23. Source: Voya IM, Bloomberg. Spread is measured against a broker-guided/Voya-recommended basket of investment-grade public bonds that are equivalent in rating, maturity, sector, and other specifics to each private transaction. Premiums are determined from Voya's combined private credit investment pool, both general account and third-party strategies.

What is investment grade private credit?

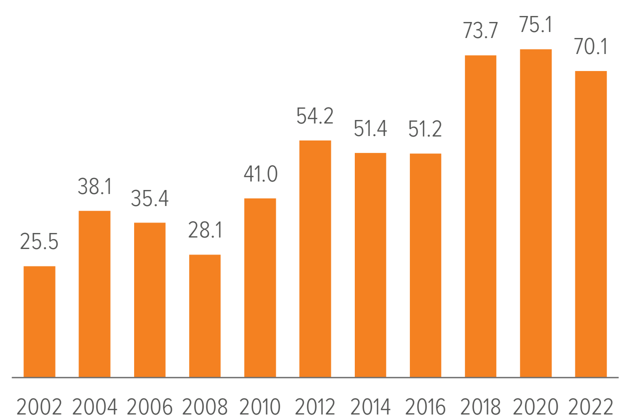
There are several types of private credit, including private placements, senior loans, distressed debt and mezzanine finance. Our focus here is on private placements, which are essentially long-term loans to corporations, 90% of which are investment grade.[7] Functionally, private placements are a hybrid of a public bond and a traditional bank loan. They share characteristics with public bonds, including a fixed rate structure and term length. Similarities with bank loans include greater upfront due diligence, priority debt and financial covenant protection, and a more engaged relationship with borrowers.

These debt offerings are private because the notes are sold only to qualified institutional buyers (QIBs[8]) and, as such, do not have to be registered with the U.S. Securities and Exchange Commission (SEC). For purposes of this paper, the terms "private credit" and "private placements" refer to Regulation D securities[9] and do not include securities issued under Rule 144A.[10]

At over $1 trillion, the aggregate market for private placements is significantly smaller than the U.S. public corporate bond market.[11] The total market volume continues to grow, and, unlike below investment grade private credit, the majority of deals (85%) are marketed by intermediaries to either the entire market or a subset of the market. Only 10-15% of deal volume in the investment grade private credit market is direct, as few investors have the scale to commit to direct transactions when the average deal size is in the hundreds of millions.[12]

Prior to 2000, the vast majority of investments were in small transactions of less than $100 million. Since 2000, deal amounts have approximately tripled, with most now averaging about $300 million. In 2017 and 2018, the investment grade private credit markets saw record levels of issuance. Demand ticked up in 2019 for technical reasons, then advanced in 2022 with more than $80 billion of private placement issuance.[13]

Exhibit 2: Agented issuance of investment grade private credit has tripled in the past 20 years



As of 09/30/23. Source: Bank of America U.S. Private Placement Market Snapshot.

[7] Voya IM estimates, based on Regulation D filings.

[8] Qualified institutional buyers are large institutional investors, e.g., insurance companies with at least $100 million of investable assets.

[9] The Securities Act of 1933 ("Securities Act") requires that all securities must be registered with the SEC unless covered by an exemption to Regulation D. The exemptions allow issuers to borrow an unlimited amount of debt without registration. Generally, in these types of transactions, issuers provide audited financial statements, are responsive to potential investors' questions, and restrict trading the offerings to "accredited investors" as defined under Reg D. The investors directly negotiate the terms of the transaction with the issuer.

[10] Rule 144A securities are also sold to QIBs and are exempt from registration under the Securities Act. But unlike traditional Reg D securities, there is less access to information, less time to review the transaction, and less opportunity to influence term.

[11] Voya IM estimates, based on Bank of America private placement data plus Regulation D filings.

[12] Deal type percentages: Voya IM estimates, based on Bank of America private placement data plus public and private communications from major investment grade private credit direct investors.

[13] Voya IM; Bank of America U.S. Private Placement Market Snapshot reports.

How do private placements differ from public bonds?

Exhibit 3: Investment grade private credit offers more flexible tenor and higher protection than public bonds

	Investment grade private credit	Investment grade public bonds
Income	Fixed	Fixed
Security	Secured/Unsecured	Unsecured
Ranking	Senior and cannot be subordinated	Can be subordinated
Covenants	Maintenance/comprehensive	None
Prepayment	Callable with Treasury +50 basis points make whole premium	Some callable at par
Tenor	Flexible 2–30 years	3, 5, 7, 10, 20 and 30 yrs
Liquidity	Actively traded private market	Actively traded public market
Recoveries	91%*	47%

As of 06/30/23. Source: Moody's Default Trends and Rating Transitions report. The investment grade public bond recovery rate is measured by the ultimate recovery, the long-term average recovery rate from 1987 through 2020. Investment grade private credit recovery rate is based on Voya Private Credit Strategy.

Private placements are debt offerings issued by a corporate borrower and are similar to public bonds. In both asset classes, companies pay a fixed rate of interest over a set period of time.

However, privates may achieve additional yield and total return compared to corporate public bonds of similar credit quality and duration due to higher up-front yields, prepayment and amendment/waiver fees, and lower actual credit losses in the event of default. Historically, investment-grade private placements have offered a spread premium to similarly-rated public corporate bonds.

Spread

The interest rate on a private placement is expressed as a nominal spread over a base rate, namely, the comparable maturity U.S. Treasury. Borrowers choose a wide variety of maturities, including five, seven, ten, 12, 15 and 30 years. Borrowers sometimes will also offer unique maturities (e.g., 22 years or amortizing schedules) depending on their borrowing needs.

The nominal spread is the amount of interest that a borrower will pay in addition to the base rate. This spread is typically a fixed amount, and it is expressed in basis points. The spread differs across industries depending on the creditworthiness of the particular borrower.

To understand the interest rate locked in by a borrower on a private placement, if the ten-year U.S. Treasury was currently at 1.50%, a borrower whose spread was 200 bp above the ten-year rate would pay interest at a rate of 3.50%. The spread is higher than a similarly-rated public bond due to an illiquidity premium. Top-tier investors such as Voya generally achieve a higher average spread to publics than the overall market (Exhibit 1).

We measure our spreads via reference to a basket of individual public bonds of equivalent term, credit rating, and sector, as we consider this more accurate. It also reflects the matrix pricing methodology most commonly used to price new investment grade private placements. However, this method tends to slightly subdue yield spreads compared to the simpler option of calculating them against an index. For example, over the past five years, Voya averaged a 92 bp spread over equivalent public bonds, but it inflates to 110 bp when measured against the Bloomberg Barclays U.S. Corporate Bond Index.[14]

Tenor

Issuers in the private placement market typically issue notes with maturities between three and thirty years; the most common maturities are seven, ten and twelve years. Historically, the attainable spread to public bonds is higher in the shorter tranches due to 1) demand for longer-duration product from many investors and 2) the lower absolute level of interest rates. Private investors have held to minimum yield hurdles more stringently than their public counterparts.

[14] Voya Private Credit Strategy and General Account total production, spread against selected public bonds of equivalent term, sector, and credit rating, 01/01/2003–09/30/2023.

Contractual protections

Private placements are made under the terms of a written contract—the note purchase agreement—which sets the interest rate to be paid by the borrower. It also sets limitations on a borrower's business operations designed to enhance the probability that the lenders will be repaid. Such limitations, called covenants, are designed to monitor the financial health of a borrower and limit the ability of the borrower to incur additional debt.

If the borrower violates these restrictions, the note purchase agreement gives lenders an option to take certain actions against the borrower, ranging from increasing the interest rate on the note to calling the notes and requiring the immediate repayment in full.

Covenants

Covenants are unique to each transaction, can vary widely depending on circumstances and are virtually nonexistent among investment grade public bonds. The covenants are designed to maintain *pari passu* (or equal) treatment with other senior creditors, and to force prepayment while the credit is still financeable by its banks or other lenders. When an exit is not possible, terms can be renegotiated to improve recovery rates if payment default ultimately occurs, or to increase the yield via fees and coupon rate increases.

Generally, there are three types of covenants:

1. Those that protect the note holder's position in the capital structure
2. Those that protect against credit deterioration, and
3. Those that protect against "event risk," such as the company favoring equity holders over creditors.

Private placements are callable at any time; however, the call is at a "make-whole" price. While technically complex, the make-whole concept allows the investor to maintain the initial yield of the investment over the remaining term, regardless of whether interest rates have increased or decreased since funding. Hence, while privates are fully callable, they are not negatively convex.

We estimate the long-term excess value of covenants to be approximately 36 bp versus non-covenanted public bonds. Value comes from amendment and waiver fees, pre-payment fees, and coupon increases (25 bp) and lower losses in the event of default (11 bp).

Prepayment

The standard provision in the U.S. private placement market is that notes are callable at the greater of the "make-whole" premium or par. The make-whole premium is calculated as the value of the notes being prepaid discounted at a rate equal to the sum of (a) the current rate of the U.S. Treasury with the same average life as the notes and (b) 50 bp. This formulation protects the note holders during times of declining interest rates.

In theory, the note holder can take the returned principal, interest and make-whole premium and invest it in a security with the same average life as the prepaid notes, yielding U.S. Treasuries plus 50 bp and remain "whole" with respect to the original yield on the investment. In rising interest rate conditions, note holders can "sell" the notes at par, which still provides a premium, because the bond is worth less in the higher interest rate environment, and then reinvest at higher yields. Private placement notes are callable at any time, but because of the make-whole provision they are not negatively convex. Make-whole fees as a percentage of the total portfolio will vary, because companies may choose to prepay loans on an ad hoc basis.

Recoveries

The private credit asset class has an inherent advantage over public bonds due to its negotiated covenant structures that are tailored to each credit. Private placements generally are *pari passu* with bank loans and ahead of unsecured bondholders. As a result, if a company becomes distressed and falls into bankruptcy, private placements are in line to be repaid with the banks and typically get paid back before public bondholders, preferred shareholders or holders of a company's equity. This has led to significantly higher recoveries on defaulted private placements in comparison to recoveries on defaulted public bonds. From 2003 to 2022 at Voya, private placements demonstrated a recovery rate of about 91% compared to unsecured public bonds, which have historically recovered approximately 46% (see Exhibit 3). This compares to industry average recovery rates of 63.4% for investment-grade private credit as a whole, according to a 2019 Society of Actuaries study.[15]

[15] The investment grade public bond recovery rate is measured by the ultimate recovery, the long-term average recovery rate from 1987 through 2020, from Moody's Default Trends and Rating Transition reports. Investment grade private credit recovery rate is based on Voya Private Credit Strategy. Private placement market recovery rate, Society of Actuaries, 2003-2015 Credit Risk Loss Experience Study: Private Placement Bonds, 04/01/2019.

Exhibit 4: Investment grade private credit carries an extensive array of protective covenants

Covenant types	Private credit covenants	Protects	Examples	Likelihood in a deal
Capital structure protection	**Liens**	Restricts future borrowing with assets and preserves location in the capital structure.	Permitted liens defined.	Frequent–nearly always present but dependent upon industry
	Priority debt	This limits all types of claims that can rank ahead of the private credit holders. These types of claims generally include liens and debt at subsidiaries.	Basket = 5% total assets	Frequent–nearly always present but dependent upon industry
	Sale of assets	This type of covenants limits the ability of the company to sell revenue-generating assets. Generally, there is a level of asset sales permitted, after which, the company must use proceeds for replacement assets or to pay down debt.	Basket = net book value of dispositions <15% total assets	Frequent–nearly always present but dependent upon industry
	Most favored lender	This type of covenant assures that if the company's main bank facility gets a different or more favorable covenant, the private credit lenders will receive the benefit of that as well.	MFL	Semi-frequent–present depending upon the industry
Financial	**Leverage or DSCR test**	Ensures repayment of debt relative to cash flows of the Company.	Debt/EBITDA < 3.5x Debt service coverage ratio (DSCR) > 1.5x	Frequent–nearly always present but dependent upon industry
	Interest/ fixed coverage	Ensures limitation of interest relative to cash flows of the Company.	EBITDA/Net finance charges ≥ 4x	Frequent–nearly always present but dependent upon industry
	Net worth	Ensures repayment of debt relative to value of the Company	Net worth > $1 billion	Semi-frequent–present depending upon the industry
Event risk	**Merger**	This type of covenant limits the types of mergers and restructuring transactions that the company may undertake.	Certain restrictions on company, parent guarantor and subsidiary guarantor mergers.	Frequent—nearly always present but dependent upon industry
	Restrictions on distributions	This type of covenant will limit the distributions the company may make to its shareholders.	Distributions limited if DSCR < 1.3x or upon an event of default	Less frequent–present typically in tighter credit markets
	Change of control	This type of covenant generally states that if a third party purchases a majority of the equity of the issuer, the lenders will be able to exit the transaction.	Offer to prepay at par upon change of control	Frequent–nearly always present but dependent upon industry
	Non-payment cross default or acceleration	This provision provides that if the company does not pay another source of debt or is in default with another source of debt, our facility will also be in default.	Cross-default for non-payment defaults	Frequent–nearly always present but dependent upon industry

As of 09/30/2023. Source: Voya IM.

Characteristics of borrowers

Borrowers are willing to pay more to issue private debt for a variety of reasons: to maintain confidentiality of their financials, to obtain more flexible funding and maturity tenors than offered by the public market, or to borrow money when their credit histories are more complex in nature. Also, many non-U.S. issuers tend to be larger-capitalized firms, which may or may not be rated and do not want to undergo SEC registration.

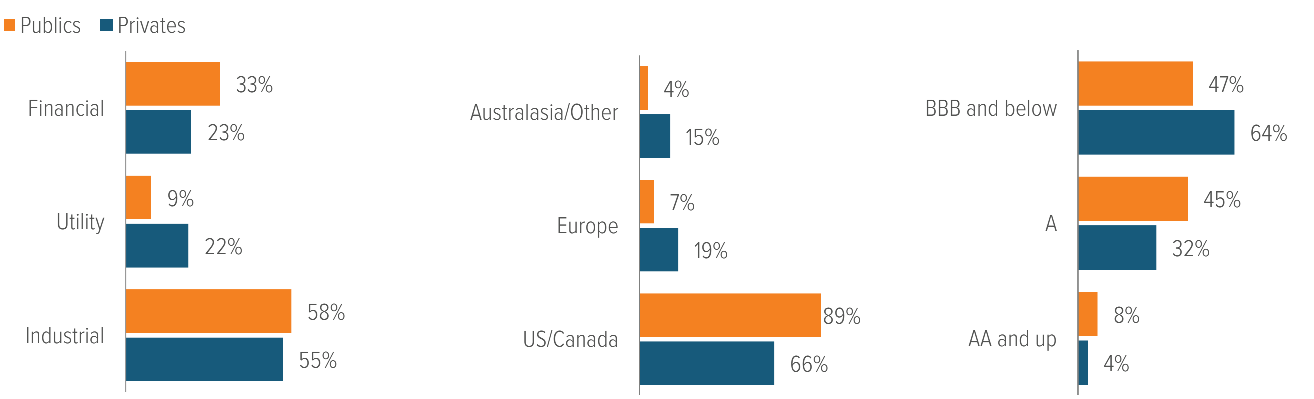
Customization is a key appeal of the private credit market. For example, privately-issued investment-grade debt has a variety of unique characteristics that are valuable to issuers, including tenures not issued in the public market (e.g., 12 or 15 year), customization of tranche sizes (e.g., $120 million, $50 million, and $100 million issued in different tranches), amortizing bonds, floating-rate notes, delay draws, non-USD swapped offerings, etc.

At 5–30 years, investment grade private credit deals are typically longer than bank loans, but require similar structural protections in order to stay pari passu. Covenants can provide non-coupon income and are crucial to avoiding and minimizing loss when defaults do occur. Broadly speaking, the covenants provide the lender with the ability to re-price or put back the loan to the company if risk in the company changes substantially.

The average size of a private placement issue is approximately $300 million, but it can range from $50 million to $3 billion.[16] The private placement space is diversified across industries and geographies. While private placements are available in all rating categories, the majority of issuance is done by borrowers with credit quality between A- and BBB-.[17] The size of the borrowers varies, with revenue of issuing companies generally ranging from $250 million to over $10 billion. Borrowers use the proceeds to finance acquisitions, refinance existing debt, support business expansions and other general business purposes.

Exhibit 5: Investment-grade private credit skews more towards utilities and non-U.S. borrowers

Private placement market



As of 09/30/2023. Source: Voya IM; Bank of America. Quality distribution is the GAAP book value of the U.S. general account and third-party clients. Public is based on the Bloomberg Barclays U.S. Corporate Bond Index; Privates represents Voya Private Credit portfolio.

Deal sourcing and deal types

Often, the breakdown in terms of investment grade private credit deal sourcing is described as agented vs. direct, but Voya identifies four distinct types of investment grade private credit deals from a sourcing perspective: Fully Distributed Agented, Limited Distribution Agented, Direct, and Club. There are significant trade-offs to investors in each of the four classifications (Exhibit 6).

A **fully distributed agented deal** is a transaction sourced by an intermediary that is marketed to all participants in the private credit market. Such deals comprise about 50% of all investment grade transactions. Fully distributed agented deals are the most liquid, but the overall percentage allocations to individual investors are smaller since more investors participate.

[16] Voya IM estimates; Bank of America U.S. Private Placement Market Snapshot reports, and industry newsletters and press releases. The largest deal announced to date is a $3bn Vanguard placement in August 2020.

[17] Bank of America U.S. Private Placement Market Snapshot reports.

A **limited distribution agented deal** is sourced by an intermediary but marketed to only a subset of participants in the market (typically 10-15 investors). These deals make up about another 35% of the market.

Club deals are sourced by a handful (typically 3-5 investors) of the largest market participants and comprise about 5% of the market. Participants are limited to Tier 1 investors such as Voya. A good example of this deal type is a recent $100 million transaction sourced by Voya where we brought three other investors into the transaction.

Direct deals are sourced and funded by a single private investor and make up about 10% of the market. For both club and direct deals, there is no direct fee paid to an intermediary; however, it is Voya's experience that an agent is contacted to verify pricing and terms relative to market. The agent may then be compensated for this service indirectly (e.g., awarded the swap that the borrower uses to convert loan proceeds to a needed currency).

The IG private credit market has a completely different dynamic than below investment grade (BIG) private credit: the structure, pricing, and liquidity in agented distribution is the same or better than direct deal flow. In addition, the IG private credit market consists of larger issuers than those found in BIG private credit, with revenue of IG private credit issuing companies generally ranging from $250 million to over $10 billion. The average size of a private placement issue is approximately $300 million, but it can range from $50 million in direct transactions to $3 billion in fully distributed deals.[18]

Exhibit 6: 85% of the investment grade private credit market is agented deals

	Agented deals		Direct or proprietary deals	
	Fully distributed agent deals	Limited distribution agent deals	Club deals	Direct deals
Description	A transaction sourced by an intermediary that is marketed to all participants in the private credit market.	A transaction sourced by an intermediary that is marketed to a subset of participants in the private credit market.	Sourced by one or more private investors and participated in by only a handful of market participants. Limited to Tier 1 investors.	Sourced and funded by a single private investor.
Market Size (%)	50% of Investment Grade Production	35% of Investment Grade Production	5% of Investment Grade Production	10% of Investment Grade Production
Agent Involvement	Direct fee for transaction	Direct fee for transaction	No direct fee for transaction; however, it is Voya's experience that an agent is contacted to verify pricing and terms relative to market. The agent is then compensated for this service indirectly (i.e. award the swap that the borrowers uses to convert loan process to needed currency).	
Allocation	Medium/Low	High	High	High
Liquidity	High	High/Medium	Medium/Low	Low

Source: Voya IM.

Rather than seeking better structure and pricing, direct investors in the investment grade market are some of the largest investors who are primarily driven to satisfy significant internal investment demand for private credit assets. Their massive internal portfolios demand a steady and large amount of private deal placements regardless of market or credit conditions.

While Voya participates in all four channels, our focus is to maximize the agented (fully distributed and limited distribution) deals, in order to achieve sufficient diversification of lenders for exit liquidity. We are active in club and direct deals, and access to these deals does increase deal flow. However, it is our experience that direct deals do not offer covenant or yield advantages over the agented deals (Exhibit 7).

Exhibit 7: Unlike middle market, investment-grade direct deals offer no yield advantages

Agented deals				
Industry	Midstream energy	Metals & mining	Oilfield services	Airlines
Rating	Voya IM: BBB- (Moody's: Baa3)	Voya IM: BBB- (Egan-Jones: BBB+)	Voya IM: BBB- (Fitch: BBB-)	Voya IM: A (class A); BBB (class B)
Size; tranches	$1,077.8mn; 11.5-year series A & series B tranches	$225mm; 7- and 10-year tranches	$122mm; 3- and 7-year tranches	$446mm; 7-year class A & class B tranches
Spread to Treasuries	230 bp; 425 bp	310 bp; 340 bp	320 bp; 360 bp	
Spread to public equivalent	56 bp; 217 bp	117 bp; 96 bp	196 bp; 169 bp	
Covenants	Change of control put at par, sale of assets limit, cross-default or cross acceleration for covenant default, debt service reserve account requirement, limit on indebtedness, restricted payments, and more.	Controls on debt/net worth, minimum net worth, a minimum current ratio, priority debt, an anti-Cookson provision, a cross default to other material financings, and a put option upon a change of control.	Interest coverage ratio test (>3.0x), total debt / distributed cash (<4.0x), minimum net worth test, and more.	Debt service coverage ratio test, overcollateralization test, look-through loan to value and concentration limits, and more.
Voya role; participants	Voya co-lead; 14 investors	Voya lead; 6 investors	Voya lead; 5 investors	Voya third largest investor; 12 investors

Direct and club deals				
Industry	Transportation services	Midstream energy	Gaming	Midstream energy
Rating	Voya IM: BBB (Fitch & DBRS: BBB)	Voya IM: BBB	Voya IM: BBB- (S&P: BBB-)	Voya IM: BBB (Fitch: BBB+)
Size; tranches	$500mn; 5-, 12-, 13-, and 15-year tranches	$100mn; 15-year tranche	$37.5mn; 7-year tranche	$89.2mn; 29.6-year final/18.1-year WAL)
Spread to Treasuries	155b bp; 195 bp; 195 bp; 200 bp	290 bp	275 bp	247 bp
Spread to public equivalent	71 bp; 80 bp; 77 bp; 76 bp	69 bp	73 bp	59 bp
Covenants	Leverage test, EBITDAR/ fixed charge coverage test, priority debt test, sale of assets test, restrictions on acquisitions, standard T+50bps call provision.	Combined net leverage test, net leverage test inclusive of off-balance-sheet guarantees, interest coverage test, sale of assets test, restricted payments test, cross-default, and a two-way MFL.	Net debt/EBITDA test of 3.75x with incremental 75 bps coupon step-up above 3.5x, EBITDA/interest test of 3.0x, net debt/cap test of 75%, sale of assets test of 15% per year with a cumulative cap of 25%, a priority debt test of 10% of tangible assets, cross default, event of default if certain casino licenses ending have a material adverse effect, coupon step-up of 125 bps if downgraded to below investment grade, an MFL, standard T+50 bps call provision.	Debt incurrence limit, change of control put at par, 6-month debt service reserve, and more.
Participants	Voya lead; 11 investors	Direct	Voya co-lead; 2 investors	Club; agented

Source: Voya IM.

The private placement investment process

Pricing in the investment grade private credit market is usually accomplished by matrix pricing against equivalent public bonds of similar term, rating, and sector.

Matrix pricing works best, of course, on private placements that fit neatly into sectors and shapes very similar to public bonds. More complex or unique investment grade private placements are still priced with reference to the nearest public bonds, but may carry more of a premium due to a lack of direct comparables. Even when third-party services are brought in to price a placement, such as when an intermediary consults on a direct deal, those third parties are themselves using matrix pricing.

Historically, nearly all participants in the investment grade private credit market mark their investments to market, re-comparing them against their matrix, on a monthly basis. This was originally driven by insurance companies' need to mark their investment grade private credit holdings (which could be thousands of CUSIPS in a single general account) to market so auditors could sign off on those values. In our experience, pricing in the investment grade private credit market is accurate, measured by the fact that investors are generally able to sell their holdings close to the price it's marked at.

The market is now in the midst of a pronounced and widespread shift to daily pricing. This is reflective of the medium-term trend of mainstreaming of investment grade private credit away from its origins as primarily an investment vehicle for large life insurance companies. Specifically, daily pricing permits greater DB and DC involvement in the market and facilitates the use of duration overlays.

When an investment bank launches a new transaction into the marketplace, it is generally reviewed by the largest participants in the market. Each investor then places a bid on the transaction. If the borrower accepts the proposed pricing and terms submitted, the investors are included in the deal. Often, investors will have comments on the legal documents or covenants, making each transaction a uniquely negotiated deal. Each Tier One investor has minimum and maximum bid sizes allocated to them based on the overall deal size; Voya Investment Management is consistently ranked in the top tier of allocations versus peers.[19]

Once the various deal points are negotiated, the investors commit (or "circle") the transaction. After that, the investors conduct further due diligence—generally an on-site visit, touring key facilities of the company and meeting the next line of operational management. In certain cases (such as repeat issuers to the private market, a directly originated deal with an existing borrower, or a project finance deal that is not yet under construction), a conference call with senior management may suffice. With a project finance deal, an analyst will make an on-site review once significant construction progress is achieved. After due diligence is completed, investors will finalize the documentation.

Due to the unique nature of the asset class, clients can invest in the market through portfolio mandates with the largest purchasers in the private placement market. These direct mandates are flexible and can be tailored to specific client needs.

Liquidity in the investment grade private credit market

There is an active secondary market for investment grade private credit. Voya estimates that 0.5% of the market's total outstanding volume, or about $4 billion, is traded in any given year. This is helped along by the fact that 85% of the market is agented deals, so there is an intermediary with knowledge of other participants who may be wanting to increase allocations.

It is worth noting that investment grade private credit is much more liquid to sell than buy due to the seemingly bottomless appetite of investors for the asset class. This means that the time to ramp up a portfolio may vary depending on the portfolio guidelines. However, sell-side liquidity is available, even in extreme markets. We estimate that two-thirds of an investment grade private credit portfolio could be sold within three weeks at less than a 10% discount during an event like the global financial crisis. This discount may even narrow over the next few years due to the market's move to daily pricing and its concomitant influx of new participants.

[18] Voya IM; Bank of America U.S. Private Placement Market Snapshot reports; industry newsletters and deal announcements.
[19] Voya IM; Crédit Agricole.

Legally, a holder can sell its position in a private placement subject to the securities laws and any contractual limitations in the relevant note purchase agreement. A majority of private placements do not have any contractual limitations on transfer; the most common limitation is to limit sale of the notes to a competitor of the issuer, which as a practical matter generally is not much of a limitation.

Conclusion

With higher returns and a lower risk profile than public fixed income equivalents, investment grade private credit has seen tremendous growth as an asset class. Private credit offers significant relative value; downside protection; and sector, country, and currency diversification benefits when paired with a portfolio of public bonds.

The last decade has seen investment grade private credit grow from its origins as a mainstay of insurance company general accounts into a broader institutional investor base; the next decade is likely to continue or even accelerate this trend due to the switch to daily pricing driving increases in both the market's available portfolio data and its number of participants.

As the largest manager of third-party insurance assets in the investment grade private credit market,[20] Voya has helped dozens of new entrants to the market build successful portfolios. Please contact our team to learn more.

[20] Clearwater Analytics, Insurance Investment Outsourcing Report 2023, released 09/2023.19.

A note about risk

Private placements are generally investment grade assets, and like all investments, there are risks associated with investing in a portfolio of private placements. Risks described below are not all-inclusive, and before making an investment in a portfolio of private placements, investors should carefully consider such an investment.

The primary risk to an investment in private placements is credit risk. Credit risk is the risk of non-payment of scheduled interest or principal payments on a debt instrument. In the event a borrower fails to pay scheduled interest or principal payments on its debt, a portfolio of private placements would experience a reduction in its income and a decline in market value.

Private placements generally involve less risk than unsecured or subordinated debt and equity instruments of the same issuer because the payment of principal and interest on private placements is a contractual obligation of the issuer that, in most instances, takes precedence over the payment of dividends, or the return of capital to the borrower's shareholders and payments to public bond holders. In the event of the bankruptcy of a borrower, a creditor could experience delays in receiving regular payments of interest and principal and may not receive the full repayment of its principal.

Portfolios of private placements are also subject to interest rate risk. One risk related to interest rates is the potential for changes in the interest rate spreads for private placements in general. To the extent that changes in market rates of interest are reflected not in a change to the base rate, the U.S. Treasury, but in a change in the spread over the base rate which is payable on loans of the type and quality in which a portfolio invests, a portfolio of private placements could also be adversely affected. This is because the value of a debt is partially a function of whether it is paying what the market perceives to be a market rate of interest, given its individual credit profile and other characteristics.

However, unlike changes in market rates of interest for which there is only a temporary lag before a portfolio reflects those changes, changes in a placement's value based on changes in the market spreads on loans may be of longer duration. If spreads rise as described above, for example, in response to deteriorating overall economic conditions and/or excess supply of new loans, the principal value of private placements may decrease in response. On the other hand, if market spreads fall, the value of private placements may increase in response, but borrowers also may renegotiate lower interest rates on their debts or pay off their debts by refinancing at such lower rates. In that case, the borrowers would be required to pay a make-whole amount, which would mitigate the risk. Private placements trade in a private, unregulated market directly between loan market participants; although most transactions are facilitated by broker-dealers affiliated with large commercial and investment banks. As a result, purchases and sales of private placements typically take longer to settle than similar purchases of bonds and equity securities. In addition, because private placement transactions are directly between investors, there can be greater counterparty risk.

Moreover, despite the increase in the size and liquidity of the private placement market, the market is still relatively illiquid, particularly when compared to the markets for bonds and equities. As a result, portfolios invested in private placements may experience difficulties and delays in purchasing or selling private placements, with resulting adverse impacts upon the prices obtained. During periods of severe market dislocation, such as occurred at the end of 2007 and during 2008, the market can experience severe illiquidity and significantly depressed prices.

Finally, many borrowers are private companies and/or companies that have not issued other debt that is rated by rating agencies such as Moody's Investors Service, Standard & Poor's, or Fitch Ratings. As a result, investment decisions related to private placements may be based largely on the credit analysis performed by the adviser to the fund or portfolio making the investments, and not on rating agency evaluation. This analysis may be difficult to perform.

Information about a private placement and the related borrower generally is not in the public domain, since private companies and companies that have not issued public debt or securities are not subject to reporting requirements under federal securities laws. However, borrowers are required to regularly provide financial information to lenders, typically in much greater detail than is available in the public markets. Furthermore, information about borrowers may be available from other private placement participants or agents who originate or administer private placements.

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