

**Private Debt
Investor**

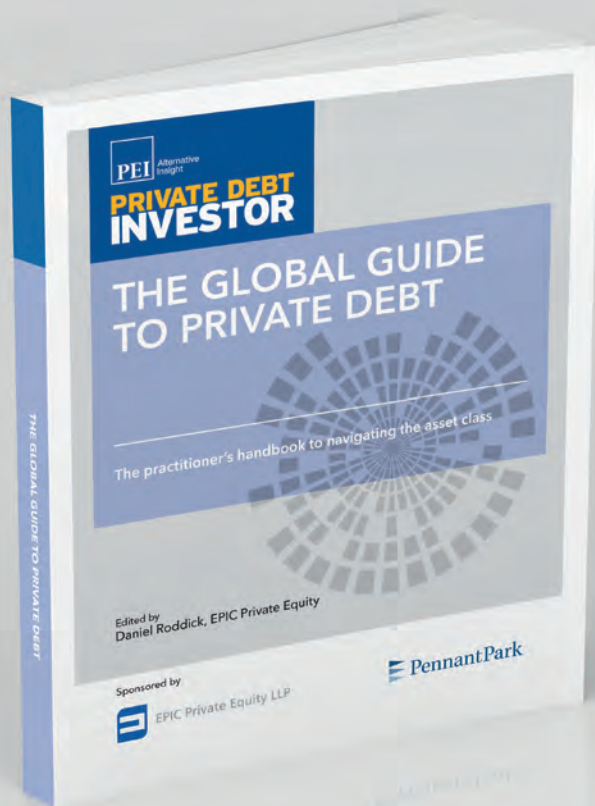
Global Investor 30

November 2019 • privatedebtinvestor.com

Our inaugural ranking
of the biggest investors



The Global Guide to Private Debt



The practitioner's handbook to navigating the asset class

Edited by EPIC Private Equity, this comprehensive and detailed guide on the private debt market brings together the views and opinions of 19 of the world's leading practitioners.

It will help fund managers:

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- Determine how best to structure the legal, taxation and financial terms of a private debt fund
- Anticipate which strategies are likely to attract the most interest from LPs ...plus much more

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Private Debt Investor

Global Investor 30

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Insight

2

Investor stories From San Francisco to Seoul, the last 12 months have seen growing interest in private debt from global institutions

The Campbell Lutyens view Senior secured private direct lending offers compelling solutions to investors looking to protect returns **4**

EDITOR'S LETTER More than just an alternative **7**

Analysis

8

Welcome to the PDI Global Investor 30
The 30 largest institutional private debt investors

The Global Investor 30 in numbers
A data snapshot **10**

What makes a top 30 investor
The methodology behind the ranking **12**

'Private debt is being used as a fixed income replacement' All the signs point to growth in both fundraising and deployment, say Campbell Lutyens head of private debt advisory group Richard von Gusovius and private debt specialist Jeffrey Griffiths **13**

Investor profiles Where are the top 30 investing? **16**

Beyond sponsored lending White Oak Global Advisors CEO and co-founder Andre Hakkak suggests investors take a wider perspective **18**

The new frontier Angel Island Capital CEO Dev Gopalan and chief strategy officer Lynette Vanderwarker explain the appeal of an asset-based strategy **20**

Staying in your lien Benefit Street Partners' senior portfolio manager Blair Faulstich describes how the firm is readying its private debt portfolio for a market downturn **22**



The 10 most active investors
The top 10 in terms of number of reported commitments provides a very different set of names **24**

The Koreans are coming Korean investors are yet to make the GI30 but it could only be a matter of time judging by the growing appetite for private debt **28**

Points of view What investors are saying **32**

Insight

Investor stories **From San Francisco to Seoul, the last 12 months have seen growing interest in private debt from global institutions**

DEC 2018

JAN 2019

FEB

MAR

APR

South Korean LPs shifting focus to European private credit

A state-backed pension fund in South Korea, the Government Employees Pension Service, made an €80 million commitment across two commingled private debt funds managed by Alcentra and BlueBay Asset Management. According to *PDI* data, Alcentra European Direct Lending Fund III is targeting €2 billion. The BlueBay Direct Lending Fund III has a €2.5 billion target.

Need for stable returns driving CIC's private investments

China Investment Corporation, the world's second-largest sovereign wealth fund, is boosting its alternative investments and direct investments, according to vice-chairman and president Tu Guangshao, speaking at the Asian Financial Forum 2019 in Hong Kong. "If we increase our exposure to direct investment and alternatives, we will create stable returns," he said, adding that this is one of the main focuses of CIC in 2019.



San Francisco pension fund plans \$800m for private credit

The San Francisco Employees' Retirement System is planning to deploy \$800 million towards private debt in 2019, with subsequent increases in coming years as the pension fund looks to hit its 10 percent portfolio allocation target for the asset class. The northern California-based retirement plan anticipates committing dramatically more to the asset class than in 2018, when it allocated \$225 million, according to pension fund documents.

Korea Post seeks global distressed debt fund managers

Korea Post is seeking two global distressed debt fund managers, according to a request for proposals. The prospective commitment size is up to \$100 million apiece. The capital comes from Korea Post's savings fund and insurance fund. The investor is seeking managers with proven investment performance in distressed commingled funds, including both pre- and post-GFC. Korea Post will exclude hedge funds and special situation-focused funds, although distressed debt funds with a partial allocation to special situations will be considered.

Two in three family offices looking to grow private debt allocation

Almost two-thirds of family offices and wealth managers are expected to increase their exposure to private debt, according to research. A survey by aviation finance specialist Shearwater Aero Capital found 63 percent of family office and wealth manager institutions intend to invest more in private debt between now and 2021, while 13 percent expect to invest less in the asset class.

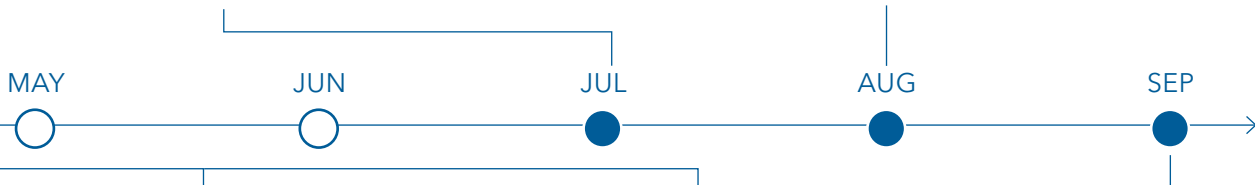
ACERA creates a dedicated private credit bucket

The Alameda County Employees' Retirement Association, a California-based public pension fund, voted to implement a 4 percent allocation to private credit. The strategy expects an average annual return of 6.7 percent. The plan outlines that ACERA will invest \$490 million in the strategy by the end of 2022 to reach the target allocation of 4 percent by 2023. The fund plans to achieve this goal by investing in no less than three core investment managers.



European and Asian investors face costly hidden fees for US debt funds

Invisible costs for international investors investing in US private debt could be eroding returns by as much as 5 percent, according to a report by investment consultancy bfinance. Historically, high taxes have put off many Asian and European institutions from investing in US debt. However, recent developments in fund structures have attempted to make US funds more appealing internationally. Nevertheless, bfinance has warned that a number of visible and hidden costs cause leakage on returns.



PensionDanmark merges alternatives and private debt teams

PensionDanmark merged its private debt and alternatives departments to give it greater investment flexibility. The move sees its current head of private debt, Kim Nielsen, take over as head of alternatives following the departure of Claus Lyngdal, who has left to become head of alternatives at Danske Bank after almost 11 years at the pension fund.



Dai-ichi Life to launch in-house structured finance team

Japan-based Dai-ichi Life Insurance Company told *PDI* that its new department, launched on 1 April, is designed to develop the company's in-house capability for corporate and structured financing. The firm announced on 22 February that the team would be led by Tetsuya Kikuta. He will oversee the investment planning department, the corporate and structured finance department, and the real estate department. Kikuta has been managing executive officer and chief general manager of investment since last year.

POBA seeks five direct lending fund managers

The Public Officials Benefit Association, a Seoul-based institutional investor, is looking for four private debt fund managers that invest in mid-market corporates in North America and one manager that lends to corporates in Asia-Pacific, a source familiar with the matter told *PDI*. It is understood that the Korean investor plans to commit \$50 million to each of the fund managers. The \$250 million in planned commitments will be invested in mid-market senior secured corporate lending strategies.

The emergence of private debt as an investable asset class in the past 10 years has had invaluable benefits for capital markets. What was once the exclusive domain of banks has now been opened to a deeper and broader network of institutional investors, namely pension funds, insurance companies, endowments, foundations, sovereign wealth funds and wealth management firms. The systemic shift of private, corporate credit risk from banks, backed largely by short-term liabilities, to private funds, backed by investors with long-term liabilities, strengthens and stabilises the savings and investment nexus at the heart of developed economies.

The exciting growth of this market presents both risks and opportunities for investors. They should tread carefully given expectations of future economic turbulence after a long period of sustained growth. Senior secured, private direct lending provides a compelling solution for investors seeking to protect their total returns versus both traditional fixed income and alternatives, while sustaining a key financial role in the economy for capital provision to mid-market enterprises underserved by banks.

Origins and growth of the market

In many ways, corporate, private debt is one of the oldest and largest financial assets in the world. Lending directly to companies privately, without a public listing or syndicated instrument, has always been one of the main components of commercial banking activity, alongside lending to consumers, real assets and governments. This market has never really been open to non-bank investors other than through the purchase of bank securities. The tightening of bank regulatory capital ratios via implementation of the Basel accords has curtailed banks' commercial lending activities in longer-dated loans to highly leveraged corporate enterprises. This particularly applies to the financing of leveraged buyouts, bolt-on acquisitions, dividend recapitalisations and major capital expenditure programmes.

The Campbell Lutyens view **Senior secured private direct lending offers compelling solutions to investors looking to protect returns**



Expert analysis by **Jeffrey Griffiths**, principal

Prior to the opening of private debt markets, institutional investors other than banks were forced to rely primarily on liquid credit instruments to gain exposure to corporate risk. Although sizeable and deep, both the investment grade and high-yield credit markets limited investors to financing large-cap businesses at tighter spreads than what the private markets can offer.

Also, institutional investors, such as pension funds, insurance companies, and endowments, have the advantage of long-term liabilities and the ability to invest for the long term, rather than

needing to match short-term liabilities with short-term assets. It makes a lot of economic and financial sense for these long-term asset holders to be the principal capital providers for longer duration credit, such as bullet maturity term loans for buyouts or capital expenditure programmes. It does not make sense, from a macro prudential perspective, for deposit-taking institutions, such as banks, with very short-term liabilities, to provide these loans. The structural and regulatory framework, therefore, for banks to exit the corporate, leveraged credit markets, and for institutional investors to enter it, is sound and desirable.

Companies need private capital, especially in the lower mid-market

As the banks retreat from longer term, leveraged credit exposure, companies that require leveraged finance and are not large enough to issue a broadly syndicated loan or high yield bond, have by necessity gravitated to the private debt fund market for capital. Banks remain the main contributors to corporate credit in short-dated, asset-backed and working-capital facilities because these instruments work better from a regulatory capital perspective. However, mid-market businesses that are looking to complete a leveraged buyout, add-on acquisition, major capital expenditure programme, shareholder recapitalisation or dividend re-cap need to approach the private debt fund world for their capital needs.

As institutional investors continue to

“There is a growing recognition that lending to non-sponsored businesses should form a core part of a private debt manager's portfolio construction”

allocate increasing amounts of capital to private markets versus public ones, the available capital for investment in private equity and debt has increased substantially over the last 10 years. Although initially growing out of a subset of private equity dealflow, growth in private debt is starting to outpace that of private equity. This is because most private, mid-market and lower mid-market businesses are not owned by private equity funds. Businesses owned by families, entrepreneurs or employees, or even publicly-listed ones, also have a need to finance growth with private debt capital. Often these businesses are unable or reluctant to issue new equity to finance this growth, and therefore private debt presents itself as a cost-effective solution.

The relevance of the illiquidity premium

In exchange for taking on illiquidity, private markets should offer investors a return premium over their public equivalents. In the case of private debt, various market estimates of this premium are between 2 and 4 percent per annum. For example, an investor can expect to earn an approximately 6 percent return by investing in the current broadly

“It is important that senior lending is backed by real assets as much as possible. Otherwise, the value of a ‘senior’ facility could be rendered worthless”

syndicated leveraged loan market in the United States. The comparable return in senior secured, private direct lending is between 8 and 10 percent, on a gross, unlevered basis.

The Cliffwater direct lending index has shown that senior private loans in the US have returned about 8 percent since 2010. This compares with an average yield to maturity on the S&P/

LSTA leveraged loan index of just above 5 percent for a similar time period (suggesting a 3 percent premium).

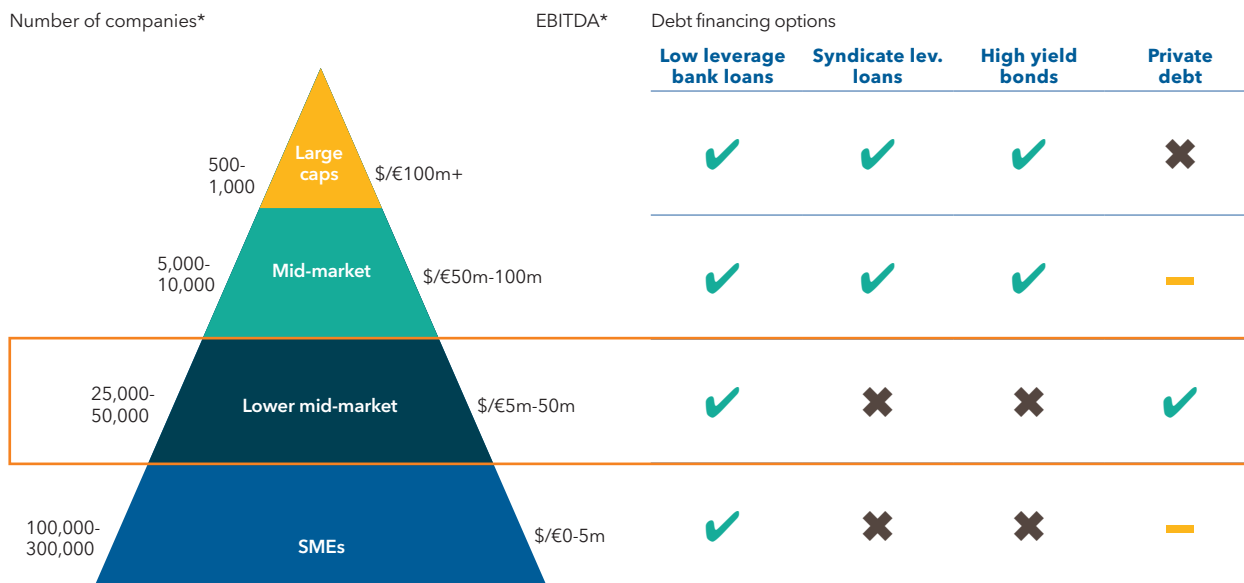
Institutional investors with a long-term investment horizon, who do not require a large amount of liquidity in their fixed income allocations, have been shifting portions of their liquid leveraged credit exposures out of public markets and into the private debt markets. This is primarily the result of being able to earn a better return for comparable levels of risk - with the only cost being the assumption of additional illiquidity.

Market risks

But it is important to recognise the risks in this market for investors. A lot of fund capital has been formed around addressing the financing of businesses in the upper mid-market, or deal sizes in excess of \$200 million. Although there are fewer lenders who can commit to larger deals, the competition to complete these transactions is often higher versus what occurs at the lower end of the market. This is especially the case for private equity sponsored deals, where the debt arrangement processes are highly efficient and intermediated.

As a result, pricing is lowest and credit

The relevance of private debt to the vast mid and lower mid-market universe



Source: Campbell Lutyens
*Estimates for either the US or European economies

Growth opportunities

The current market for private debt expansion is not only limited to traditional, private equity-backed deals.

There is a growing recognition that lending to non-sponsored businesses should form a core part of a private debt manager's portfolio construction. This leads to greater diversity in deal selection, and often superior pricing power and robust creditor documentation in non-sponsored businesses. Also, most businesses in the lower mid-market are not owned by private equity sponsors, but that does not make them unattractive debtors to providers of private debt capital. The challenge is opening the non-sponsored market up to capital formation – and encouraging signs of this growth has filtered through the markets recently.

Another growth area is providing not just term loans to companies, but also competing with banks on asset-based facilities, such as working capital loans and equipment leases. Banks often have rigid requirements for these loans, and private debt funds are increasingly seeing an opportunity to provide customised solutions to businesses that have non-standard financing requirements in this area.

Finally, private debt does not only need to be the realm of high leveraged corporate balance sheets. There is a growing market for investment grade-type risk financed privately. This would provide investors with an illiquidity premium over investment-grade bonds, rather than leveraged loans or high yield bonds. The opportunity to provide leverage to most family-owned, mid-market businesses is naturally capped by their often more prudent desire to restrict leverage to a reasonably low level for financial stability.

However, these financings are often not possible due to bank restrictions. There is a very promising market in the making for providing low-levered loans to businesses for mid-single-digit returns in return for a lower risk exposure, rather than only focusing on higher risk, higher return sub-investment grade credits.

protections are weakest in larger cap deals, where the financing packages need to resemble more the terms on offer in the publicly traded credit markets. It is important that lenders at the upper end of the market remain as selective as possible and turn away deals that may be stretched from a leverage perspective and provide unattractive risk-return dynamics versus what is available in the public markets.

Likewise, managers will deliver "alpha" in senior secured lending by loss avoidance, and not necessarily through maximisation of gross returns. Investors should evaluate strategies based on their assessment of whether an appropriate return is being extracted based on the risks assumed. It is not enough to benchmark funds based on their gross or net returns, especially in an environment in which default rates have been so low in the last decade.

Fund managers who choose the right credits, minimise default rates and maximise recoveries will likely outperform those who may build the highest-yielding portfolio but sacrifice on diversity, creditor protections and quality of asset protection. A manager's philosophy of investment in the current market, and their rigour in implementing it, is arguably a better predictor of future performance in an environment where credit losses have been very minimal.

Finally, it is important that senior lending is backed by real assets as much as possible. Otherwise, the value of a "senior" facility could be rendered worthless. Managers in leveraged credit must lend to businesses that have estimable and reliable recovery values in the case of insolvency or distress. Certain services businesses, such as in the technology sector, are currently commanding high levels of leverage, some with relatively light asset protection. Senior lending strategies depend on a robust recovery value in order to protect in a downside scenario and avoid capital losses, which can very adversely impact the net performance of a fund and wipe out interest income earned in the rest of the portfolio if not properly diversified.

Resilient returns

Despite the likelihood of entering more difficult economic conditions in 2020, investors should view private debt exposure – especially well-managed, diversified portfolios of senior secured loans – as offering robust and resilient returns. The high levels of current income earned on portfolios can act as a strong buffer against elevated loss rates. The value of asset protection, covenant enforceability and portfolio diversification are greatest when going into an elevated credit risk environment. Relative to other markets in both liquid leveraged credit and equity alternatives, private debt has proven to provide robust and resilient returns. Investors are fortunate to have this new market as an allocation alternative to navigate increasingly complex markets and protect and preserve quality returns for their stakeholders. ■



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Editor's letter

More than just an alternative



Graeme Kerr

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When will we stop foisting the alternatives label onto private debt? That struck me as I glanced through *PDI's* first-ever global investor list and saw the breadth of the institutional investor community committing to private debt strategies.

Some such as the Texas County and District Retirement System have invested as much as 18 percent of their assets in private lending strategies. The proportions may be smaller at other institutions, but with \$230 billion in total capital commitments, private debt has clearly become more than just an alternative for these investors. It is a core part of their returns strategy.

And the investor base is clearly growing. I spent a decade as a financial journalist in Tokyo in the 1990s and came to appreciate the unimaginably large asset pool held by the government-backed pension schemes and the postal savings system. The story of how these notoriously cautious institutions have gradually warmed to private markets is one of the key investment themes of recent years, and it was notable how the rise of Asian investors was a core topic of our recent *PDI* Europe Roundtable in London.

Interesting to note, therefore, the appetite of Korean investors. Korean pension funds were among the delegates at *PDI's* inaugural Seoul Forum this year and, judging by their enthusiastic response, it can only be a matter of time before one of these joins our ranking.

Compiling these lists is a painstaking task and we are indebted to the *PDI* Research and Analytics team for their work in pulling this ranking together. There are valuable contributions, too, from Campbell Lutyens, our partner in this project. Campbell Lutyens' conviction that the private debt markets offer a compelling investment opportunity is the perfect retort to the gloom-laden downturn talk all too prevalent in these uncertain times.

Enjoy the supplement

Graeme Kerr

“ Private debt has clearly become more than just an alternative for these investors ”

Welcome to the PDI Global Investor 30



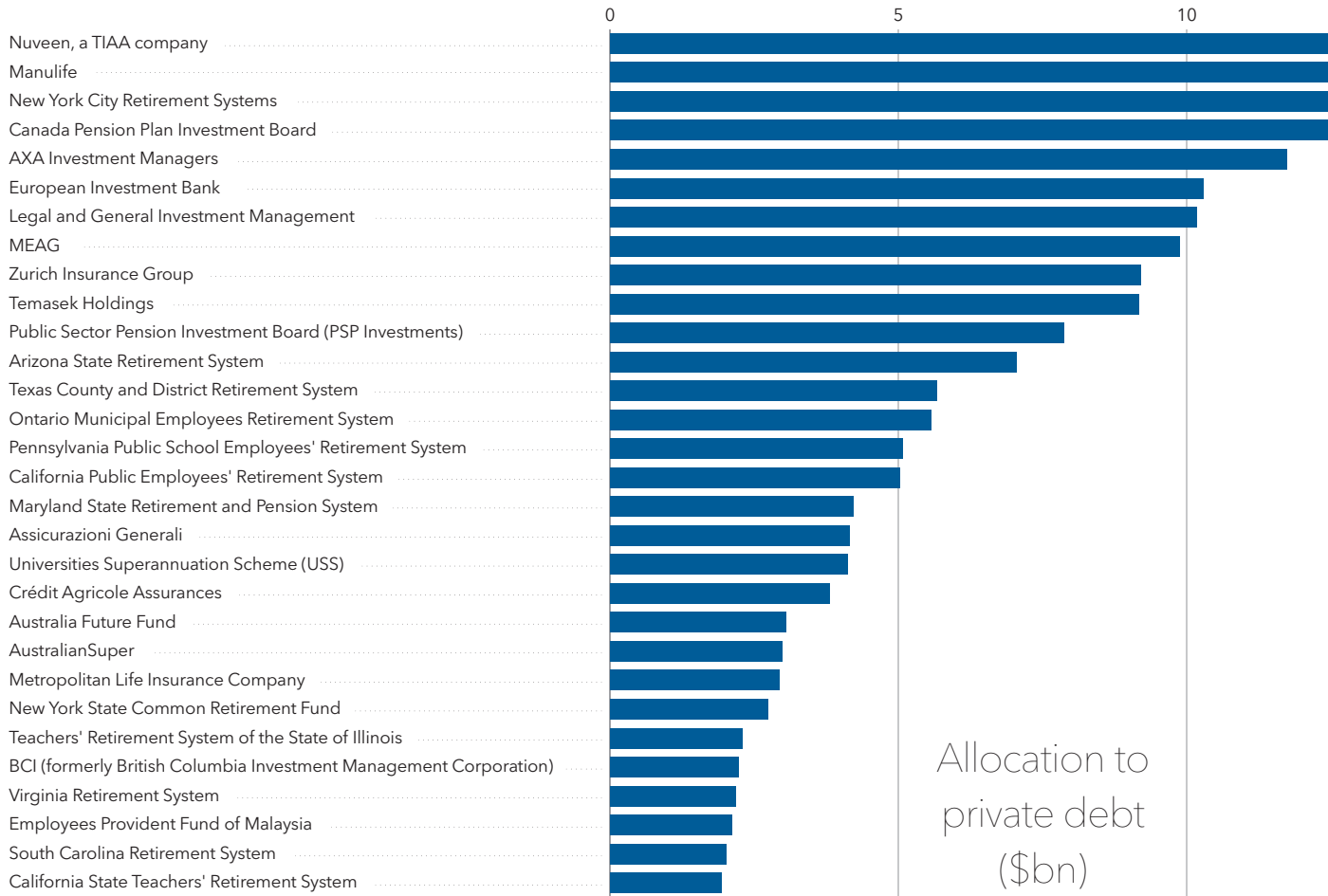
Private Debt Investor is proud to present its first-ever ranking of the world's largest institutional private debt investors based on the market value of private debt portfolios. Our Research and Analytics team carried out primary and secondary research on more than 100 institutions to produce this ranking. We look forward to publishing it again in 2020

Rank	Institution	Headquarters	Private debt allocation (%)	Private debt allocation (\$m)
1	Nuveen, a TIAA company	New York	12.2	30,698
2	Manulife	Toronto	3.2	27,275
3	New York City Retirement Systems	New York	9.6	19,246
4	Canada Pension Plan Investment Board	Toronto	5.1	15,066
5	AXA Investment Managers	Paris	1.4	11,738
6	European Investment Bank *	Luxembourg	1.6	10,288
7	Legal and General Investment Management *	London	1.6	10,181
8	MEAG	Munich	3.3	9,874
9	Zurich Insurance Group *	Zurich	4.7	9,200
10	Temasek Holdings	Singapore	4.0	9,164
11	Public Sector Pension Investment Board (PSP Investments)	Ottawa	6.3	7,870
12	Arizona State Retirement System	Phoenix	17.5	7,053
13	Texas County and District Retirement System	Austin	18.6	5,666
14	Ontario Municipal Employees Retirement System *, **	Toronto	7.8	5,561
15	Pennsylvania Public School Employees' Retirement System	Harrisburg	9.1	5,077
16	California Public Employees' Retirement System	Sacramento	1.4	5,024
17	Maryland State Retirement and Pension System	Baltimore	8.0	4,216
18	Assicurazioni Generali	Trieste	0.7	4,152
19	Universities Superannuation Scheme (USS)	Liverpool	4.7	4,113
20	Crédit Agricole Assurances *	Paris	1.2	3,801
21	Australia Future Fund *	Melbourne	3.0	3,051
22	AustralianSuper	Melbourne	2.7	2,985
23	Metropolitan Life Insurance Company	Whippany	0.7	2,935
24	New York State Common Retirement Fund	Albany	1.3	2,733
25	Teachers' Retirement System of the State of Illinois	Springfield	4.4	2,300
26	BCI (formerly British Columbia Investment Management Corporation)	Victoria	1.9	2,223
27	Virginia Retirement System	Richmond	2.7	2,187
28	Employees Provident Fund of Malaysia	Kuala Lumpur	1.0	2,106
29	South Carolina Retirement System	Columbia	6.3	2,015
30	California State Teachers' Retirement System	Sacramento	0.8	1,934

* figures from date prior to 31 March 2019

** figure includes mortgages

The Global Investor



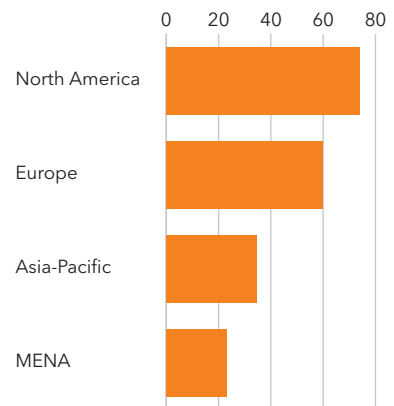
\$230bn
 Total capital commitment of the top 30 to private debt

\$153bn
 Total capital commitment of the top 10 to private debt

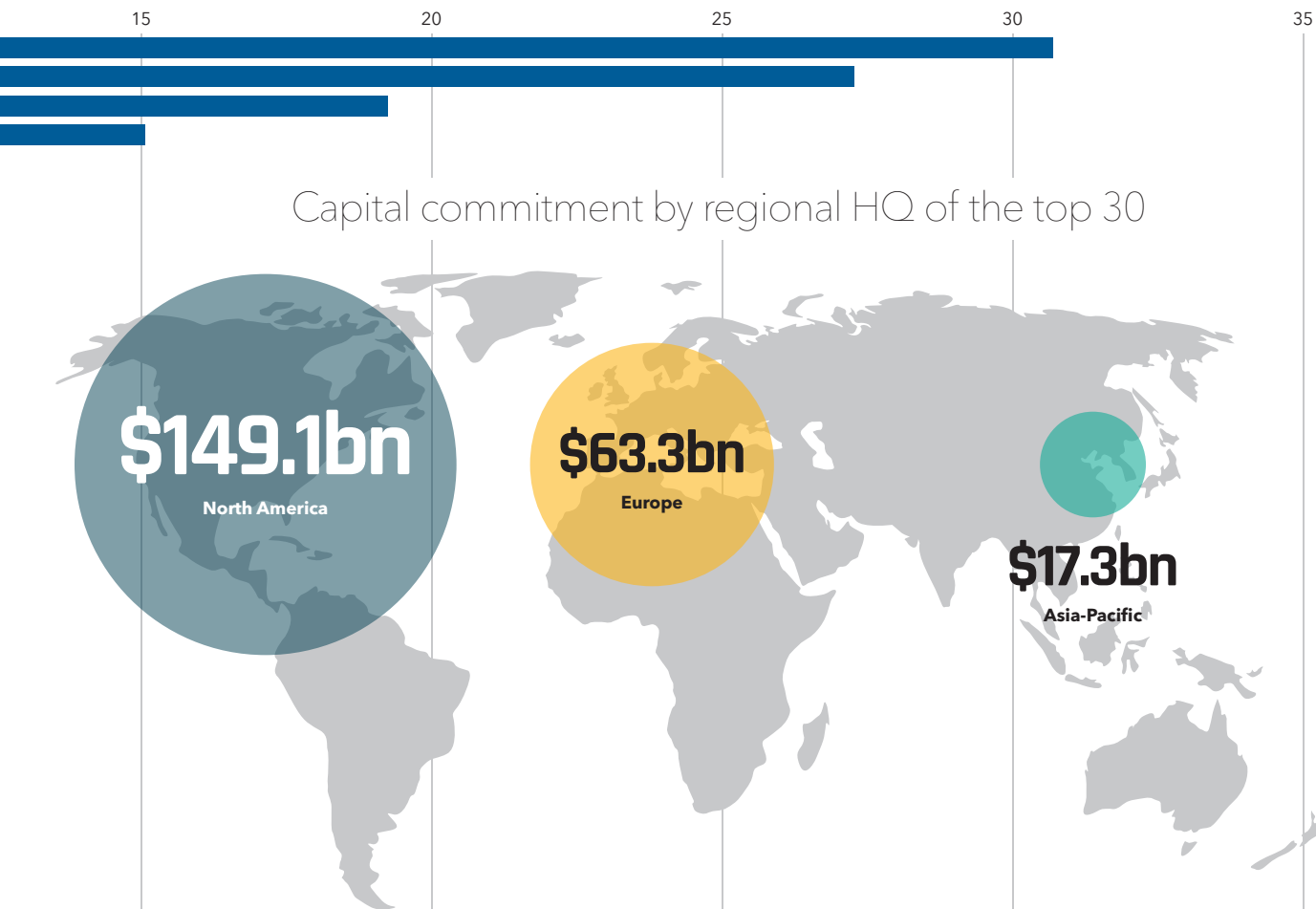
Investor appetite

PDI data reveal private debt investors have a clear preference for North America opportunities

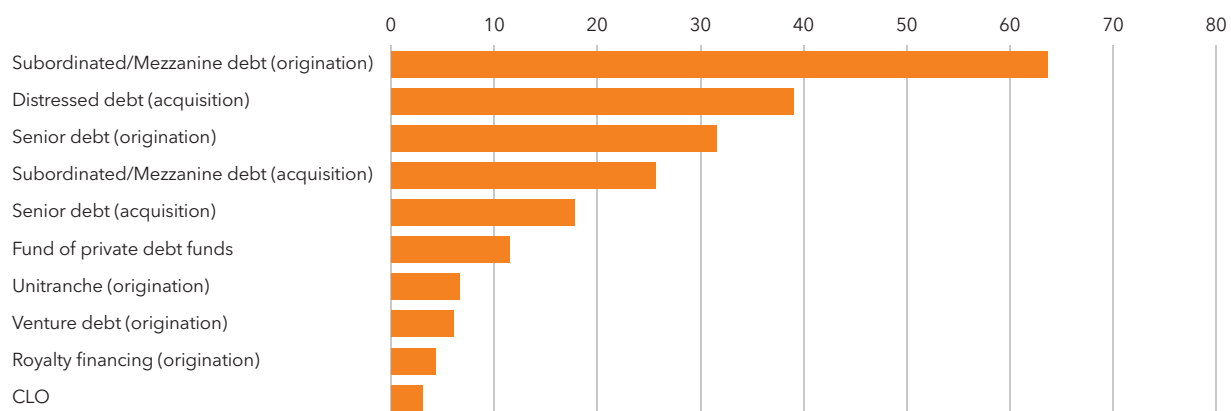
Regional breakdown of appetite to private debt by investors globally (%)



30 in numbers



Strategy preferences of private debt investors globally (%)



What makes a top 30 investor?

The Global Investor 30 is based upon the market value of investors' private debt investment portfolios. This value is measured at a single point in time for all investors to provide a like-for-like comparison. For this year's ranking, it is 31 March 2019.

This is a ranking of investors only and not funds of funds or private debt funds.

What the ranking includes

- **Private debt** The definition of private debt investment, for the purposes of this ranking, is capital committed to a dedicated programme of investing in the debt of private companies, or the non-bank debt financing of leveraged buyouts, infrastructure projects and real estate. This includes distressed debt, funds of private debt funds, royalty financing, senior debt, subordinated/mezzanine debt, unitranche and venture debt.
- **Investor criteria** Investors with a defined allocation to private debt and active investors in private debt funds that may not have defined allocations are both considered for this ranking. Where the investments are made in what may be termed 'grey areas', we reserve the right to make the final judgment based on applicability according to our definition.
We understand that investors' definitions of private debt may not entirely mirror the definition given above. Hence, we have used our discretion to determine the most appropriate figure for each investor profiled.

Structures and strategies

- Capital committed or invested through the following strategies is included:
- Funds (both open-ended and closed-ended)
 - Separately managed accounts
 - Commitments to private debt fund managers that happen to be publicly traded
 - Capital committed to co-investment vehicles
 - Direct investments
 - Proprietary capital (we do not consider assets managed on behalf of third parties)

What the ranking excludes

- **Expected commitments** We do not count pending or future commitments and investments or the uncommitted portion of an institution's target allocation.
- **Hedge funds** We do not count hedge fund strategies as these primarily target liquid securities or trading strategies.
- **Opportunistic investments** With these, there is no hard capital allocation to an investment programme.

Research process

PDI seeks to communicate directly by phone and email with investors to find out the market value of their private debt portfolios. In the absence of primary data, we have gathered data from secondary sources and sought to validate the researched figure with the investors before publishing the final list.

KEYNOTE INTERVIEW

'Private debt is being used as a fixed income replacement'



Institutional investors are still in the discovery phase, but all the signs point to growth in both fundraising and deployment, say Campbell Lutyens' head of private debt advisory group Richard von Gusovius and private debt specialist Jeffrey Griffiths

An extended period of low growth, low inflation and low interest rates has been a boon to private debt. Investors have taken note. According to our *PDI Global Investor 30* debut ranking, the top 30 of them combined have allocated over \$200 billion to the asset class. It is a significant chunk of capital and marks its emergence from a niche alternative strategy to an increasingly mainstream part of any private investor's portfolio.

With expectations of rising allocations to private debt over the next five years, we asked Campbell Lutyens' head of private debt advisory group Richard von Gusovius

and private debt specialist Jeffrey Griffiths about where investors are eyeing opportunities and where they should be careful.

Q Given the level of fundraising and deployment, is the private debt market overheated?

Jeffrey Griffiths: The question is: Is private debt more overheated than other pockets of the alternative market? I would argue no because although returns have compressed, as all asset classes have, it has not been substantial. Fundraising has been quite stable and we don't see it falling back significantly in the future. We also see a healthy level of de-

ployment. There is even a slight imbalance where managers' desire to deploy capital is not completely met by the provision of capital by the investor community.

Richard von Gusovius: We are more optimistic today regarding capital raising than at the beginning of the year. As expectations of rising interest rates vanished over the course of the first half of 2019, more investors actively expressed an interest to start or increase allocations to private debt. This is slightly offset by some direct lending fatigue among investors that deployed two or three years ago that are waiting to see how their

When you talk to LPs, are they wary of a possible downturn?

RvG: A lot of them have strong views that there will be one. Views range from a corporate credit-led Armageddon, which we don't believe in, to a sideways movement of sector-led volatility, for instance by the German automotive industry. Investors need to make sure they are diversified over a broad set of strategies, sectors and geographies and that their underlying GPs don't take unnecessary risks. We often see GPs that want to participate in the larger end of the market are tempted to underwrite larger loans to raise a larger fund going forward. That's a very dangerous spot.

JG: Investors in this market tend to be risk averse. They are not necessarily looking for upside but for downside protection. They worry about whether this is the right time to invest. With downside protected senior secured lending strategies you shouldn't try to time the market. It's about adjusting the size of your allocation. If we do experience a rough patch, we could see more aggressive participants perform badly and some angry investors. That will flush out the market and help investors discern between riskier and more conservative practices.



commitments perform before they take it to the next level. That's natural.

There are pockets of exuberance but if you look at the capital overhang numbers over the past five years, GPs have always been able to deploy that capital. Compared to the broader syndicated loan market, private debt continues to see higher equity cushions and lower leverage levels particularly at the smaller end of the direct lending market, which we find particularly attractive. And we see increased use of direct lending, particularly among financial sponsors transacting smaller deals. Previously they depended largely on banks.

Q Would you say then that investors are under-allocated to private debt?

JG: Definitely. The traditional investor, a pension fund or insurance company, typically have long-term liabilities that require returns of 5, 6 or 7 percent. That lends itself very nicely to a private debt investment strategy. However, the average allocation to private debt is still in the low single digits, 2-5 percent max. Investors will typically have a large allocation to low returning fixed income – government and investment grade bonds – and maybe some high yield debt, and also a sizeable allocation to pub-

lic and private equity. They are weighted on each end of the risk spectrum. We would argue that investing in private debt is more efficient and less volatile. But we understand it's a relatively new asset class where investors would like to monitor performance over the longer term before they build out their allocation.

Q Is there room for growth in both capital raising and deployment?

JG: Definitely in the senior secured direct lending market that is starting to diversify into transactions with non-private equity owned businesses, including family and employee-owned companies. That's a much bigger opportunity than any other in alternatives.

RvG: Also, increasingly investors are looking to deploy outside of corporate lending into more asset-based structures, consumer lending and real estate. There's continued interest in infrastructure but also in aviation, equipment financing and working capital financing. That's a trend we've seen over the last 18 months and where there is probably not enough of an institutional grade offering yet.

Q During fundraising, what concerns do investors voice?

RvG: A few years ago investors would only be worried about deployment. Those that have been in this asset class for four or five years have certainly learned a lot and now know the questions they need to ask: Is the team big enough to deploy capital well; are managers well diversified geographically and in underlying sectors; how would a manager respond when things go wrong? They look at the team and ask who is your workout expert? They are more realistic than they were about the prospects and more informed.

Q Are they carving out more private debt-specific allocations?

RvG: Increasingly yes, but still at a low base. Institutions are still in the discovery phase. They are subject to stringent approval processes, so once they have gone through all the pain of establishing the asset class, they will run it separately rather than invest from their public or alternative pockets. Certainly private debt is being used as a fixed income replacement rather than an alternative asset class. That's where most of the growth will come from.

Q What types of new investors are eyeing private debt?

JG: We see more insurance companies investing in the market. Asia has a large, expanding pension market where institutions have to invest outside their home markets typically. This type of exposure can be attractive. And we also see some family offices increasing allocations as a stable source of income in their portfolios.

RvG: One segment that is yet to be fully tapped, at least outside of the US where private investors have access to BDCs, is private wealth. The retail market certainly would benefit from more affordable offerings. If someone were to create a product that independent financial advisors could put into individual pension funds that would unleash quite a big volume of capital.

Q Where do they first dip their toes?

JG: New allocations generally go into lower risk, lower return, large fund strategies with brand name managers with longer track records. That's why you've seen, particularly in Europe, an explosion of fund sizes where brand name managers are able to aggregate increasingly large sums of capital.

RvG: Private debt has reached a place where managers at the large end have pulled away. Those teams need to deploy capital into huge transactions and are increasingly competing with the public markets. We've seen unitranches of over \$1 billion being offered and executed. That wouldn't have been possible three or four

“Private debt is being used as a fixed income replacement rather than an alternative asset class. That's where most of the growth will come from”

RICHARD VON GUSOVIVUS

years ago. Sponsors at the large end can keep transactions out of the public realm for which they pay a premium. In terms of number of transactions, there's much more happening at the smaller end of the market,

where relatively speaking there is an under-supply of capital.

Q Is that where you see the most opportunity?

JG: Financing lower mid-market companies with EBITDA of between \$5 million and \$30 million, including non-sponsored transactions, is where we see the biggest opportunity and the best risk return, the strongest deal structures, reduced competition and the best pricing.

Q And where should investors exercise caution?

JG: There is more risk at the larger end of the market where the pricing is thinner and the erosion of creditor protection has been a theme that has filtered down from the leveraged loan market.

Through another default cycle, we don't expect to see a change in default rate behaviour, but loss rates might be higher because creditor protections are weaker. And private equity sponsored activity may witness higher loss rates.

The interests of equity and debt holders can be very different and antagonistic. The most aggressive business owners are typically private equity funds that are motivated by financial gain, as opposed to a family or employees who hold a much more constructive, longer-term value preservation mindset.

RvG: At the larger end of direct lending, typically sponsored lending, we have seen cases where private equity owners were able to use weaker creditor protection to their advantage, ahead of a credit event, for example by being able to sell off profitable parts of the business, IP, etc, and extract value for themselves when traditionally the lender would have had a say over capex or disposals.

Sponsored lending is an important part of any given portfolio, but investors need to ensure there are no conflicts of interest and their GPs are underwriting companies, and not sponsors. Investors can simply check during due diligence whether the GP in question has a material concentration of sponsors in their loan portfolio.

Also, at the larger end of the market, some very large funds are competing for a limited number of transactions, and as they start competing with capital markets and therefore need to lend more for less for longer, LPs should be very cautious. ■

As more LPs look to this market, do you see any changes in fund structures, fees or terms?

RvG: As investors learn the asset class, build relationships and seek to deepen them, we will see more permanent capital vehicles and the rise of large bespoke mandates that absorb the sizeable allocations entering this market. Rather than LPs recommitting every two to three years, for which they don't have the bandwidth, in this model investors will have core direct lending relationships with say two US and two European GPs that manage open-ended structures they can call. The GP will take the principle flows and reinvest the capital and give the investor the share of income they need to meet their liabilities, and the investor will have the capacity to pursue more accretive strategies around it.

Profiles

The institution types:

- Global insurer
- Sovereign wealth fund
- European pension fund
- N American pension fund
- Asia-Pacific pension fund
- Asset manager/bank

1 Nuveen, a TIAA company

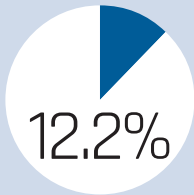
AUM: \$252.4bn
Head office: New York

Nuveen is the investment arm of the Teachers Insurance and Annuity Association of America-College Retirement Equities Fund and is one of the largest investment managers in the world. Its private debt investments focus on subordinated and mezzanine debt funds in North America and Western Europe.

Private debt allocation

\$30.7bn

Private debt allocation as % of AUM



12.2%

2 Manulife

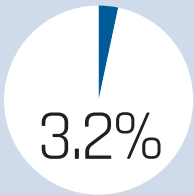
AUM: \$850.4bn
Head office: Toronto

Canadian headquartered Manulife provides more than 28 million customers across North America, Asia and Europe with financial advice, insurance and wealth management solutions. As one of the most active investors in private debt, the institution focuses on opportunities across most regions globally.

Private debt allocation

\$27.3bn

Private debt allocation as % of AUM



3.2%

3 New York City Retirement Systems

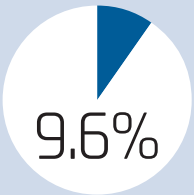
AUM: \$200.7bn
Head office: New York

The New York City Retirement Systems is a collection of five pension funds across the City of New York covering Teachers, Police, Fire and other employees. Each of the five funds has its own board of trustees to decide asset allocation and strategy.

Private debt allocation

\$19.2bn

Private debt allocation as % of AUM



9.6%

4 Canada Pension Plan Investment Board

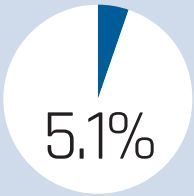
AUM: \$293.8bn
Head office: Toronto

As one of Canada's largest pension funds, the Canada Pension Plan Investment Board is a major investor in all alternative asset classes, including private debt. The firm is increasingly making direct investments in the asset class, having acquired debt fund manager Antares and has set up its own in-house private debt team.

Private debt allocation

\$15.1bn

Private debt allocation as % of AUM



5.1%

5 AXA Investment Managers

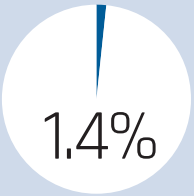
AUM: \$841.6bn
Head office: Paris

The investment management arm of French insurer AXA has a relatively small allocation to private debt given its immense size. Its private debt investments focus on CLO and senior debt funds across North America, Europe and Asia-Pacific.

Private debt allocation

\$11.7bn

Private debt allocation as % of AUM



1.4%

6 European Investment Bank

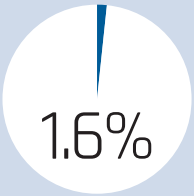
AUM: \$636.7bn
Head office: Luxembourg

The European Investment Bank is the lending arm of the European Union and has a strong focus on backing investments in SME and mid-cap businesses, both of which fall within the scope of traditional direct lending funds. Its most recent investment was €80 million to venture debt vehicle the Eiffel Essentiel Fund.

Private debt allocation

\$10.3bn

Private debt allocation as % of AUM



1.6%

The institution types:

- Global insurer
- Sovereign wealth fund
- European pension fund
- N American pension fund
- Asia-Pacific pension fund
- Asset manager/bank/other

7 Legal and General Investment Management

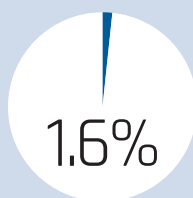
AUM: \$628.5bn
Head office: London

The insurer has long been a player in private debt, having run its own in-house private debt investor which it later spun out as Pemberton. It continues to invest in Pemberton's funds, having backed its most recent vehicle.

Private debt allocation

\$10.2bn

Private debt allocation as % of AUM



8 MEAG

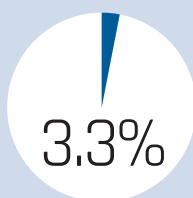
AUM: \$303.1bn
Head office: Munich

MEAG manages the assets of Munich Re and ERGO, as well as a number of institutional and private clients and has reach across Europe, Asia and North America. The firm's private debt investments tend to focus on private debt funds in North America, Asia-Pacific and Europe.

Private debt allocation

\$9.9bn

Private debt allocation as % of AUM



9 Zurich Insurance Group

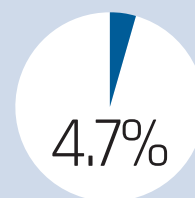
AUM: \$195.0bn
Head office: Zurich

Zurich Insurance Group has committed a significant chunk of its \$195 billion of assets to alternatives and particularly favours private debt and real estate assets. Private debt accounts for almost 5 percent of its total assets under management, equivalent to nearly \$10 billion.

Private debt allocation

\$9.2bn

Private debt allocation as % of AUM



10 Temasek Holdings

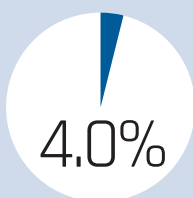
AUM: \$229.1bn
Head office: Singapore

Temasek is an investment firm with significant investments in Asia. Its allocation to private debt is small but the firm is increasing its role in the asset class and finalised its first direct investment last year with a \$200 million facility for a New York-based clothing rental firm.

Private debt allocation

\$9.2bn

Private debt allocation as % of AUM



11 Public Sector Pension Investment Board

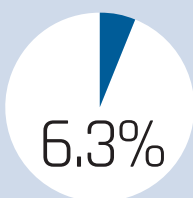
AUM: \$125.9bn
Head office: Ottawa

Canada's PSP Investments is a major player in alternative assets and manages a diversified global portfolio. Private debt is a relatively small part, but the firm has made big commitments including €500 million for European fund manager AlbaCore in 2016.

Private debt allocation

\$7.9bn

Private debt allocation as % of AUM



12 Arizona State Retirement System

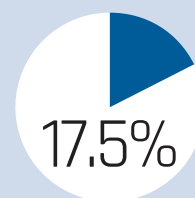
AUM: \$40.3bn
Head office: Phoenix

Arizona's public sector pension fund is another prolific investor in alternatives, with private debt commanding the largest allocation from its funds. The firm has 17.5 percent of its portfolio committed to the asset class and could go further with a target allocation of 20 percent.

Private debt allocation

\$7.1bn

Private debt allocation as % of AUM



Q&A

White Oak Global Advisors chief executive and co-founder Andre Hakkak suggests investors take a wider perspective and look beyond sponsored lending



Often, investors looking at the private debt market assume the terrain is primarily comprised of sponsored lending opportunities. Not so, says White Oak Global Advisors chief executive and co-founder Andre Hakkak. He believes that the real private debt opportunity is to be found in lending to businesses seeking financing but excluded from bank lending.

Q How does White Oak Global Advisors go about investing?

A We focus on non-sponsored, traditional lending to businesses that a bank may perceive to be a little too risky to put on its balance sheet. When the bank says, “no, we can’t help you”, we are positioned to say, “maybe we can”. Unlike banks that fund loans with their liabilities, we match our loan assets with investor capital. We have 25 products in three categories: equipment and leasing loans, asset-based loans and bank term loans. A highly diversified portfolio is a better proposal to investors than a concentrated one, and our funds have thousands of underlying credits diversified by sector, loan type and geography.

Q Why don’t you look at sponsored deals?

A Our addressable market in the US encompasses more than 350,000 small and medium-sized businesses, as well as a portion of 3.3 million merchants, some of whom will graduate into small businesses each year. In contrast, there are only 12,000-13,000 businesses owned by private equity sponsors to which private debt managers can provide lev-

erage. However, there are 500-600 managers presenting sponsored lending as traditional lending. This means the investor base has a skewed view of the nature and volume of non-bank speciality lending.

Q What kinds of limited partners invest in your funds?

A Our LPs are global insurance companies, pension funds, charities and sovereign wealth funds.

Q What comes up in conversations with investors?

A Number one: they have heard so much about sponsored lending that we feel they need to take two steps back and look at the whole lending landscape and get educated. We provide them with a lot of facts and data.

Then there’s a lot of uncertainty regarding the macro environment and geopolitics. People are taking a more cautionary approach to their portfolios. We’ve heard investors say everything from “we want to have more of a liquid portfolio” to “it’s the

top of the cycle, we’re not going to do any more private credit”.

Chief investment officers may say they are doing less private debt while continuing to allocate a lot of money to private equity. We would say at this point, at the top of the cycle, investors should be aiming to occupy a stronger position in the capital structure of a business.

Q Are there new types of LPs looking at private debt?

A In the US, the larger alternative investment manager platforms are definitely moving downstream by launching business development companies and integral funds to target high-net-worth and accredited investors. On a leveraged basis, these structures have strong purchasing power and most are focused on providing leverage to private equity firms.

Q Where should investors and managers be cautious?

A It’s easy to say you’re being very cautious and to be conservative. But, in reality, a lot of the risk we underwrite is idiosyncratic. You can find wonderful investment opportunities at the top or bottom of the cycle. If you only offer highly levered cashflow loans, then of course you are more susceptible to economic cycles. If you’re lending to businesses on an asset-based basis, that’s a safer bet and you can provide a more defensible portfolio. Sometimes investors take a big brush and paint a whole sector as hazardous when there are segments within it that provide very attractive risk-adjusted returns. ■

The institution types:

- Global insurer
- Sovereign wealth fund
- European pension fund
- N American pension fund
- Asia-Pacific pension fund
- Asset manager/bank

13 Texas County and District Retirement System

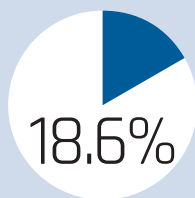
AUM: \$30.4bn
Head office: Austin

Texas County has a substantial 18.6 percent allocation to private debt yet remains below its 25 percent allocation target. As a result, it has been regularly deploying capital, most recently providing \$250 million for Silver Point Specialty Credit Fund II.

Private debt allocation

\$5.7bn

Private debt allocation as % of AUM



14 Ontario Municipal Employees Retirement System

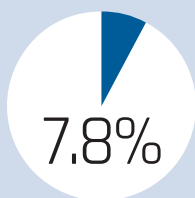
AUM: \$71.1bn
Head office: Toronto

The fund has a long history of alternatives investment, including a near 8 percent exposure to private debt. The pension plan has a focus on long-term, sustainable returns that also focuses on ESG concerns.

Private debt allocation

\$5.6bn

Private debt allocation as % of AUM



15 Pennsylvania Public School Employees' Retirement System

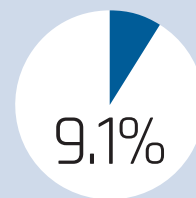
AUM: \$55.8bn
Head office: Harrisburg

The pension fund for Pennsylvania's public school employees has more than \$5 billion invested in private debt and made several commitments in 2018 and 2019. Its most recent was \$200 million for Bain Capital Distressed and Special Situations 2019.

Private debt allocation

\$5.1bn

Private debt allocation as % of AUM



16 California Public Employees' Retirement System

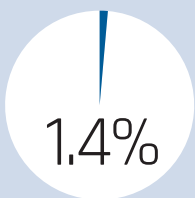
AUM: \$357.7bn
Head office: Sacramento

The largest public pension fund in the US has long been a key player in alternative assets. Its private debt exposure is comparatively small but still amounts to more than \$5 billion. In 2018 it committed \$250 million to TowerBrook Structured Opportunities II.

Private debt allocation

\$5.0bn

Private debt allocation as % of AUM



17 Maryland State Retirement and Pension System

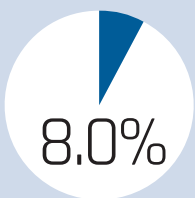
AUM: \$52.7bn
Head office: Baltimore

Maryland's public pension fund has more than 405,000 members and is seeking consulting services to help it invest more into private markets. It continues to invest in debt funds and in 2019 provided \$150 million for CVI Chesapeake Credit Opportunities.

Private debt allocation

\$4.2bn

Private debt allocation as % of AUM



18 Assicurazioni Generali

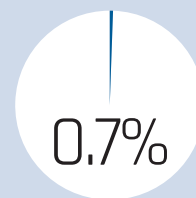
AUM: \$583.5bn
Head office: Trieste

Trieste-based insurer Assicurazioni Generali commands significant assets but has a relatively small exposure to private debt at less than 1 percent of its admittedly large portfolio. The firm's private debt investments tend to target pan-European senior debt funds.

Private debt allocation

\$4.2bn

Private debt allocation as % of AUM



Q&A

Angel Island Capital CEO Dev Gopalan and chief strategy officer Lynette Vanderwarker explain the appeal of an asset-based strategy

Angel Island Capital, after more than a decade investing as a permanent portfolio company of private equity investment firm Golden Gate Capital, is spreading its wings. The San Francisco-based manager with approximately \$3.4 billion of assets under management is currently deploying capital in Credit Opportunities, its flagship investment strategy, and Asset Based Opportunities.

We asked AIC's chief executive Dev Gopalan and chief strategy officer Lynette Vanderwarker why the firm is targeting asset-based lending opportunities.



Q Asset-based means different things to different people - what's your definition?

A Dev Gopalan: Investors see “asset-based” as a broad category consisting of everything from airplane leasing to structured credit to bespoke transactions to risk transfer trades. We focus on three main verticals. The first is housing, which includes lending against things like mortgage servicing rights and actual single-family homes. The second is consumer, which covers lending against pools of consumer loans. These two verticals will constitute the bulk of the assets in our Asset Based Opportunities investment strategy. Our Asset Based Opportunities strategy also includes investments in “risk transfer” opportunities, such as businesses in equipment leasing. As an example of a risk transfer loan, we've just closed a \$28.7 million expansion loan to consumer loans business Aura, which is backed by a pool of residuals.

Q Why are investors branching out into strategies like asset-based lending?

A DG: Many investors exposed to corporate credit or direct lending are worried that we're 10 years into a bull market and headed for a correction. Asset-based lending

is less correlated to corporate credit and offers downside protection for the same type of return profile.

Additionally, we believe this strategy will grow as businesses grow and their capital needs expand. In our view, private sources of capital are better positioned to service such demand since these opportunities require complex solutions, which many banks are not willing or able to provide.

Q Which investors are potentially branching out into strategies like asset-based lending?

A Lynette Vanderwarker: Public pensions, insurance companies, endowments, high-net-worth individuals and the same folks that have focused on the regular first-lien senior secured direct lending market. These are increasingly specialist, established investors looking at asset-based lending to comprise a return in the low- to mid-teens and generate a 9-11 percent current income. These investors typically understand that additional modest levels of leverage may be employed in making these types of investments and certain deal sizes may be relatively large. Now that private credit is a permanent asset allocation within

many institutions' overall allocation, the reality is that corporate credit doesn't cut it on its own. The illiquidity premium has faded.

Q Why did you lend to Aura?

A DG: We first started looking at Aura in 2012. We have a strong focus on being a good partner to companies with good environmental, social and governance practices like Aura because it's providing loans to communities that don't have access to banks due to their credit score. The company uses payment history, for instance, remittances, to determine risk. The loan is backed by a pool of residuals segregated from the company's other assets, which provides downside protection. There's also a very tight covenant package, delinquency triggers and a company guarantee – multiple ways out for us to get repaid.

Q What does Angel Island Capital look like five years from now?

A LV: AIC aims to build out a multi-strategy credit platform – focusing on not only corporate credit but asset-based solutions – that caters to the objectives of institutional and high-net-worth investors seeking private credit exposure. ■

The institution types:

- Global insurer
- European pension fund
- Asia-Pacific pension fund
- Sovereign wealth fund
- N American pension fund
- Asset manager/bank

19 Universities Superannuation Scheme (USS)

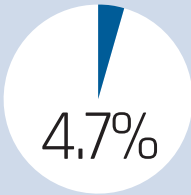
AUM: \$87.5bn
Head office: Liverpool

The USS has a substantial 30 percent of its capital allocated to alternatives, of which private debt is the smallest component. It serves both defined benefit and defined contribution pension savers and has a particularly strong focus on investing in the UK.

Private debt allocation

\$4.1bn

Private debt allocation as % of AUM



4.7%

20 Crédit Agricole Assurances

AUM: \$326.7bn
Head office: Paris

Crédit Agricole Assurances is a major French insurer with operations worldwide. It has a modest allocation to private debt relative to its large portfolio and is known to have previously invested in mezzanine funds via French asset manager Amundi.

Private debt allocation

\$3.8bn

Private debt allocation as % of AUM



1.2%

21 Australia Future Fund


AUM: \$102.7bn
Head office: Melbourne

The Australian sovereign wealth fund is responsible for investing on behalf of several vehicles. As well as the main Future Fund, it also invests from the Medical Research Future Fund, Aboriginal and Torres Strait Islander Land and Sea Future Fund and the DisabilityCare Australia Fund.

Private debt allocation

\$3.1bn

Private debt allocation as % of AUM



3.0%

22 AustralianSuper

AUM: \$111.8bn
Head office: Melbourne

AustralianSuper is one of the largest pension providers in Australia and claims to provide services to one in 10 working Australians. Its private debt allocation is relatively small compared with other alternative asset classes and has historically been focused on investments in the Asia-Pacific region.

Private debt allocation

\$3.0bn

Private debt allocation as % of AUM



2.7%

23 Metropolitan Life Insurance Company

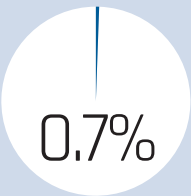
AUM: \$431.8bn
Head office: Whippany

MetLife is a US-headquartered insurer that has offices in the US, Japan, Latin America, Asia, Europe, the Middle East and Africa. The firm has a 0.7 percent allocation to private debt and has historically invested in mezzanine funds across North America and Europe.

Private debt allocation

\$2.9bn

Private debt allocation as % of AUM



0.7%

24 New York State Common Retirement Fund

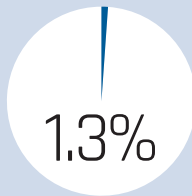
AUM: \$210.2bn
Head office: Albany

The fund claims to be the third-largest public pension plan in the US with more than one million members. It continues to make commitments to private debt, especially distressed debt. In 2019, it provided \$200 million for Clearlake Opportunities Partners II.

Private debt allocation

\$2.7bn

Private debt allocation as % of AUM



1.3%

Q&A

Benefit Street Partners' senior portfolio manager Blair Faulstich describes how the firm is readying its private debt portfolio for a market downturn



In the private debt space, established lender Benefit Street Partners focuses on two main strategies: a senior secured-only approach, and a second strategy that allows the manager to lend across the capital structure. Senior portfolio manager Blair Faulstich explains why, in this current market environment, the firm is sticking to the top of the capital structure.

Q There's lots of talk of a downturn - do you see one on the horizon?

A We expected to have seen a macro-recession already. We believe one's coming at some point in the next couple of years. A variety of macro factors concern us and we are seeing warning signs of late-stage behaviour, including rising leverage levels, tighter spreads and a significant deterioration of credit documents, particularly at the large-sponsored end of the market. That trend is starting to work its way down into the middle market, where we are active. In this type of environment, we're dialling down our risk, playing defence and investing our partners' capital at the top of the capital structure. We're not chasing yield right now; we're chasing safety and durability. It's a capital preservation strategy.

Q What type of businesses do you lend to?

A A combination of private equity-backed and non-sponsored businesses in the North American middle market. We focus on the core middle market with companies that generate between \$25-\$100 million of EBITDA. We believe this part of the market will outperform the lower middle market in an economic downturn.

Q Have concerns about the macro-environment impacted the sectors you lend to?

A We have always avoided highly cyclical sectors and are focused on diversifica-

tion as downside protection across the portfolio.

Within each industry we continuously monitor trends and will increase or decrease our exposure to a sector to reflect that. We are not industry generalists and leverage our sector-focused analysts across the portfolio.

Q What are LPs worried about?

A Investors are concerned about many issues, but they are often asking us about general macro economic factors, such as trade wars, currency issues, Federal Reserve policy and political unrest. We say wait for a market reset – there will be one. That's the time to rethink where to play in the capital structure.

Q Given investor caution, are LPs looking for new strategies?

A LPs concerned about competition within the private debt space are looking to add niche strategies to core direct lending positions with a heightened focus on aviation finance, asset-backed lending and royalty finance.

Q After a future downturn, what will the private debt market look like?

A It's a crowded space and there will be a shake out of private debt managers when the next recession hits. We believe managers of scale with internal workout capabilities are best positioned to weather a downturn.

Private credit is now a permanent part of the leverage finance market ecosystem – that won't change, but we believe there will be fewer firms. ■

"We're not chasing yield right now; we're chasing safety and durability. It's a capital preservation strategy"

The institution types:

- Global insurer
- Sovereign wealth fund
- European pension fund
- N American pension fund

- Asia-Pacific pension fund
- Asset manager/bank

25 Teachers' Retirement System of the State of Illinois

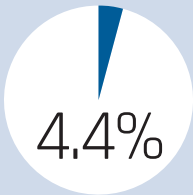
AUM: \$52.2bn
Head office: Springfield

The pension fund has been actively seeking out debt opportunities in recent years. It has backed vehicles that invest across the capital stack including senior debt, mezzanine and distressed funds. In 2019, it provided \$100 million for Taurus Mining Finance Fund II.

Private debt allocation

\$2.3bn

Private debt allocation as % of AUM



4.4%

26 BCI

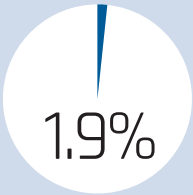
AUM: \$115.2bn
Head office: Victoria

Although Canadian pension fund BCI has been a big investor in alternative assets, which makes up more than one-third of its portfolio, private debt is still a relatively small part of this. The fund has invested in a wide range of corporate lending strategies across senior debt, mezzanine and distressed.

Private debt allocation

\$2.2bn

Private debt allocation as % of AUM



1.9%

27 Virginia Retirement System

AUM: \$80.4bn
Head office: Richmond

The pension fund serves 705,000 members in defined benefit, defined contribution and hybrid plans. It has particularly sought out investments in distressed debt vehicles. In 2019, it committed \$150 million to KKR Real Estate Credit Opportunity Partners II.

Private debt allocation

\$2.2bn

Private debt allocation as % of AUM



2.7%

28 Employees Provident Fund of Malaysia


AUM: \$210.6bn
Head office: Kuala Lumpur

Malaysia's public pension plan has a small but significant allocation to private debt and is focused on investing in fund of private debt funds. It has a broad geographic scope and can invest globally with a preference for corporate debt opportunities.

Private debt allocation

\$2.1bn

Private debt allocation as % of AUM



1.0%

29 South Carolina Retirement System

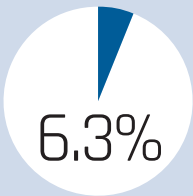
AUM: \$32.0bn
Head office: Columbia

The South Carolina Retirement System manages five pension funds for public employees including police, national guard and judges representing more than 590,000 members. It continues to back private debt funds and in 2019 committed \$500 million to a joint venture with Barings BDC.

Private debt allocation

\$2.0bn

Private debt allocation as % of AUM



6.3%

30 California State Teachers' Retirement System

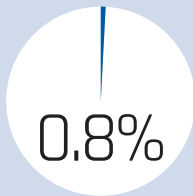
AUM: \$227.8bn
Head office: Sacramento

CalSTRS has a significant allocation to alternatives, particularly real estate, but its private debt exposure remains relatively small. It backed two debt funds in 2018, including a real estate debt joint venture with POBA and the Peak Rock Capital Credit Fund II.

Private debt allocation

\$1.9bn

Private debt allocation as % of AUM



0.8%



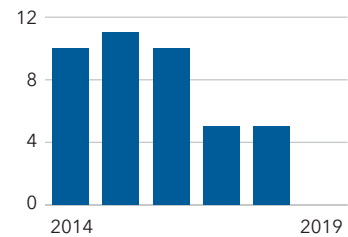
The 10 most active investors

Our Global Investor 30 lists the leading private debt LPs in terms of the amount of capital, but which investors are the most active in the asset class? This list of the top 10 investors in terms of number of reported commitments provides a very different set of names

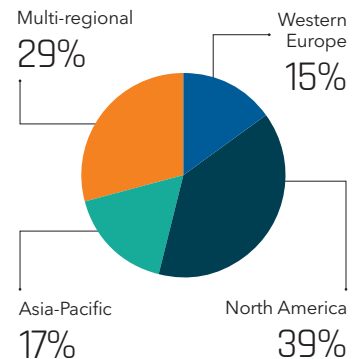
1 University of Michigan

Size of portfolio
\$12.1bn

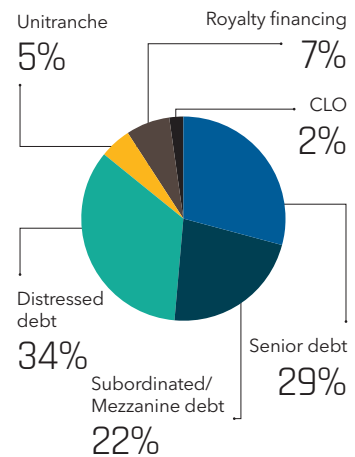
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



Source: PDI

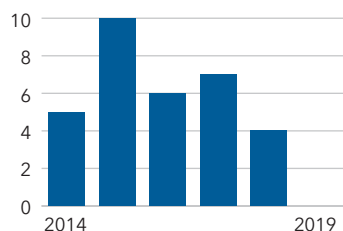
Figures may not add up to 100% due to rounding

2 Florida Retirement System Trust Fund

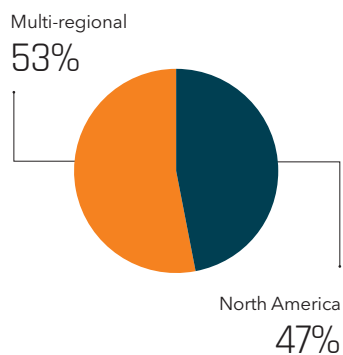
Size of portfolio

\$164.4bn

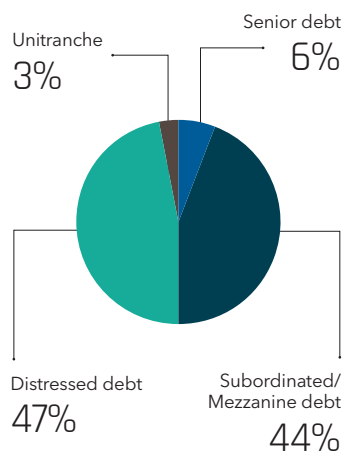
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



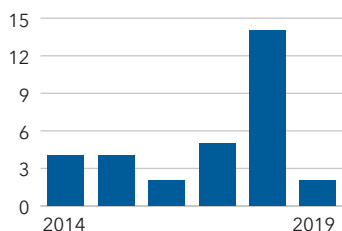
Source: PDI

3 Texas County and District Retirement System

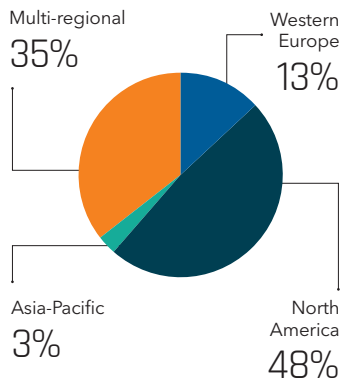
Size of portfolio

\$30.4bn

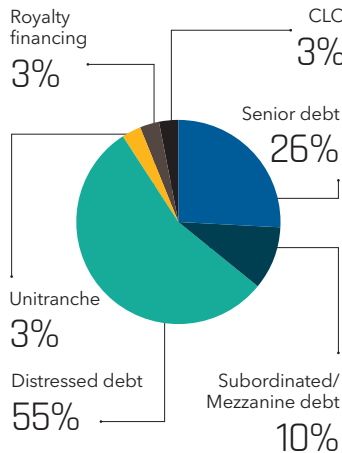
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



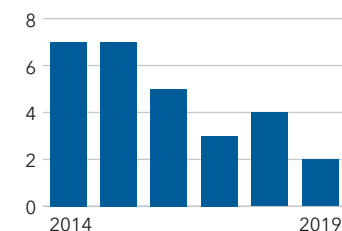
Source: PDI

4 Pennsylvania Public School Employees' Retirement System

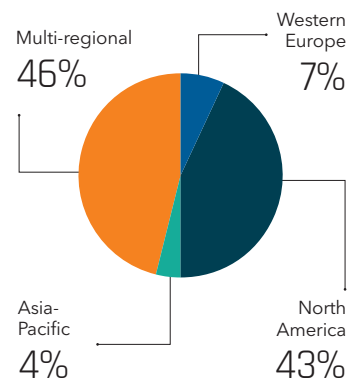
Size of portfolio

\$55.8bn

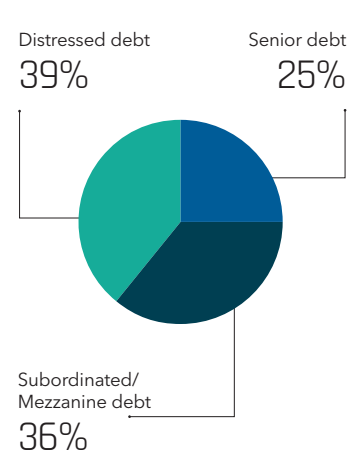
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



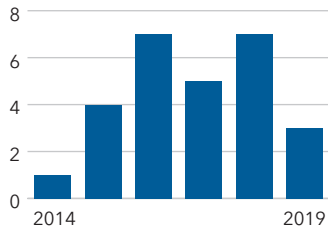
Source: PDI

5 San Francisco Employees' Retirement System

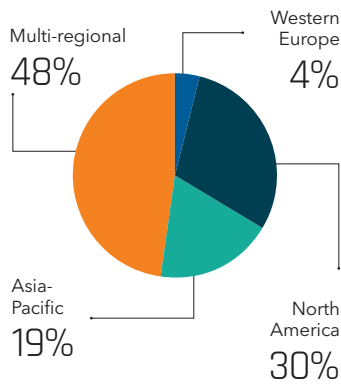
Size of portfolio

\$24.1bn

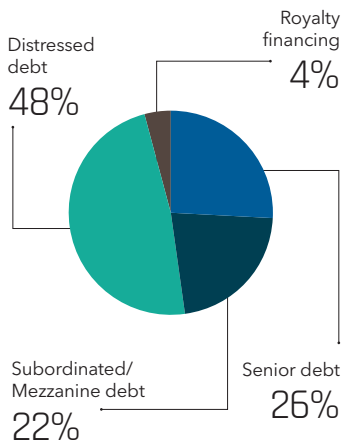
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



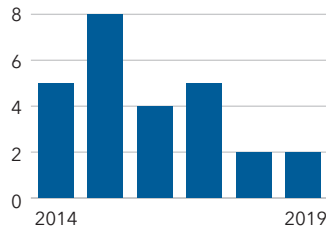
Source: PDI

6 New York State Common Retirement Fund

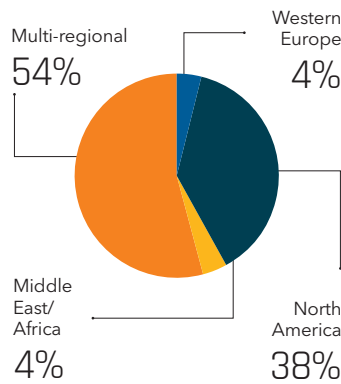
Size of portfolio

\$210.2bn

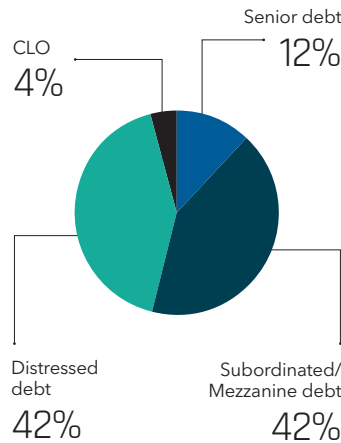
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



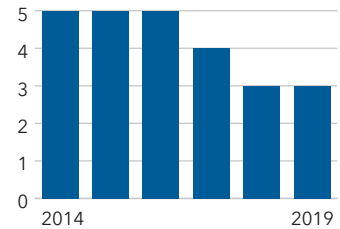
Source: PDI

7 Teachers' Retirement System of the State of Illinois

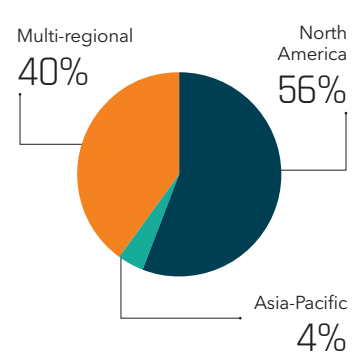
Size of portfolio

\$52.2bn

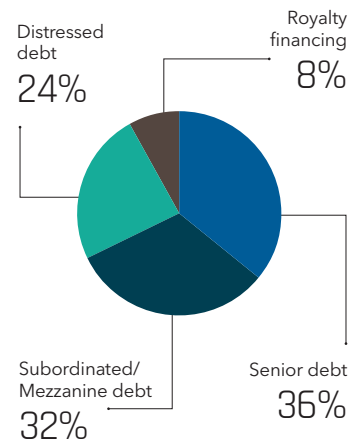
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



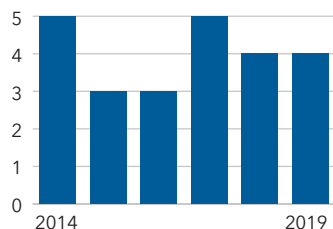
Source: PDI

Figures may not add up to 100% due to rounding

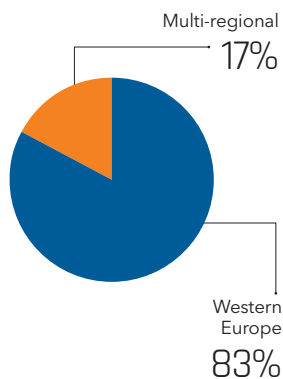
8 European Investment Fund

Size of portfolio
\$33.3bn

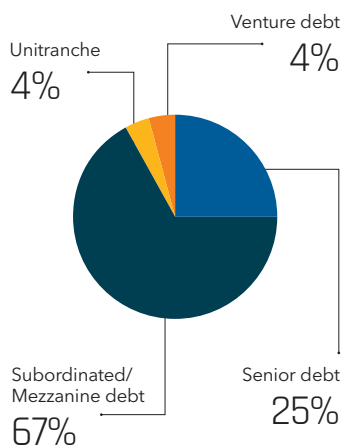
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy

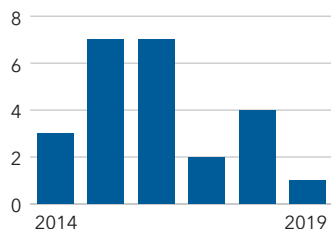


Source: PDI

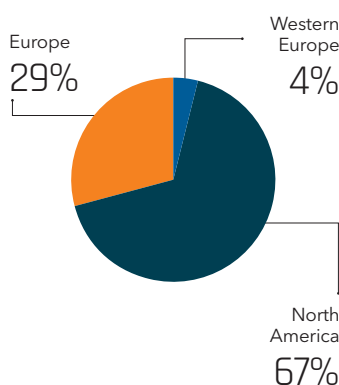
9 Texas Municipal Retirement System

Size of portfolio
\$30.0bn

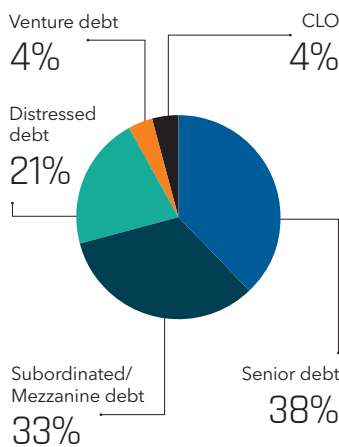
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy

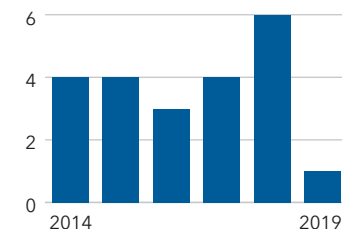


Source: PDI

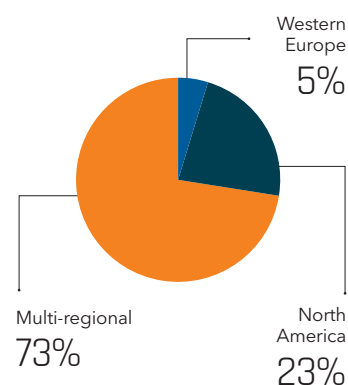
10 Teachers' Retirement System of Louisiana

Size of portfolio
\$20.9bn

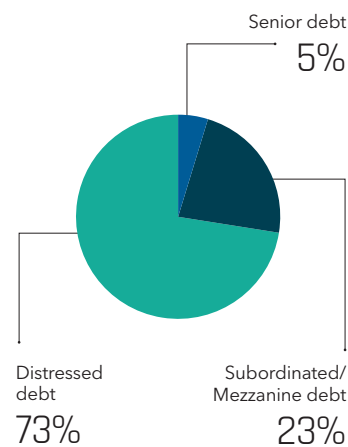
Fund commitments by vintage



Total commitments by regional focus



Total commitments by strategy



Source: PDI

Whether it was September's report that the Public Officials Benefit Association (POBA), a Seoul-based institutional investor, is seeking five direct managers to allocate \$250 million to North American and Asian mid-market corporate lending strategies or the news that Korea Post needs two global distressed debt fund managers for prospective commitments of up to \$100 million apiece, there is little doubt of the growing appetite of Korean investors for private debt.

That was apparent at *PDI's* inaugural Seoul Forum held earlier this year.

Many of the LPs at the event like the asset class because it seems tailor-made for their needs: a consistent stream of distributions, unlike buyout funds, so investors can meet their obligations.

Many pension funds also view private debt as a better risk-adjusted alternative to fixed income. While other LPs around the world share similar sentiments, Koreans think about the asset class differently to many European or US investors. Here are the key takeaways from the Seoul event.

It's all about outbound

Korean investors' interest in direct lending continues to be keen, but most commitments are to credit funds investing in other parts of the world, as Korea is dealing with a sluggish domestic economy and low interest rates.

But investing in the US is coming at a rather expensive premium and currency hedging costs are bringing Europe into focus. When making US dollar-denominated commitments, Korea LPs may need to shave 1.5 percentage points off net returns because of currency hedging arrangements, said Janghwan Lee, head of the alternative investment management team at Lotte Non-Life Insurance Company.

Jurisdictional issues (insolvency regimes and bankruptcy laws) are at the heart of educating Korean investors when it comes to European direct lending, said Pemberton Asset Management's head of Asia-Pacific business development, Shintaro Mori.

European countries have taken steps in recent years to bolster their restructuring statutes, Pemberton managing partner Symon Drake-Brockman added, to ensure businesses can seek court protection and



The Koreans are coming

Investors from Korea are yet to make the Global Investor 30 but it could only be a matter of time judging by the growing appetite for private debt, write Andrew Hedlund and Arshiya Khullar



“In the case of the US, it is hard to meet our target returns by investing in private real estate debt at this moment, after converting the returns into South Korean won”

JANGHWAN LEE
Lotte Non-Life Insurance Company

raised only slightly more than \$5 billion. The majority, some \$14 billion, was dedicated to North America.

Funds in market are seeking more than \$55 billion, targeting all geographies. However, only \$13.9 billion is targeting either multiple regions or areas other than North America and Europe. There is a possibility that the capital available for real estate debt could diminish. The South Korean financial regulator is set to implement a new international accounting standard for insurance contracts and new capital standards, which could cause some insurers to lower their overall real estate allocation.

A Seoul office would help

Two Korean institutional investors with real estate strategies told the audience at the Seoul conference for *PERE* that investment firms should set up shop in the country and hire local investment professionals.

“Business will not happen overnight or only after one meeting,” said Woncheol Suh, head of private markets at the Government Employees Pension Service. “[Managers] will have to make more efforts to build a relationship through trust and rapport. That is why we are asking that you open a Korea office.”

Lotte Non-Life Insurance’s Lee said a key consideration is whether the credit manager is willing to educate investment staff about the asset class and help them build contacts in the space. In addition, a source at an advisory firm noted that the goal of many Korean investors is to end up on a fund’s LP advisory committee.

All of these are measures that require extensive time and resources – particularly establishing a Seoul office. But LPs often respond well to personal introductions or recommendations from people they know.

“We are [strongly] controlled [by the government] and limited by our budget,” Suh explained. “We are [also] under [a] severe manpower shortage. We have people wearing many different hats [at work]. Have more patience while dealing with us.”

The Korean private credit market may be less mature than the US or European equivalents, but it is a bright spot in Asia. Fund managers may spend significant sums of money and rack up frequent flyer miles into the hundreds of thousands. But the pay-offs could be plentiful as the asset class evolves within the larger Asia-Pacific region. ■

emerge as a going concern with a right-sized balance sheet.

Germany reformed its insolvency laws to allow secured creditors to have a say earlier in the case and debtors gained additional protections to help them keep their doors open. In recent years, Spain added incentives for lenders to offer bankruptcy loans to help a business get to the finish line in a restructuring.

Senior debt-focused credit managers have received a warm welcome from Korean LPs, given the inherent downside protection being at the top of the capital structure provides, one delegate said.

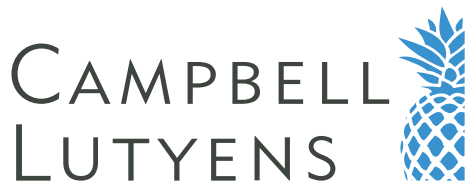
Commitments have largely remained in senior and junior debt, with relatively little attention given to distressed debt and niche strategies. Several LPs said it may be a good time to start looking at special situations vehicles.

Real estate reluctance

The portfolio that Lee oversees holds roughly \$2 billion in real estate investments, only \$50 million of which is in debt. Both the US and Europe are tough areas to invest in at the moment.

“In the case of the US, it is hard to meet our target returns by investing in private real estate debt at this moment, after converting the returns into South Korean won. And because of the low interest rate environment, it is hard to meet our target returns in European countries also,” Lee added, explaining the reluctance to deploy more capital in real estate debt strategies.

Real estate debt fundraising plunged in 2018, dropping by almost half from 2017, according to data from sister title *PERE*. The strategy seemed strong in the first half of 2018, in which it locked down \$15.7 billion. The second half was weaker, when it



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Expert commentary

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Investor points of view

“Alternatives are still a very important part of the overall asset allocation in PensionDanmark”

KIM NIELSEN of PensionDanmark on the decision to merge its alternative assets and private debt capabilities

“The challenge is that we have capital constraints, because we are regulated by various insurance regulators, and we have considerations around our credit rating”

THOMAS SHANKLIN of Nationwide Insurance on the difficulties insurers face

“If we increase our exposure to direct investment and alternatives, we will create stable returns”

TU GUANGSHAO of China Investment Corporation on why it is turning towards alternatives

“The big risk for those large funds is over-reach; if they raise more money than they can invest well, or make some bad calls, it could damage their brand names”

JOHN BOHILL of StepStone Global on the trend towards mega funds

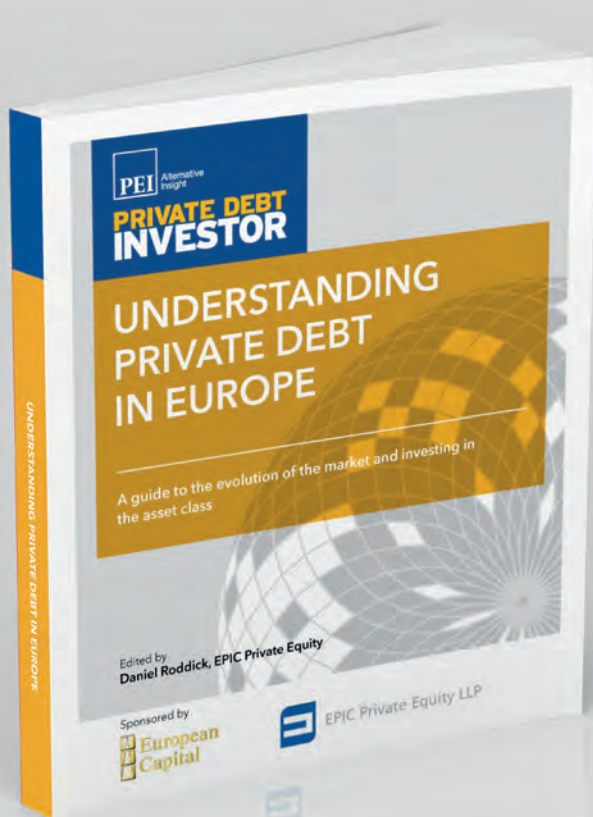
“We plan to increase our allocation to the distressed and special situations category in 2019 and 2020”

TAEBOK KANG of Korean Teachers' Credit Union on where the best opportunities lie

“We've been doing a lot of research work over the past year trying to understand which markets are accessible”

JOHN GRAHAM, global head of credit investments at CPPIB, on its expansion plans

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