A Primer on Private Placement Debt Investments

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Contents

Executive summary

Fixed income assets are well suited to institutional investors, such as insurance companies and pension funds, given their potential for stable income cash-flows and low volatility characteristics.

For investors seeking long-duration, enhanced income and capital preservation, the Investment Grade private placement debt market is an attractive investment choice that is well placed to satisfy these requirements.

In this well-established yet evolving and growing market, Aberdeen Investments is a leading global player.
This primer offers an overview of Investment Grade private placement debt investments, outlining the key features of the asset class and its potential benefits for institutional investors.

Private placement debt investments: key market features

A private placement is a privately marketed, long-term corporate debt offering. Private placements are typically Investment Grade senior debt securities issued by companies with over USD100m of EBITDA .

Private placements are less liquid than public corporate bonds owing to limited secondary market trading activity. However, investors are compensated for this with an illiquidity premium that offers an additional return.

The other key differences between private placements and traditional public corporate bonds are in the way the debt is structured, marketed and distributed. Brokers typically work with small groups of qualified institutional investors on private placement debt transactions.

While there are key differences with other forms of debt, private placements do have some comparable features to public corporate bonds as well as traditional bank loans. Exhibit 1 below provides a key features comparison of private placement debt and the other major forms of private and public corporate debt.

Exhibit 1: Alternative debt types – key features

Key features	Bank debt	Direct lending	Private placements	Public debt capital markets
Market Description	• Debt financing provided by bank institutions • Credit quality across the spectrum	• Debt financing provided private equity / private credit institutions • Typically sub-Investment Grade	• Debt financing predominantly provided by insurance company/asset liability matching investors • Mostly Investment Grade	• Institutional / wholesale credit investors • Investment Grade and High Yield
Typical issuer size	• No size limitation	• EBITDA USD5m to USD100m	• EBITDA USD100m+	• EBITDA USD100m+
Issuer rating requirement	• No ratings required	• No public rating required	• No public rating required • NAIC designation if purchased by US insurer	• Public rating(s) required
Format	• Floating and Fixed Rate Revolver • Term Loans	• Typically Floating Rate • Amortisers, Payment-in-kind, Senior and mezzanine financing	• Typically Fixed Rate Bullet • Amortisers • Typically senior	• Fixed and Floating Rate Bullet • Amortisers • Typically senior, with subordinated also available
Tenor	• Up to 10 years	• Up to 5 years	• Majority up to 30 Years • Available up to 60 Years	• Majority up to 30 Years • Available up to 50 Years+
Prepayment risk	• Yes	• Yes	• No (pre-payment with 'make-whole' premium)	• Varies by indenture

Source: Aberdeen Investments.

Market size and currencies

The broader private credit market, which includes private placements, has grown rapidly in recent years. Technical drivers in the market have increased investor interest in these areas. This primer addresses the private placement segment of the private credit market.

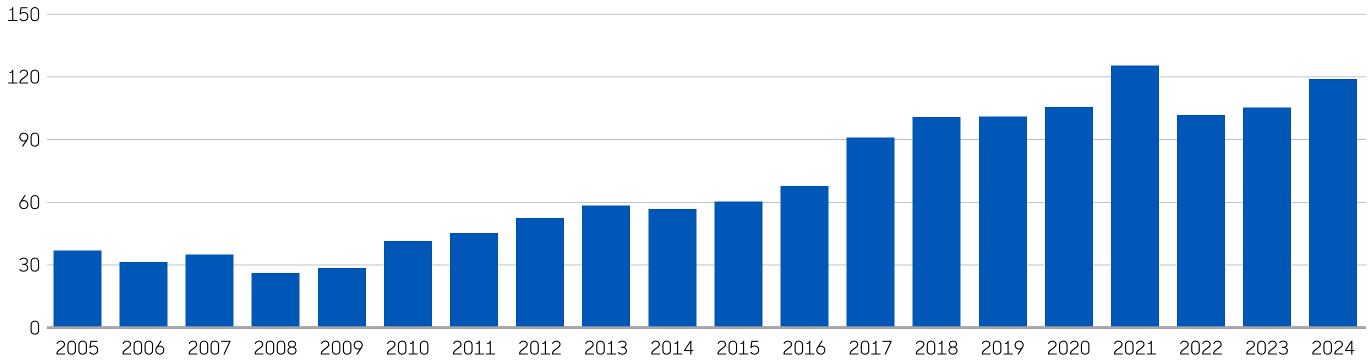
The private placement debt market is roughly USD1 trillion in size, with US-domiciled debt the largest source by region. Two distinctions of the private placement debt market versus direct lending are the size of the deal sizes and credit quality, with offerings of the former typically of Investment Grade quality with sizes ranging from USD100m to as large as USD1bn+. Direct lending on the other hand usually has smaller deal sizes of less than USD100m for the majority of sub-Investment Grade credits.

Private placement market issuance is primarily in USD, although issuance in non-USD has grown meaningfully in the past 5-10 years reflecting the growth of issuer diversity.

Figure 1: Private placement market annual issuance volumes (2005-2024)

Private Placement Market Issuance Volumes

USD eqv billions

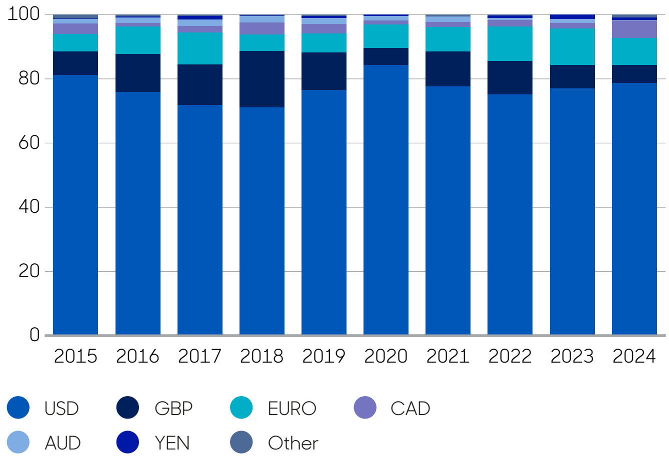


Source: Private Placement Monitor as at 31 December 2024.

Figure 2: Private placement market annual issuance by currency (2015-2024)

Private Placement Issuance by Currency

% of total annual issuance

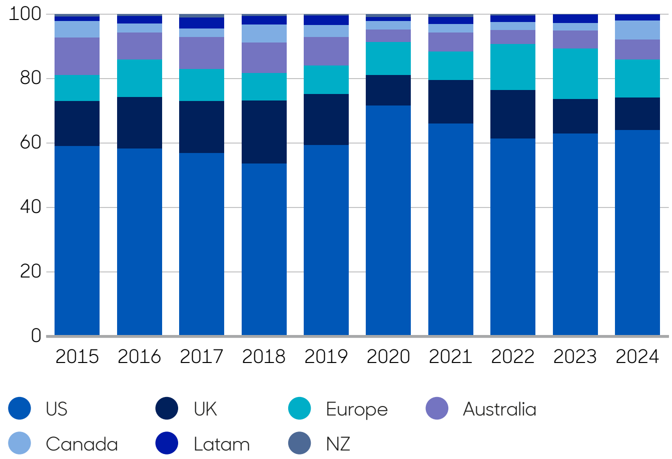


Source: Private Placement Monitor as at 31 December 2024.

Figure 3: Private placement market annual issuance by region (2015-2024)

Private Placement Issuance by Region

% of total annual issuance



Source: Private Placement Monitor as at 31 December 2024.

Tenor

Private placement issuance tenors have a wide range from 3 to 30 years+. However, the deepest pool of liquidity and largest portion of issuance is in 10 years. Additionally, 7, 10, 12 and 15 years are considered as 'benchmark' tenors.

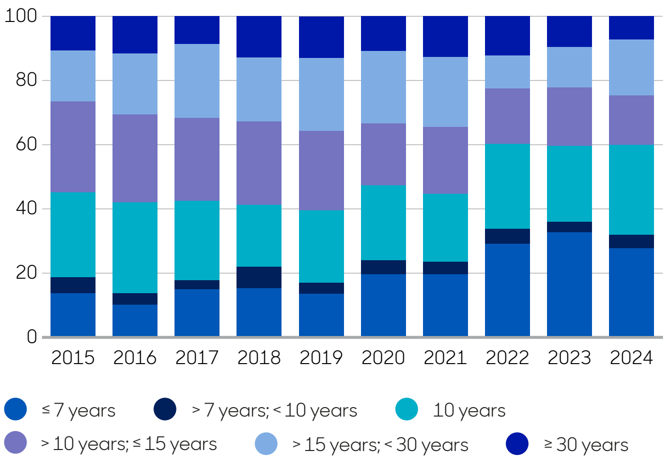
One of the key distinctions of private placement debt versus public bonds is scarce secondary trading activity. Private placements are often held to maturity thus are much less liquid than public bonds.

While there is the concept of 'benchmark' tenors in private placements, in practice, issuance tenors can actually be highly bespoke (for example with 'off-the-run' or 'non-benchmark' tenors permissible) and also customisable to the specific needs and preferences of both issuers and investors.

Figure 4: Private placement market annual issuance by tenor (2015-2024)

Private Placement Issuance by Tenor % by volume in USD eqv

%



Source: Private Placement Monitor as at 31 December 2024.

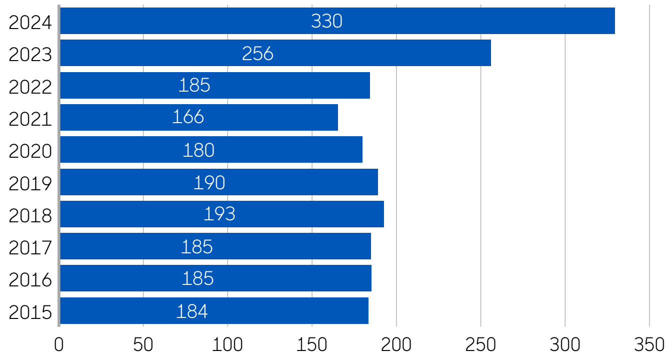
Issuance/transaction size

As with customisable issuance tenors, there are no minimum or benchmark issuance/transaction sizes for private placement debt investments. Furthermore, repayment profiles can be customised beyond bullet repayment structures, for example with amoritisation or amortising with growth rate step-ups etc.

Figure 5: Private placement average deal size (2015-2024)

Average Total Deal Size (USD eqv)

USD eqv millions



Source: Private Placement Monitor as at 31 December 2024.

Funding/settlement timing

Another attractive feature for borrowers is the delayed funding feature of private placements. Subject to investor demand, this can be attractive for borrowers as it allows them to secure a coupon based on benchmark rates and spreads on the day of pricing, thus neutralising market-risk and set a settlement date of meaningful latency following pricing. This allows for the reduced cost of carry of existing debt that is approaching maturity.

Up to three months delayed settlement at no additional cost to the borrower is standard in USD issuances and most other currency private placements. In the GBP market, investors will typically offer up to four months delayed settlement at no additional cost to the borrower. For delayed settlements longer than this, investors will demand a premium that steps-up with each additional month beyond three-to-four months after pricing.

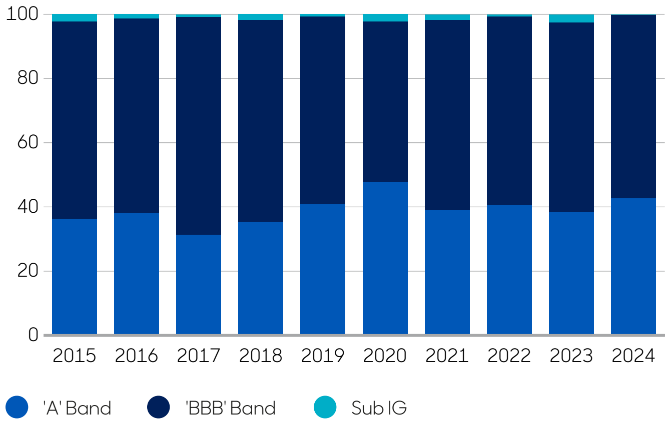
Credit quality

The overwhelming majority of transactions in the US private placement market - 95% plus of annual issuance - are Investment Grade. Unlike in public debt markets, for private placement debt issuances, a public rating by one of the major credit rating agencies (Moody's, S&P, Fitch) is not required. This aspect can sometimes be appealing for smaller private companies that may value the additional confidentiality and reduced disclosure burdens, in addition to the cost savings.

Figure 6: Private placement credit rating breakdown (2015-2024)

Private Placement Issuance by Credit Rating Band (based on NAIC designtion by volume in USD eqv)

% of total annual issuance



Source: Private Placement Monitor as at 31 December 2024.

While an external credit rating is not required to access the private placement market, in practice, to aid the price discovery process, issuers increasingly are obtaining ratings. At present, c. 80% of annual issuances obtain ratings from a credit agency, with c. 60% of annual issuances obtaining ratings from one of the big three credit rating agencies.

The NAIC designation explained

The North American Insurance Commission ("NAIC"), which is the US insurance sector regulator, issues NAIC designations. This designation maps the required capital charge that NAIC-regulated US insurers need to post against their investments. NAIC designations are prevalent in the marketing of private placements since the majority of buyers continue are US insurers. NAIC designations largely map to the following ratings bands:

- NAIC-1: A- or Higher
- NAIC-2: BBB+ to BBB-
- NAIC-3 and below: BB+ or lower

It is worth noting that NAIC designations are distinct from external agency or internal investor ratings. This is because the designation is derived from a combination of the following:

i. the corresponding designation (if available) of an external agency that is recognised by the NAIC;

ii. the views of the insurer themselves; and/or

iii. an analysis by the NAIC based on historical data. As such, unlike external agency or internal investor ratings, it is notable that NAIC designations are not forward-looking.

Spread

Private placement investments typically deliver a higher yield than public bonds to compensate investors for the forgoing of liquidity (i.e. an illiquidity premium) as well as structural complexity where relevant. This is essentially what allows for higher total returns for private placements than what can be achieved by public bonds of similar credit quality. Most rates are expressed as a nominal spread range over a comparable US Treasury (e.g. UST10 + 100bps).

Documentation

Issuers must provide historical financial data and a purchase agreement, such as Note Purchase Agreement ("NPA") to issue in the private placement market. Transactions are typically negotiated directly between lenders and borrowers, with the assistance of external legal counsels. However, it is worth noting that the disclosure and documentation requirements of private placement are much less onerous than for public bonds. Combined with the potential forgoing of external debt ratings, this can entail significant execution cost savings for borrowers.

Covenants

Covenants are common in private placement transactions and are unique to each individual deal. Covenants often provide an additional degree of assurance for investors that goes beyond that of public markets. Covenants are negotiated and adjusted to fit the profile of each credit. If a company goes into bankruptcy, private placement debtholders are often paid back before other bondholders.

Covenants are generally designed to protect against event risk, credit risk, and any changes in the debt positioning within the capital structure. They are valuable for private placement investors, particularly because liquidity is forgone when investing in private placements.

In addition to extra assurance for investors, covenants can also provide an avenue through which private placement investors have a 'seat at the table' well before any potential bankruptcy events. This gives both borrowers and investors the opportunity to work together in the event of credit distress, which can directly contribute towards maximising recoveries.

Prepayments and recoveries

Private placement notes are callable, but only with early prepayment 'make-whole' penalties. While callable at any time, the make-whole concept allows the investor to maintain the initial yield of the investment over the remaining term, agnostic to the benchmark rate moves since the investment was priced and crystalised. Recoveries are also generally higher in default situations for private placements than public bonds because of various covenant protections.

Why borrowers access the private placement market

There are many reasons why companies choose to borrow via the private placement debt market. A key factor is greater flexibility for borrowers and the ability to customise the issuance to their specific needs. The private placement debt market, being distinct from other lending sources, also serves to diversify borrowers' lending arrangements.

Private placements require less public disclosure than public debt issuance, which may be appealing for companies looking to avoid extensive disclosures, thus reducing issuance costs and maintaining confidentiality. In addition, the private placement debt offering processes tend to be much less sensitive to prevailing macroeconomic and market conditions, which might be due to the hold-to-maturity expectation of investors.

Why invest in private placements

From the investor perspective, private placement debt offers three key investment advantages:

01	**Economics: Yield enhancement** – securing an additional spread for the foregoing of liquidity enables the crystallisation of yield enhancement on an upfront basis. Ancillary income over the life of the transaction, such as amendment fees and prepayment make-whole provisions are further potential yield-enhancement sources.
02	**Diversification** – portfolio diversification is typically improved since there is usually limited crossover in issuers accessing both the public and private market. We estimate that there is less than 10% of issuer crossover between the public bond and private placement market.
03	**Capital efficiency** – for institutions subject to prudential regulations, such as insurers, the capital charge attracted by private placement investments is most likely the same as for public fixed income, and does not entail the types of capital charges that are often attributable to some other alternative asset class investments. As such, overall capital efficiency can be enhanced.

In addition, since Investment Grade private credit is more structurally customisable, it tends to be well-suited for asset-liability matching portfolio management strategies compared to public bonds. Furthermore, it offers prepayment protection and better scope to maximise recoveries.

Exhibit 2: Investment Grade private placements versus Investment Grade public credit

	Investment grade private placements	Investment grade public credit
Income	Fixed	Fixed
Security	Secured and unsecured	Secured and unsecured
Ranking	Largely senior. Seldom subordinated positions – limited to bank financial issuers	Can be senior or subordinate
Covenants	Maintenance / comprehensive	None
Prepayment	Callable with Treasury +50bps make whole premium	Some callable at par
Tenor	Flexible, 2–30 years+	3, 5, 7, 10, 20, and 30 years
Liquidity	Available although limited, which is more a function of the seldom intent to exit positions before maturity, rather than limited demand	Actively traded public market
Recoveries	100%[1]	58.1%[2]

[1] Investment grade private placements recovery rate is based on our Private Credit Strategy since inception to date. **Past performances is not a guarantee of the future.**

[2] As at 31 December 2024. Source: Moody's Default Trends and Rating Transition report. The Investment Grade public bond recovery rate is measured by the ultimate recovery, based on the long-term average recovery rate from 1987 to 2020.

Key investment benefits of private placements for institutional investors

Economics

Private placements typically achieve higher yields than comparable public bonds because of the illiquid nature of the securities. The illiquidity premium allows private placement investors to receive greater compensation relative to similar credit risk public Investment Grade bonds.

Historically, private placement investments have seen fewer defaults than public bonds given the structural and legal protections provided to private placement holders. Further, private placement transactions allow for the negotiation of covenants directly with borrowers to protect lenders in the event of a default or other major events that may require structural protection.

Enhanced recovery via structural superiority and legal protections

Private placement debt deals are typically offered via a Note Purchase Agreement, which is a written contract setting the interest rate that borrowers will pay, as well as other structural protection features.

Covenants are designed to instill financial discipline in borrowers and protect investors against significant changes within the company that could affect the company's ability to repay its debt. This is especially important within the private market as the securities are illiquid and are often designed to be held to for longer periods. There are many types of covenants, and they are uniquely tailored to each individual credit.

Private placement notes are typically pari passu to bank loans. This means that noteholders from a private transaction typically have better recovery than public bondholders who are unlikely to have the same structural protections are bank lenders and private noteholders.

Exhibit 3: Sample of covenant features typically incorporated in private placement debt deals[3]

Covenant Types	Private credit covenants	Protects	Examples	Likelihood in a deal
Capital structure protection	**Liens**	Restricts future borrowing through assets and preserves location in the capital structure	Permitted liens defined.	Frequent – nearly always present, but can depend on industry
	Priority debt	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 Anti-Cookson clauses	Frequent – nearly always present, but can depend on industry
	Sale of assets	Limits the borrower's ability 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 can depend on industry
	Most favoured lender	Protection in the event of the borrower's main bank facility obtaining different or more favourable covenants – in such cases, the private credit lenders can receive the same benefits of the changed covenant as well	Most favoured lender	Semi-frequently– present, but can depend on industry
Financial	**Leverage or Debt Service Coverage Ratio (DSCR) test**	Ensures repayment of debt relative to cash flows of the company	Debt/EBITDA < 3.5x, DSCR > 1.5x	Frequent – nearly always present, but can depend on industry
	Interest / fixed coverage	Ensures limitation of interest payments relative to cash flows of the company	EBITDA / net finance charges ≥ 4x	Frequent – nearly always present, but can depend on industry
	Net worth	Ensures repayment of debt relative to the overall net value of the company	Net worth > $500 million	Common among financial issuers
Event risk	**Merger**	Limits the types of mergers and restructuring transactions that companies may undertake	Certain restrictions on companies, parent guarantors and subsidiary guarantors and mergers	Frequent – nearly always present, but can depend on industry
	Restrictions on distributions	Limits the distributions the company may make to its shareholders	Distributions limited if DSCR < 1.25x, or upon an event of default	Less frequent – present more typically in tighter credit markets
	Change of control	If a third party purchases the majority of the equity of the issuer, then lenders will be able to exit the transaction	Offer to prepay at par upon change of control	Frequent – nearly always present, but can depend on industry
	Non-payment cross default or acceleration	If the company does not pay another source of debt or is in default with another source of debt, our facility will also be considered in default	Cross-default for non-payment defaults	Frequent – nearly always present, but can depend on industry

Source: Aberdeen.

[3] Note, not all of the covenant examples shown here will always be exhaustively included on every deal, rather there will be variations based partly on sector or industry norms.

Diversification

Private placements offer an opportunity to diversify fixed income portfolios away from solely public investments. Regardless of cyclicality in market conditions, non-public investments offer a different type of security in a fixed income portfolio, while still paying a premium over comparable public bonds.

Non-public investments can provide valuable 'all-weather' protection against undue volatility stemming from market condition changes and generalised risk sentiment shifts, which public markets are more frequently susceptible to.

Asset liability management

Investors in private placements are often insurance companies or other institutions that require asset-liability matching, namely assets providing good yields and stable fixed cash flows that can match liabilities over long durations.

Due diligence and stewardship

Owing to the illiquidity of the assets, due diligence requirements for private placement transactions are greater, with pre-deal negotiations taking place over longer time periods than other debt structures. Typically, there is a circa two-week 'in-market' period compared to usually intra-day completions for public debt offerings.

The due diligence process for private placements typically involves extensive back and forth between lenders, borrowers, brokers, and legal counsel to gather all necessary information prior to the collation of bids for an investment. This includes the negotiation of covenants, which is a critical part of the investment process in this asset class.

Why Aberdeen Investments is the private placement manager of choice for insurers

Our private credit business stands out for its innovative tailored solutions, proven track record, and commitment to sustainability. Managing USD13bn in private credit assets, we specialise in high-quality asset-backed, small to mid-sized private credit deals. With a team of 20 professional investors averaging 19 years of industry experience, we offer tailored solutions to meet the unique needs of its clients.

Operating within a unified fixed income business, we leverage deep credit expertise to construct portfolios that meet insurers' liability-matching needs. As the only independent investment firm with an insurance background, we have been investing in private credit markets with insurance clients since 2012. As at 31 December 2024, we manage USD 10.4bn of private placement and infrastructure debt on behalf of our clients. The commitment to excellence is reflected in bespoke private credit mandates, regulatory expertise, consistent ratings, and comprehensive reporting, making Aberdeen Investments a leading manager in private credit.

Investment involves risk. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. Past performance is not a guide to future results.

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