



ACTUARIAL SOCIETY
OF SOUTH AFRICA

Advancing Actuarial Excellence

Private Credit: The Risk Adjusted Edge in Institutional portfolios

27 March 2025



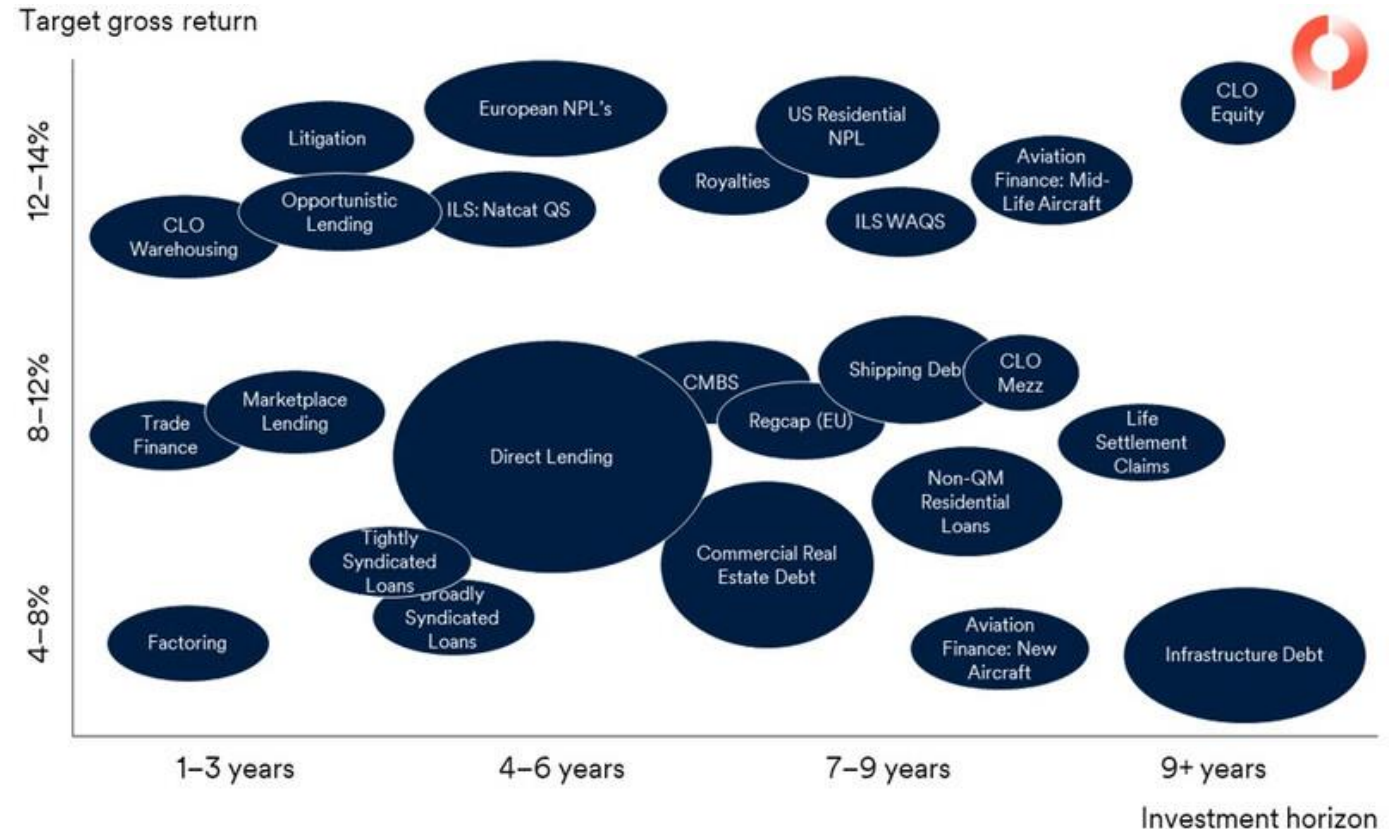
Agenda

- What is Private Credit?
 - Which institutional portfolios / investment strategies?
 - Evolution of Private credit
 - Benefits of Private Credit
 - But...
-

Introduction to Private Credit



“Private credit refers to non-bank lending where loans are not traded on public markets, encompassing direct lending, mezzanine debt, distressed debt, and other financing from institutional investors, hedge funds, and private equity firms...”



Private Credit - Institutional Investors and Investment Strategies

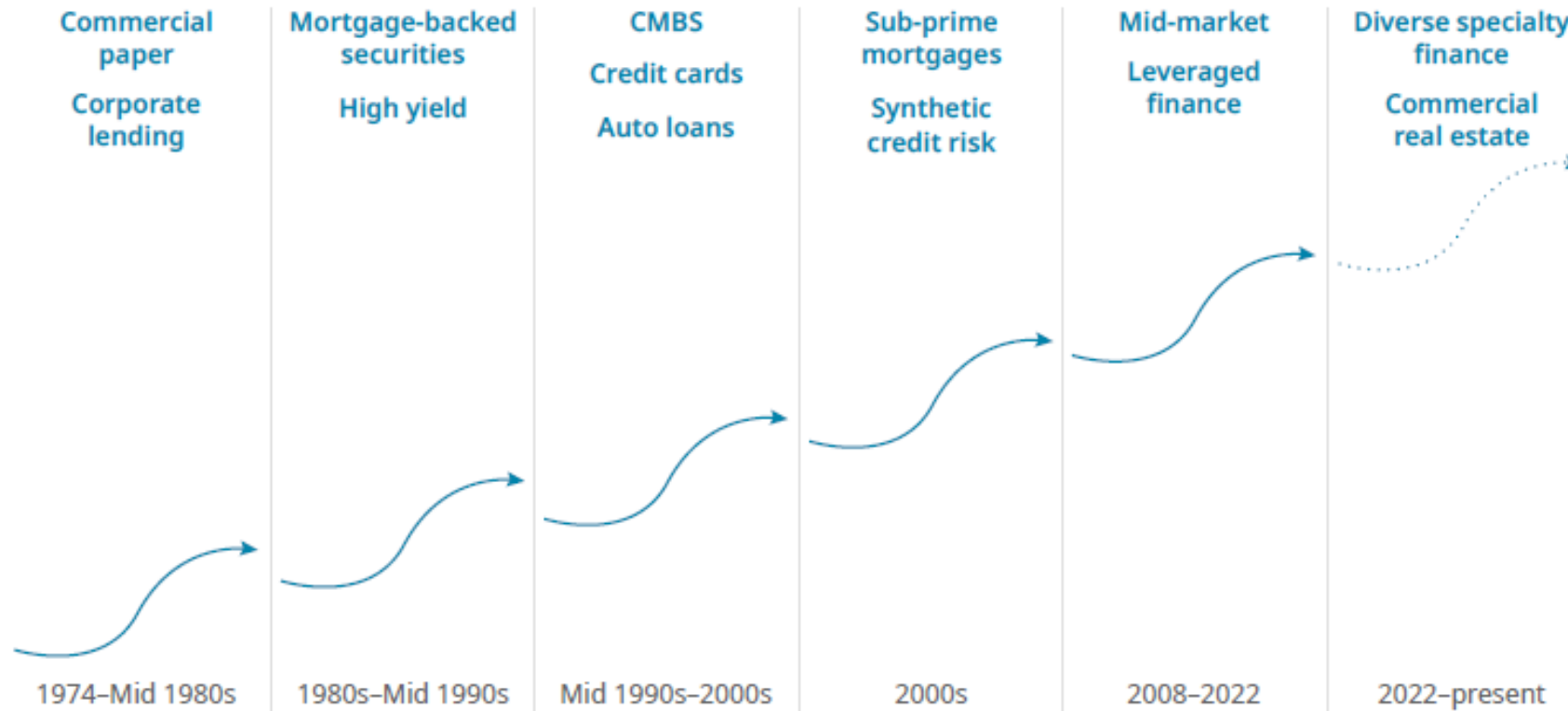


Typical Users	Investment Approach	Description	Key Characteristics
Pension funds, Insurance companies	Liability-Driven Investment (LDI)	Matches assets to liabilities, focusing on duration and cash flows.	Common for defined benefit plans, ensures funding for future liabilities, reduces risk.
Endowments, Foundations	Endowment Model	Diversified strategy with significant alternative investments (e.g., private equity, hedge funds).	Long-term growth focus, high allocation to illiquid assets, aims for 5% real return.
Sovereign wealth funds, Endowments	Active Management	Aims to outperform benchmarks through security selection, market timing, etc.	Requires skilled managers, higher fees, potential for alpha generation.
Pension funds, Mutual funds	Passive Management	Tracks indices for cost efficiency, minimizes active management costs.	Lower fees, suitable for large-scale, low-cost implementation, follows market returns.
All types, especially Endowments	Portable Alpha	Separates alpha from beta using derivatives for market exposure and alpha-generating strategies.	Enhances returns, maintains diversification, involves complex implementation.

The Rise of Private Credit as an Asset Class



Exhibit 1: Waves of bank disintermediation



Source: Oliver Wyman analysis

The Rise of Private Credit as an Asset Class



DEPOSIT SHARE OF HOUSEHOLD SAVINGS

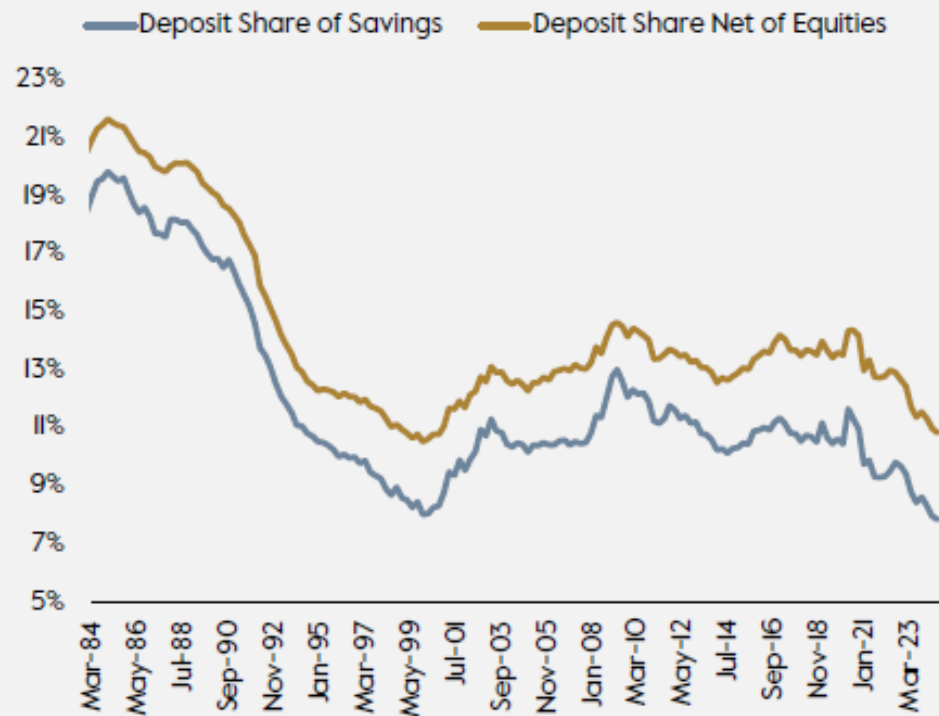
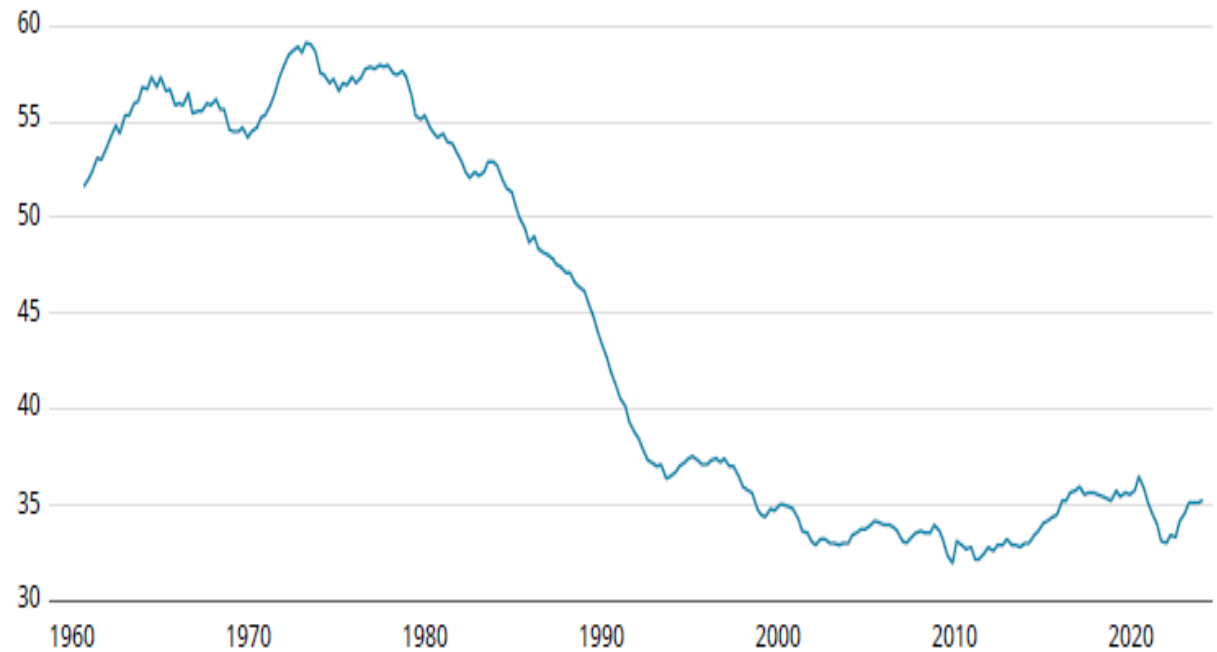


Exhibit 2: Banks have a falling share of private lending in the US economy

In percent



Note: Chart shows banks share of total outstanding lending volume to households and non-financial businesses

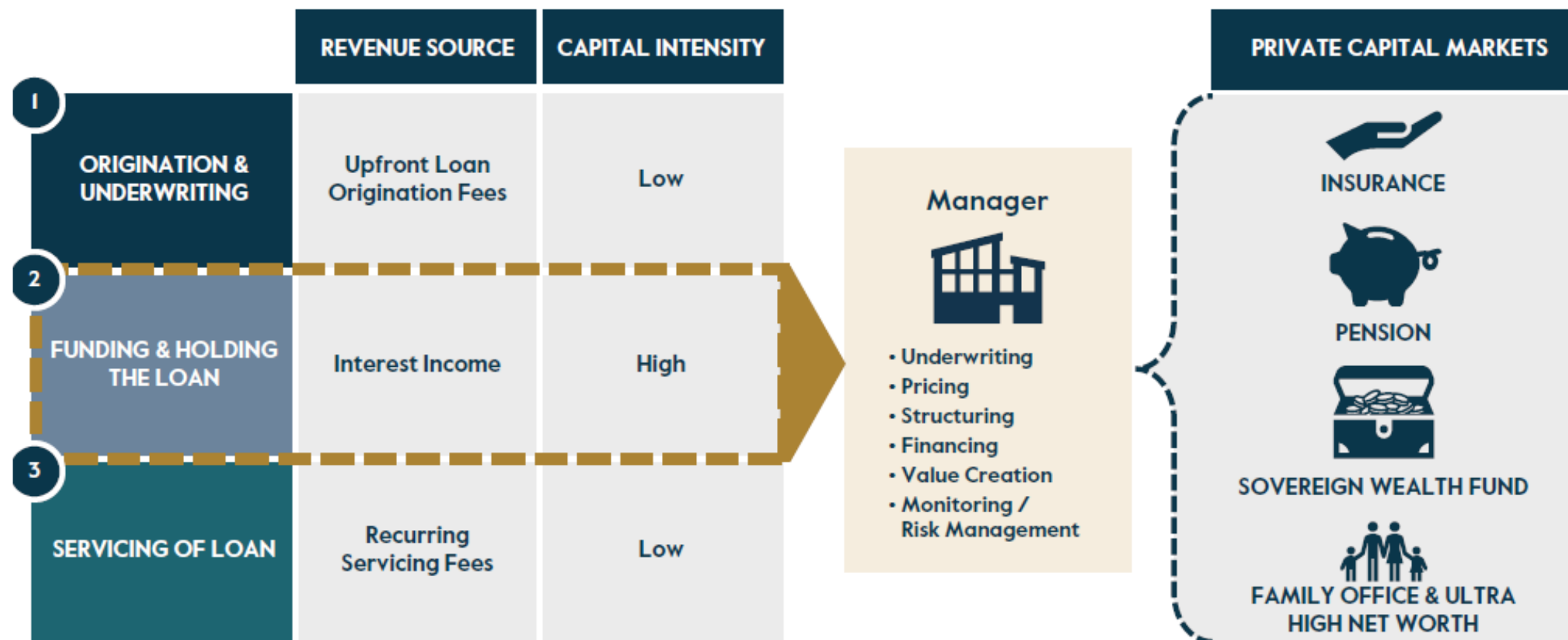
Source: Federal Reserve Board, FRED (Federal Reserve Bank of St. Louis), Oliver Wyman analysis



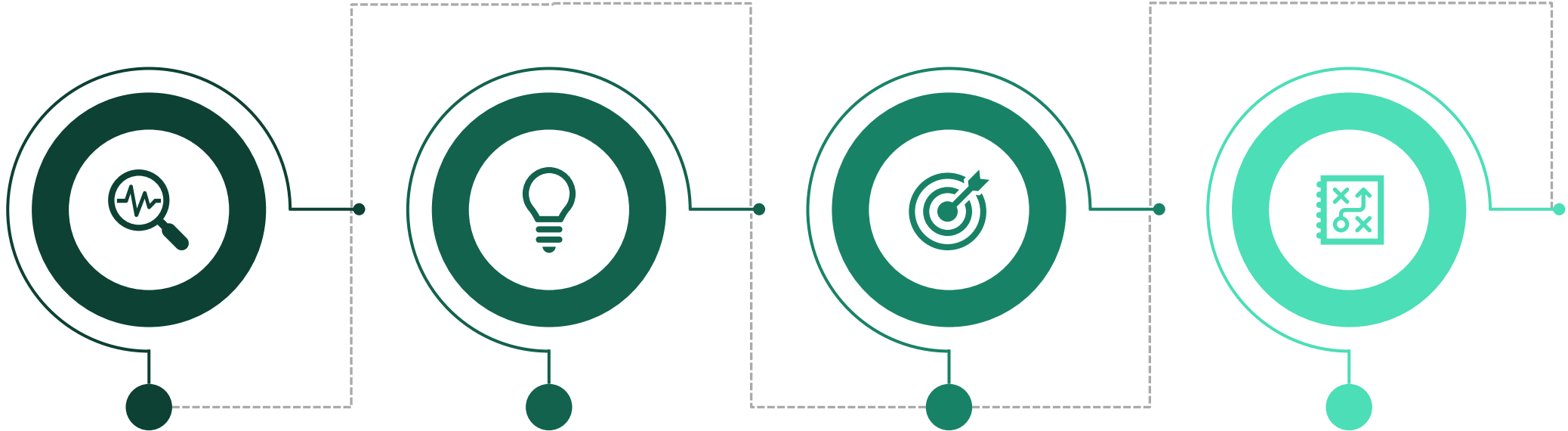
An Evolution of Lending Leading to...

Banks are increasingly seeking to externalize portions of their balance sheet...

...by partnering with managers in the Private Capital Markets



Key Benefits of Private Credit



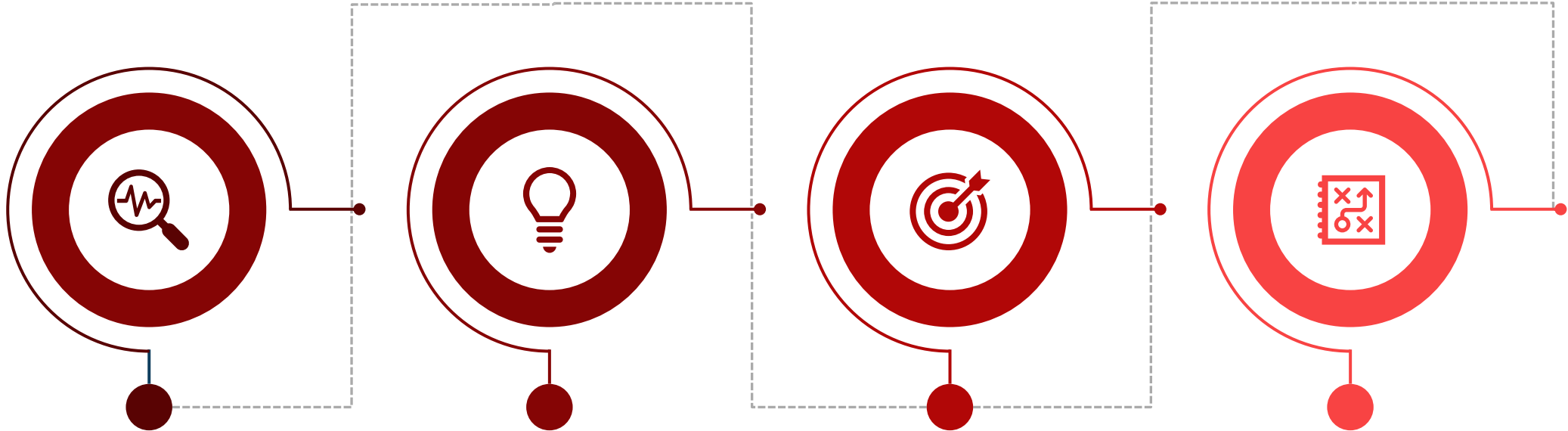
**Enhanced Yield and
Risk-Adjusted Returns**

**Portfolio
Diversification**

**Structural Protections
and Covenants**

**More liquid than other
private markets**

Enhanced Yield and Risk-Adjusted Returns



Higher Yields:

Provides a yield pickup of 200-400 basis points over comparable public securities (e.g., listed corporate bonds)

Illiquidity premium also adds to higher yields compared to listed instruments

Targeted Strategies:

Allows customization of risk-return profiles through selective underwriting, balancing equity-like returns with debt-like downside protection

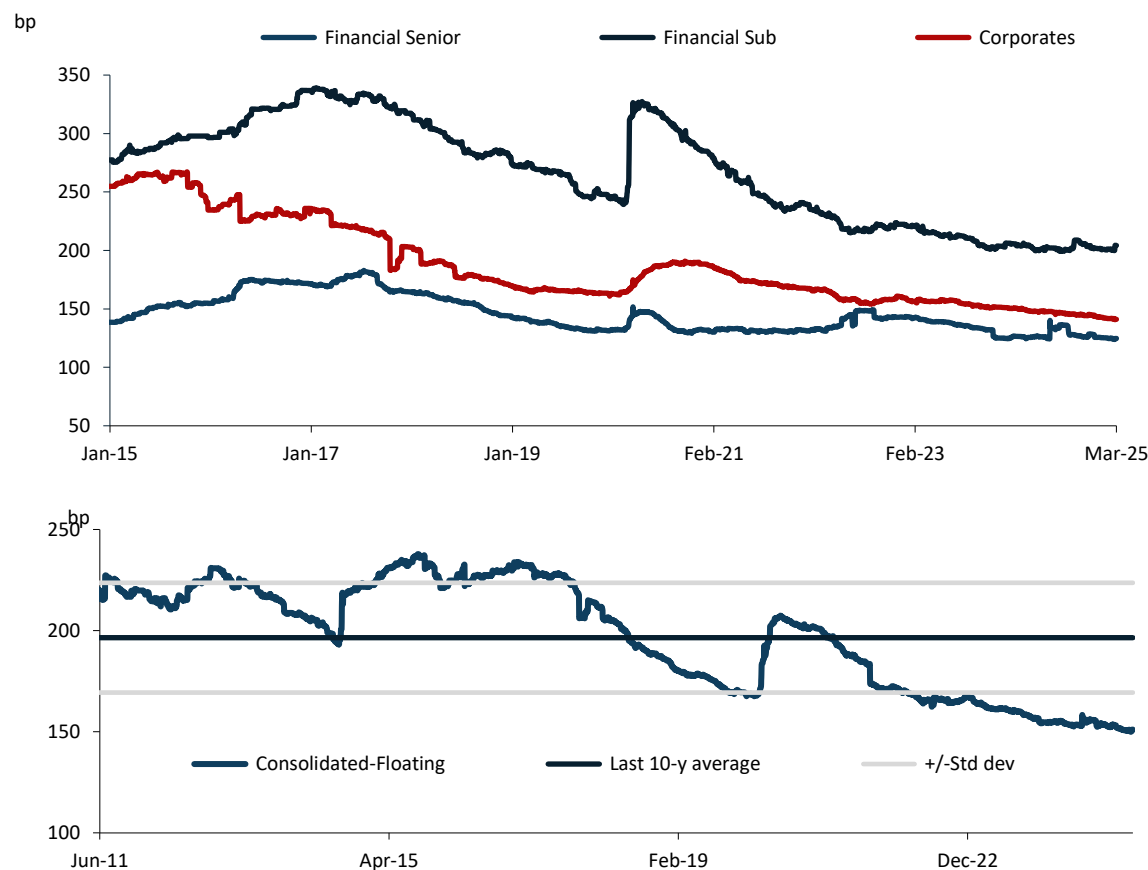
Default Management:

Lower loss-given-default rates

Enhanced Yield and Risk-Adjusted Returns



Enhanced Yield

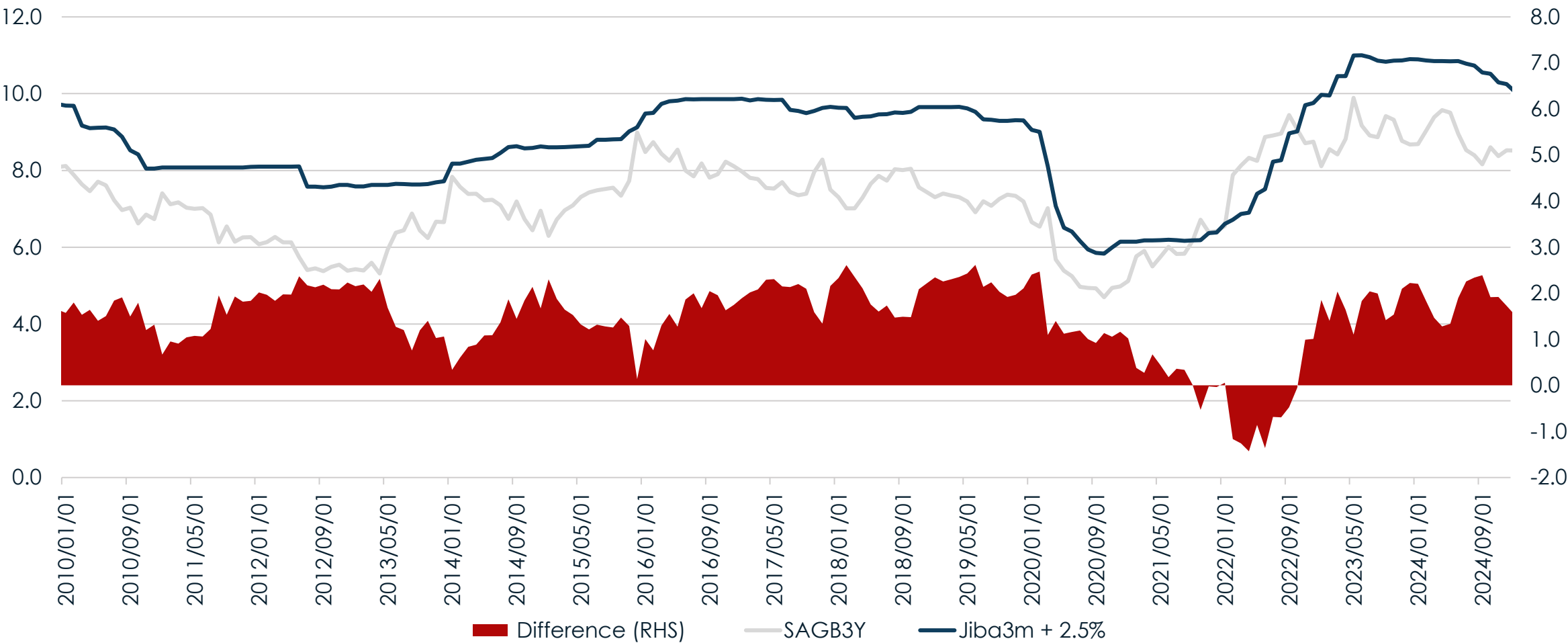


Risk-Adjusted Returns

- We've observed lower volatility in private credit – especially infrastructure debt
- Mark to market volatility is lower –
 - Less frequent trading
 - Less overreaction
- Our default frequency has been too low to be statistically significant – but –
 - We've also observed lower loss rates – due to structuring
 - We are able to manage workouts better
 - We are able to step in earlier – protect company value

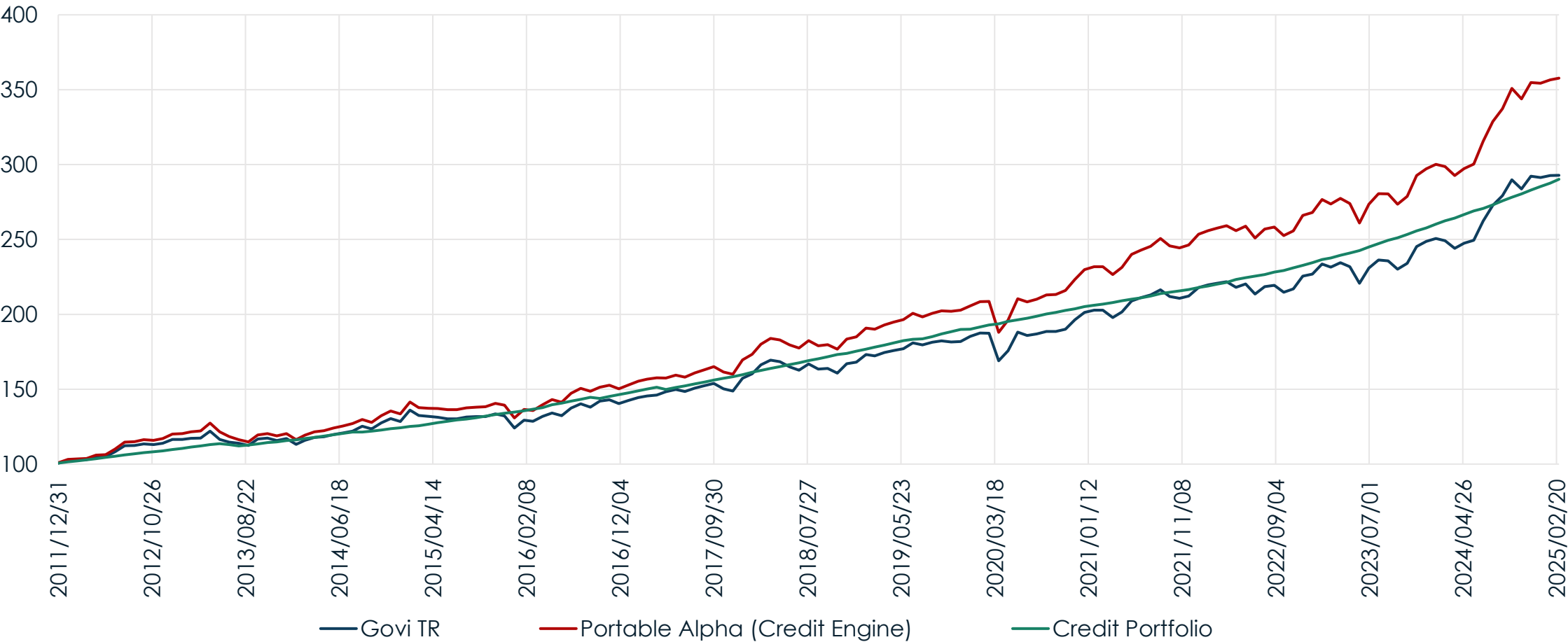


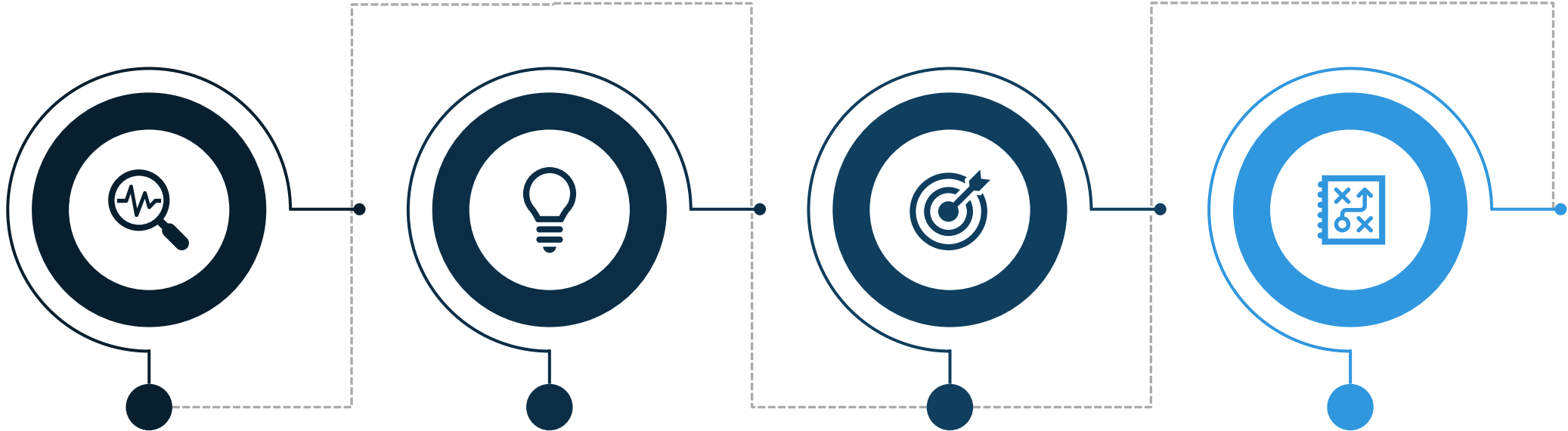
Enhanced Yield and Risk-Adjusted Returns





Portfolio Diversification





Low Correlation:

Globally, correlation coefficients of 0.2-0.4 with equities and public bonds, driven by company-specific and private market dynamics.

Unique Risk Factors:

Exposure to middle-market firms and niche sectors unavailable in public markets diversifies risk sources.

Efficient Frontier:

Improves portfolio Sharpe ratio by enhancing returns without proportional risk increases (e.g., studies show a 10% allocation can boost risk-adjusted returns by 15-20%).

Fixed-Income Diversification:

Complements traditional bonds with varied credit qualities and maturities.

Portfolio Diversification



Unique JSE listed debt issuers - DMTN

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Banks	10	13	11	15	18	16	17	15	15	16	18	19
Corporate	32	26	21	20	24	21	25	22	19	27	26	24
Muni	2	2	1	1	2	1	1	-	-	-	-	-
Securitisations	11	9	11	11	11	12	15	10	16	13	12	13
SOE's	8	7	6	8	7	5	7	7	5	5	2	3
Total	63	57	50	55	62	54	64	55	55	62	58	59

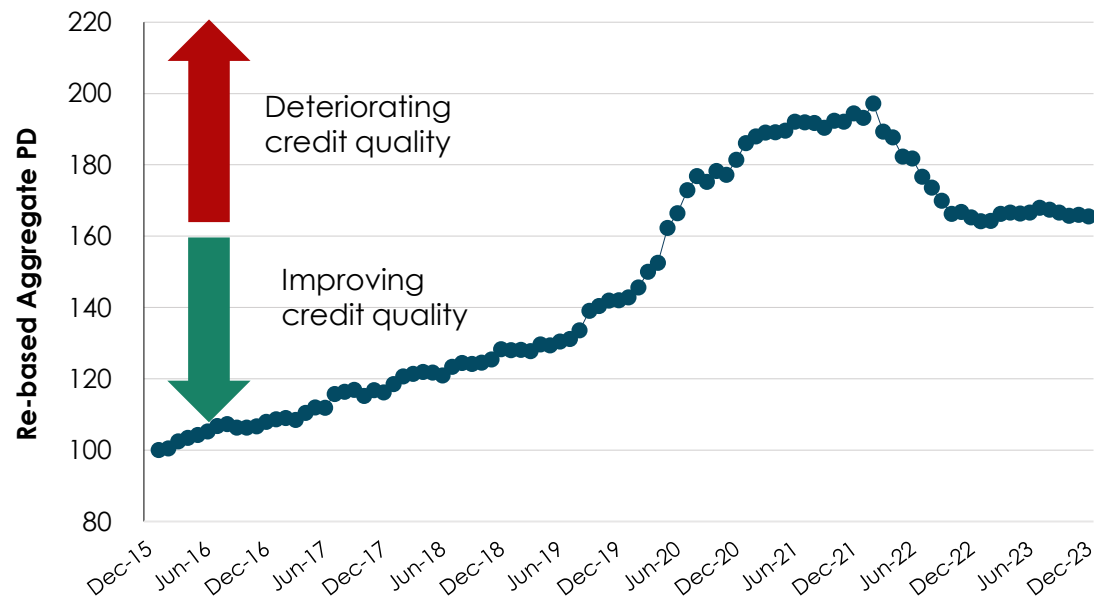
Portfolio Diversification



Unique private debt
issuers –

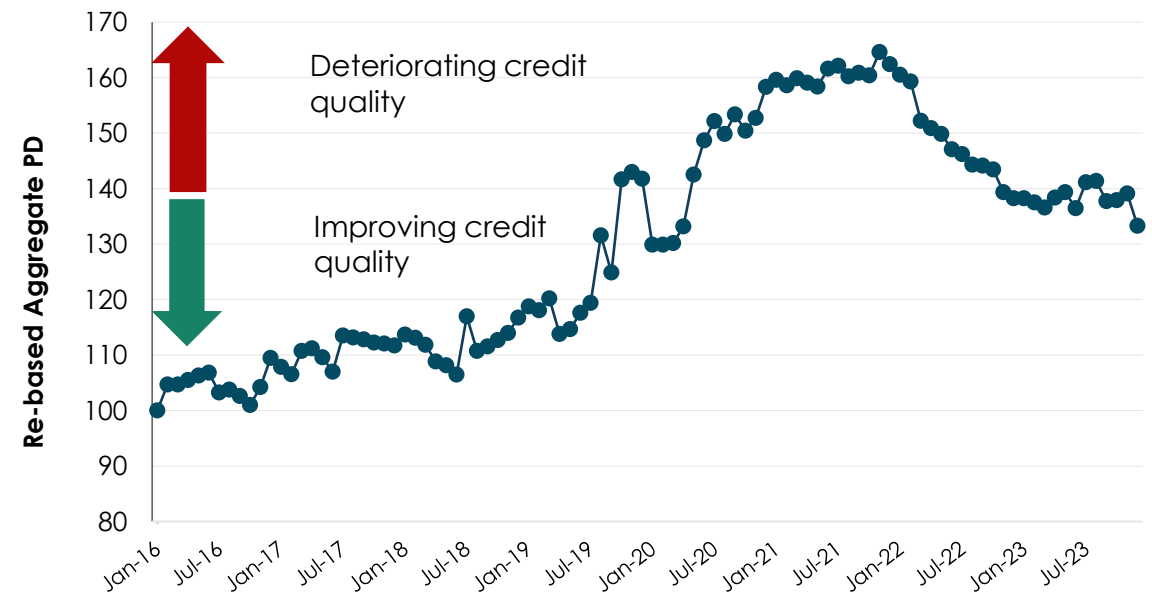
SA Large Corporates
(multi banked) –

202 constituents



DMTN issuers –

SA Large Corporates –
19 constituents



Structural Protections and Covenants



- **Strong Covenants:** Maintenance and incurrence covenants enforce financial discipline (e.g., debt-to-EBITDA ratios), reducing default risk.
- **Negotiated Terms:** Direct lender control over agreements allows tailoring to risk tolerances and monitoring of borrower health.
- **Seniority Benefits:** Higher recovery rates (50-70% vs. 40% for high-yield bonds) due to collateral and capital structure priority.
- **Risk Management:** Aligns with actuarial stress testing by embedding contractual safeguards.

Source: Moody's Investors Service

Priority Position	Issuer weighted Recovery Rates	
	2021	1983-2022
1st Lien Bank Loan	66.4%	65.7%
2nd Lien Bank Loan	34.1%	33.3%
Sr. Unsecured Bank Loan	n.a.	46.3%
1st Lien Bond	65.9%	55.0%
2nd Lien Bond	98.1%	44.2%
Sr. Unsecured Bond	48.7%	37.7%
Sr. Subordinated Bond	17.0%	31.0%
Subordinated Bond	n.a.	32.0%
Jr. Subordinated Bond	n.a.	22.3%
* We use market prices (bids) to proxy recoveries in this exhibit.		



Aspect	Listed Credit	Unlisted/Private Credit
Liquidity	High; traded on stock exchanges like BSE or NSE, allowing easy buying and selling.	Low; traded over-the-counter (OTC) with limited secondary market, making it harder to liquidate.
Transparency	High; real-time pricing and regular disclosures are mandatory due to exchange listing.	Low; less information is publicly available, requiring more due diligence from investors.
Yield/Returns	Generally lower yields due to lower risk and higher liquidity.	Generally higher yields to compensate for higher risk and lower liquidity.
Credit Risk	Lower; typically issued by governments, public sector units, or established companies with strong credit ratings.	Higher; often issued by private companies with potentially lower credit quality and less public information.
Accessibility	Open to the general public; can be purchased through brokers or online platforms.	Limited to select investors such as high-net-worth individuals (HNIs), institutional investors, or family offices; often through private placements.

But(t)...



- Accessing these benefits are not easy...
- Origination | Deployment
- Risk assessment and implementation
- Ongoing monitoring – covenant monitoring
- Work-outs

Step 1 internal rating



- quantitative process (CreditEdge)
- **qualitative process**
- issuer and issue ratings

Step 2 credit vetting



- Central Credit Committee (CCC) and credit sub-committee
- **reporting to Sanlam Board**

Step 3 limit setting



- Based on **mandate**
- **pricing**

Step 4 monitoring



- internal vs external ratings using internal credit system (CCMS)
- **monitoring of limits by SI Compliance**

Conclusion



- Private Credit is here to stay. It is evolving and growing.
- Incorporating it into institutional portfolios have many benefits.
- But –
 - It is an alternative asset class that requires specialist skills
 - Origination
 - Risk assessment
 - Implementation
 - Work-out: recovery optimisation