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Private Credit: Significant Risk Transfer Market Outlook

1. Introduction

Credit risk transfer (CRT) creates and sells financial instruments to transfer credit risk from one market participant to another. CRT is widely used in consumer and commercial credit markets as an integral part of credit underwriting and risk management, and it is relevant for almost all market participants, including banks, investors, and insurance companies. The CRT market, represented primarily by credit guarantees on asset-backed securities, supports the issuance of asset-backed securities and related products by taking on a portion of the credit risk. The term "significant-risk transfer" (SRT) describes credit risk transfer by government-sponsored enterprises when they issue securities not explicitly guaranteed by the government and without obtaining a credit rating equal to or above their own. This text contributes to our understanding of the workings and performance of the SRT market. It reveals how the GSEs complete SRT seamlessly and suggests that possible SRT market disruptions caused by reforming the GSEs are likely manageable. Moreover, it discusses institutional arrangements governing the GSEs' SRT transactions, risk-based pricing of the guarantees, and potential scenarios for the future of the SRT market. Since the mortgage risk market is of significant interest to the authorities under the new regulatory environment, this text also discusses the regulatory treatment of mortgage risk alternatives, including the remaining private credit enhancement market.

1.1. Background and Definition of Private Credit

Private credit, a significant market risk transfer channel, has grown significantly since the end of quantitative easing. This growth, reflective of the substantial price gains of corporate loans in a loose monetary environment, has been driven by strong credit growth, leveraged finance, and opportunities for foreign investors. Private credit has become a key player in the market, providing several long-term loans to large companies and owners, traditionally arranged syndication without

securitisation, or under the two new investment funds that provide customised financing. In recent years, the non-bank investment category has exploded, attracting a variety of investment strategies, from the combination of insurance, alternative banking business, pension funds, religious institutions, and funds to managers of speciality fund managers/portfolio management.

The advantages of private credit are that it offers issuers flexible covenants, which can support long-term growth and investment in their business while obtaining tailor-made credit solutions tailored to the individual requirements of each unique term of credit and investment appetite as much as possible. Despite the negative connotations of the word "private", it's worth noting that most of the credit-financed public sector options exist in the private sector, especially the loan market, where the financing provided is not syndicated but is accompanied by due diligence, a term loan arranged among a small group of syndicated banks or a commercial bank led by a balance sheet administered by a sole lender. Moreover, the majority of listed companies and private companies that benefit from different sources of funding to open or expand in advance of strategic investor, shareholder, or restructuring requirements or to raise funds are considered to be privately owned companies since the bonds of public companies are considered part of the group of companies, for the classification section or putative private debt placement of the relevant service providers, including arranger, placement agent, and trustee.

1.2. Importance of Significant Risk Transfer Market

Significant Risk Transfer (SRT) is an essential feature of the traditional Insurance-Linked Securities (ILS) market. Reliance on SRT is also evidence of the critical funding and risk-bearing role reinsurers provide for the global economy. It is no surprise that regulatory scrutiny is heightened here as well. Regulators' treatment of SRT markets is warranted by third-party limits' outsized impact on carriers. Yet, targets and resource drivers for SRT transactions differ significantly from developing a catastrophe bond in the ILS space. Restricting types and coverage limits of SRT transactions could lead to increased demand for risk-bearing capital within traditional reinsurers of last resort. Consequently, there is solid motivation for SRT transactions throughout the P&C sector, yet in 2018, the market for these products came with several challenges.

SRT parties are, by definition, professional and sophisticated. This is a noteworthy difference from SRT sectors on the life insurance side. In the life sphere, where

there are minimal inherent institutional conflicts with transactions, SRT markets are much larger and more significant in ticking regulatory adequacy boxes. While the industry and a collective population may be better protected against a future black swan event with less third-party capital, global reinsurers are out of feasible solutions to intercept the growing claim runoff from maturing insurance and reinsurance agreements on their business books. The sophisticated professional buyers creating credit solutions distinguish their credit investment risk appetite and safeguard through intensely negotiated features in underlying transactions. In this regard, discrimination on behalf of state assistance would not be welcomed. However, these investors and the transactions they propose and execute fundamentally differ from those creating catastrophe risk transfer solutions.

2. Historical Evolution and Growth of Private Credit Market

Both economic and regulatory factors have significantly shaped the development of the private credit market. The evolution of private credit dates back to the pre-financial crisis era. It began as a niche market, driven by real estate and asset-backed deals such as mortgage-backed securities with a limited lending activity of investment and pension funds. The onset of the financial crisis of 2007-2008, where highly leveraged financial institutions had an addiction to structured products, and the subsequent implementation of stringent debt capital adequacy requirements has further reinforced this trend.

A subsequent reduction in bank lending to small—and medium-sized enterprises in the euro area triggered the launch of the ABS purchase program in November 2014. In contrast, private credit evolved due to changes in bank regulation and capital requirements, facilitating a structural deleveraging of banks post-2008. Such changes led banks to cautiously assess what type of loans they could support under the new regulations.

2.1. Pre-2008 Financial Crisis

The introduction of different types of levered credit products continued in 2006, and the credit cycle was at its confusing euphoria stage when expectations were positive and models did not work. The decrease in defaults suggested the degree of leverage. The market generated estimates of implied default rates and implied recoveries, confirming the bubble-like conditions at the top of the credit cycle, which helped investors evaluate their returns. From early 2006, a series of megadeals became underwritten. These deals, among many others, created portfolios 6-9 times the equity capital. Collateral losses at these leverage levels

were sufficient to bring the mezzanine tranches to default over-collateralization, already at 100%. The different types of CDO tranches with different seniority provided investors with the right each time to pocket the spread without exposure to moral hazards coexisting within the CDO.

Improperly understood correlation contributed to the favourable opinion, preventing the analysis from discovering the investors' high exposure to the same collateral in similar products. Mortgage market growth did not meet market expectations, so investors had to identify mortgage bonds that paid default frequency not lower than historical performance. Banks suggested the idea, strongly asking the mortgage originators to recommend mortgage brokers extend the selection criteria, particularly among current-pay, Alt-A, and subprime borrowers, to maintain their commissions. Credit derivatives helped by moving loans and expanding the selection to the private rented sector. Possible losses in the pools held in banks' balance sheets began to increase. Banks consequently encouraged banks to sell their previously originated assets to facilitate the required financial engineering operations. When Lehman Brothers failed, eight of the 12 largest mortgage brokers of 2006 went bankrupt because their business model disappeared. The peak of the mortgage bubble lasted thanks to the upstream sale fees, which were destroyed along with lending incentives when defaults began to touch the normalised level.

2.2. Post-2008 Financial Crisis

Key risk transfer markets, including private credit markets, have experienced significant growth during the post-2008 financial crisis. The closure of major financial institutions forced numerous large, formerly interbank, risk-sensitive market participants to withdraw; commercial banks, in particular, withdrew their market business activities as rulemaking and higher capital costs reduced these activities. Other sectors have benefited, including small high-frequency trading operations and principal rather than agent positions, as smaller regional and mid-sized banks reduced risk transfer capabilities or ceased trading. Other sectors, such as new asset managers, large commercial centres, platforms, and shadow banks, including smaller investment funds and public policy regulated or controlled trading, continue to increase in importance within risk market functions on an ongoing basis. Both high-frequency and speculative trading continue to be strong drivers towards points of widening market bifurcation, especially with trading

centres that feature high concentrations, high volumes, or where high correlations appear – having a high, current relevance to policy.

3. Key Players in the Private Credit Market

Many institutions invest across the various sectors and commingled vehicles in private credit. Investors span the spectrum from retail through investment-grade credit office tenants to sub-investment-grade borrowers in the business development company. The sources of financing include traditional bank lenders, insurance companies, speciality finance companies, middle market lending funds, business development companies, and large asset management firms.

However, the most significant trend in private credit has been the substantial growth of asset management firms in the leveraged lending space. Those firms offer various credit-based products from several platforms, with multiple investor restrictions and liquidity constraints. Key participants include more prominent global asset managers and a handful of specialised middle-market lenders. Due to the heterogeneous nature of private credit, opportunities abound across the business cycle, even if many lenders have only been active in the leveraged loan or broader private credit markets since the financial crisis. Lastly, there is also variation in the size of the buy-side players and the amount of credit support necessary for securitisation vehicles sold to institutional investors and specialist funds.

3.1. Traditional Financial Institutions

Private credit, comprised of leveraged loans, high-yield securities, mezzanine, and other illiquid senior secured debt instruments, is generally originated by traditional financial institutions and is used by their middle market and lower middle market customers as a source of business funding. These loans finance general operating needs, acquisitions, equipment purchases, and real estate construction. The sponsors, banks, insurance companies, and other financial entities that originate these loans will generally retain a portion of the debt but still require additional access to funding sources to maintain their book of assets. When providing private credit to their middle market and lower middle market borrower clients, the traditional business model for these institutions is to hold some of the financing on their balance sheet and find a capital market buyer for a portion of the funding yet-to-be-funded. This technique allows them the arbitrage of providing ongoing client service, charging loan origination fees and a portion of the interest paid while avoiding overexposure to credit risk on their balance

sheet. This type of credit risk transfer has been in place for over 20 years, with asset-backed securitisations as the predominant funding sources pari passu with retained A and B tranches sold to help transfer risk back to the capital markets.

3.2. Alternative Investment Managers

The portion of outstanding exposure of Alternative Asset Managers (AAMs) significantly contributes to the level of private credit exposure already outstanding for central global banks. European banks hold approximately 20% of a fragmented market, with the top two holding only 4% of overall exposure, the 10th highest accounting for less than 2% and the 20th accounting for less than 1%. We can surmise from this data that European banks are still very active in this space, and no single central bank has overwhelming influence over AAMs. This lack of concentration limits the potential for systemic risk based on private credit to emerge from banks lending to AAMs.

One of the compelling reasons for holding private credit within bank SC is that prices are significantly higher than for equivalent listed credit and more generally higher than for public credit. Charging a significant risk transfer premium to recognise this fact makes eminent sense, but it is important not to overstate the risks. Firstly, there can be a significant TOB effect, given the non-economic reasons for holding a specific exposure. Secondly, the private credit market is still relatively immature, and the rapid growth of the last few years may have increased the fundamental growth rates, which, perhaps surprisingly, created a small wedge between inherent private and public credit rates.

4. Regulatory Environment and Compliance Issues

As a rule, official government bodies approve export credit insurance and guarantee programs, and private credit and guarantee packages that do not have this backing fall within the regulatory and oversight framework of private credit or commercial risk insurance. The particular risk characteristics of the package, the class plan rating, and commitment minimums will determine which body oversees the portfolio based on the solvency of the insurer selected by the policyholder. Speaking of portfolio assessments, we should not forget the prudential supervision of companies under the financial holding company umbrella, which is performed by the relevant authorities and is aimed at ensuring safety and soundness in the organised field of reservoirs by moving profits out of one freely owned company and into another, to minimise losses. Repackaging

enables moving underwriting profits and capital surpluses to a segmented company to keep it well capitalised on an up or down profit and loss bid.

The Companies Act and judicial supervision of risk ratio practices fall within the jurisdiction of the relevant regulator. The basis for classification proposals oversees optional state standard provisions for all business classes. The new independent stadium becomes an independent risk absorption zone. It absorbs operations to reduce overhead costs and concentrations of risk while stabilising operations and maintaining the economic value of unhypothecated assets. Voluntary reinsurance structures help stabilise or achieve long-term nonproportional quota share risk distribution, company underwriting profits, and capital balances. They offer a few choices concerning reinsurance limit breaches for nonproportional quota share businesses where the mixed layer of quota share and excess of losses reinsurance protects the peripheral interests of the quota share, ceding the company's equity. For this reason, effective quota share transactions at surplus ratios approaching 100% or greater to underwriting institutions with agreed renewal support were structured right from the start with the relevant approval and designation.

4.1. Impact of Basel III and Solvency II Regulations

The banking sector is facing a tide of changing regulatory requirements intended to enhance prudent risk management. Unfortunately, it could also reduce the amount of traditional or originating risky loans, which is unlikely to support the growth of the real economy. This is why a risk transfer market is increasingly essential to the global economy and the overall management of corporate benefits for banks. The significance of implementing the banking regulations is redistributing capital reserves, which were previously used for lending to more efficient projects. Now, it can be deployed to transfer substantial credit risk to investors.

Banks can retain significant risk to meet the capital requirements via the subordinated debt structure. This is one of the most efficient structures for executing subordinated debt transactions. By moving credit risk from the balance sheet to the capital markets, the structure is intended to help the bank reduce the risk-weighted assets they can sell and thus free up capital under the requirements. Among the several covered bonds and risk transfer programs that banks can use to manage their balance sheets, the financial instruments and the structure of the transactions meet all the Capital Rule Requirements. The risk-sharing structure is

also re-examined and shown to comply with the retention rule introduced under the Capital Adequacy Directive.

4.2. Key Compliance Challenges in Private Credit

As explained in the introduction, the compliance challenges and complexities faced by banks and non-banks engaged in private credit come less from the legal and business fundamentals of private credit than from the applied nature of these principles, not only in dealing with structured transactions or particular exceptions, but in dealing with a much higher number of private transactions of divergent characteristics that are highly dependent on the underwriting, motivation, documentation, and administration for accurate risk assessment. How the derivative partnership risks around risk ecosystem principles apply to banks and non-banks very much reaches an endpoint of risk intent. Regulators must seize transparency, fairness, and creditor parity rights through appropriate engagement enforcement. The bank structures with the least need for applied risk regulation are those with a highly standardised ecosystem—legal framework—using smaller, less dynamic, and diverse loan participations and debt trading with a few external funds.

For these constituencies, the lack of a pre-set ecosystem can lead to a lack of pricing transparency and vector inclinations, aggregated risk, and leveraged liabilities, often resulting in regulatory non-compliance. When examined in light of the risk-corresponding principle and exposure limitations, these institutions may indeed be banking without the appurtenance of full-risk regulation. A potential outcome of compensation-driven leverage limits might be a service-agency-risk segmentation through which a bank would sponsor other financial institutions under the economics equivalent rule.

5. Risk Assessment and Management in Private Credit

The significance of risk assessment and management in the private credit asset class cannot be overemphasised. The market's high leverage and risk profile should translate to commensurate attention paid to accurately assessing and trading these risks. In developed credit markets, regular rating reviews and significant attention typically accomplish this buyers pay to open-market borrowing. However, by the covenant limitations, private credit does not have these benefits. For many investors, risk assessment is carried out to a large extent at the point of purchase, causing the market to be highly illiquid.

The desire for investors to access relatively riskless disposable income from private credit markets, while their risk-bearing capacity is rapidly filled with increasing participation, raises moral hazard issues. In the short term, market participants may be forced by remuneration pressures or short-term trading incentives to overleverage the income-producing capacity of these products, using any remaining risk-bearing capacity of the asset manager to cover resulting losses. When regional or market risk shifts dramatically, redeeming unfunded, untransmitted, or illiquid risk becomes paramount. Meetings between the owners of unfunded risk and the fiduciary managers are subject to incredibly high monitoring risk, with assets in managed accounts generally having better outcomes. Assertions that private credit investment carries strong client fiduciary alignment weaken when fund parent company support is invariably required and guaranteed as a primary selling point. The regulatory overlay during rapidly growing trading, characterising a risk transfer role, also becomes salient. Reducing poor industry practices results in more robust client–fiduciary alignment relative to industry tendencies. Yet, it must be acknowledged that fiduciary alignment is more of a condition of entry due to political economy forces rather than an industry-shared social welfare outcome. The mutuality of survival is designed to protect the fiduciary from financial industry capitalism, causing high fees or discretionary compensation made possible by regulatory oversight.

5.1. Credit Risk Assessment Methods

An investor seeking to assess the default risks in a structured product often encounters the common problem of estimating the gap by an expectation given the absence of a default track record of a SPA or the scarcity of listed debt/equity of such SPAs. Over the years, financial and academic services have developed various empirical models to assess the probability of default and recovery rate if an issuer defaults. We face many obstacles and problems in estimating the actual likelihood of default of privately issued securities, such as difficulty in measuring credit spreads, a lack of transparency and liquidity, and difficulties in approving and making large deals caused by actuarial complexity. The securitisation of diverse credit profiles is significantly exposed to economic risk factors that cannot be conveniently modelled. Each issue has specific material risk parameters, complicating the modelling and portfolio construction.

In corporate bonds, median recovery rates are roughly half the average—53% versus 41%—because most bonds are collateralised. The scarcity of data leads to a

lack of a reliable time history. Credit quality diversification and credit risk result from these complexities. Across different types of credit risk and stressed economic scenarios, credit attributes, industry exposures, minimum deal size, dealing agency or uniform credit enhancement, dependable credit analysis, and churn loan security structure effects are consistent. Average annual default rates for risk-based accounts and local depositors are greater than or equal to those for random loan security structures. These are theoretically and empirically unresolved since the first securitisations in 1980.

5.2. Liquidity Risk Management

Many private credit funds build liquidity into their strategies with a combination of structured liquidity from a small number of long-term investors, the use of leverage alongside the ability to sell existing positions, as well as longer-term investment horizons or a set of investment vehicle provisions as alternatives. The relative lure of avoiding correlations with traditional fixed-income strategies, the improved return prospects of private credit, and the often-liberal terms of bilateral lending encourage non-traditional investors to explore the sector. They will doubtless require similarly diverse methods to manage liquidity risk. Structured liquidity offers solutions through investment from well-funded and often patient entities that require higher yields and may also pay less attention to securities not denominated in the lending strategy currency. Generally, structured facilities fund at the wait while benefiting core fund investors and GPs. When that is done, keeping dry powder on hand can be easier if opportunities arise later. We think further opportunities exist for managers to improve structured liquidity to limit private strategies' own market impact risk, for example, by considering investing excess capital with an incumbent strategy at the cost of reducing future investment performance or directing excess capital to growth strategies that ideally have no resemblance. Regulatory approaches to managing market impact are complex. Still, they can also influence the structure of bilateral or intermediated investment capital in ways that could add private credit to the broad range of liquid markets for sophisticated market participants who should play a more central role in trading asset market risk.

6. Innovations and Trends in Private Credit Market

It is a recurring narrative that the current stage of the credit market cycle is marked by rapidly increasing complexity and innovative product structures, reorganisations that include multiple classes of debt, and relatively junior classes

with new rights and remedies, as well as a range of methods of protection for such junior courses. Innovations can entail new market-making and liquidity management constructs. Concern with some recent trends has led to an evolving dialogue involving market participants and public policymakers. These types of conversations often flow from the experience of the several most recent major defaults and restructurings. Each era has its own set of challenges and innovations.

In 2020, credit markets were characterised by the sheer size and scale of investment and lending activities. A partial chronicle of innovations within the credit market itself involves the emergence of a raft of additional finance providers. In the ranks of traditional finance, counterparties are trading houses in a variety of deal structures and new asset classes, which itself is a non-euphemistic recharacterisation of the trend toward diversification, complexity, and interrelationship of tranches of debt classes with upper tiers holding significant first loss equity risk that have appeared, mainly due to their participation in highly rated debt issuance vehicles.

6.1. Technology and Data Analytics

Improvements in technology and the abundant availability of data are revolutionising the asset management industry in general and creating enormous opportunities in the private debt space. Technology has transformed how asset managers evaluate data, generate insights, augment fundamental analysis, and holistically manage investment processes. Managers increasingly deploy complex data analytics tools capable of processing large data sets within shorter periods. In addition to providing a comprehensive set of foundational insights, these tools allow asset managers to test market hypotheses without requiring additional resources while reducing the time investment horizon. Increasingly, asset managers are using big data and other analytic resources in strategy construction, screening, and selection of investment portfolios as tools to drive alpha, identify potential dangers, navigate complex macro environments, incorporate alternative data sources in the investment due diligence process, and build alternative authorisation platforms to guide their clients' investment decisions.

The acceleration of big data and technology deployment means that superior asset managers now have an advantage over managers who cannot afford or leverage technology's advancing predictive platform. They are better at unearthing changes in structure, liquidity, technical indicators, and transaction data that signal inflexion points, risk factors, and potential returns. This rapid growth of

technology further complicates the prospective growth circumstances and creates critical investment attributes, which could put superior money managers on the line. This technology and data explosion may help asset managers build more profound, advanced analytics and investment views. Consequently, asset managers will be more able to enhance their investment activity and optimise results with fewer resources within a stricter regulatory framework. Growth and the employment of big data and advanced analytics will help illustrate how sophisticated, purely cost-driven strategies will provide more stable, higher-default risk diversifiers than the more complex-style loan portfolio.

6.2. ESG Integration in Private Credit Investments

A natural candidate for including ESG analysis in credit selection is the private credit asset class, in which direct lending is carried out to provide a large amount of capital to private companies. Moreover, efforts to enhance corporate value from the perspective of the "social" aspects that affect various stakeholder relations and the "governance" that aims to balance interest distribution, conflict management, and the company's long-term development have become increasingly important issues. For private credit asset management, the management company is interested in the financial lifecycle of investee companies, and active dialogue on the cultivation of investee companies rather than enforcement is expected. Direct lending through private credit investments is better positioned to ensure that the joint financing of companies and investors, sponsorship provided to companies or other stakeholders, and proper procedures for deploying capital are carried out consistent with the interests of both companies and investors.

To enhance ESG alignment in private credit investment opportunities, active dialogue with companies seeking fund procurement is required, and providing sponsors with resources to support ESG development in investee companies via dedicated ESG investment specialists can make the ESG investment process effective. It can also enhance the success of the investment. Investors can protect themselves by using private credit investors as "active shareholders." Private credit asset managers have a weekly and detailed dialogue with their sponsors, following the company's performance, financial status, and progress towards the intended outcome. This level of engagement differentiates the asset class from other credit investments. The credit manager should consider ESG alignment in partnership with the sponsor, discuss integrating these factors into the investment plan, and adjust the alignment/plan analysis during the investment lifecycle.

Also, when asset managers enter into the ESG investment role in the lead, alignment with the sponsor on these principles becomes more effective, which results in the development of investee companies and alignment in times of dislocation.

7. Geographical Focus and Market Opportunities

Geographical Focus and Trends

Relative value opportunities can be found across markets and segments where local economic and political conditions reflect their potential for growth and investor demand inside and outside local capital. Excluding certain countries, G-EM countries are likely to achieve their peak growth and financial elasticity rate sometime between 2020 and 2030, in our judgment. Still, collectively, the pace of growth during this period is likely to be twice what it is in the US. Local investor pools will become appreciable if growth assumptions arise, mainly where domestic policies align with global interests. Even when significant institutional credibility is in place, local investor pools can only absorb limited amounts of deleveraging transactions.

Risk, duration, time, judgment, and perhaps creativity on the part of investors are the main parameters to navigate the new PE space. Despite their structural differences and important cyclical risk determinants, significant global growth of the Asia ex-Japan rate will be anchored in the strong, but likely less traded, business and commercial risk foundation of considerable consumer demand. There is the potential to develop projects and initiatives ranging from natural resource development to bridge those investor and counterpart risk differences. At the trim business level, efforts to attract qualified investors can also support business development and consumer growth and contribute to the continued strength of the Asian market.

7.1. North America

2016 US CLO issuance was lower than in 2014-2015 but remained high, particularly during the first half of 2016, at around 220 deals. Although the market did experience significant wobbles during the second half of 2016, these were more from a political than fundamental risk perspective. There was a substantial increase in loan defaults during the second half of 2016, mainly in the oil and gas sector, but lower reserve accounts and greater use of firewalls should protect CLO noteholders. We expect US CLO issuance in 2017 to be slightly lower than in 2016

in both the primary and secondary markets. CLO funds have accounted for nearly 60% of all leveraged loan purchases since 2013, selling most of their recent deals to warehouse, open market, and private equity fund CLOs. 2017 will see a continuation of this trend before regulatory sanctions cause CLOs to retreat from the market.

New regulations and other laws hit the CLO sector but seem unlikely, at this stage, to have a material impact on volumes. In other words, the market has had time to make arrangements and adjust. Over 2016, 183 U.S. CLOs issued USD 81 billion of U.S. CLO Notes, accounting for 58% of the overall USD 139 billion of new, rated U.S. leveraged loan transaction volume. CLO issuance should continue to do well in 2017, assuming current market dynamics remain. While CLO risk retention regulations, with an early phase-in period of late 2016, only directly concern rated CLO notes, the proposed EU rules could significantly affect demand.

7.2. Europe

The EU is going through a period of profound transformation, calling into question its geographic boundaries, political organisation, and the role of states within the EU. This context is reshaping Europe's role and relationship with the rest of the world. The future of the euro, the liberalisation of financial and product markets, the return to full or part-time war, the consequences of refugees and terror, the need for a border adjustment tax or a VAT, the environmental and energy transitions, together with negotiations about transatlantic trade agreements and control of their banking, energy, industrial, and digital networks, are factors directly affecting the economic and financial future of the Eurozone, the EU, and more broadly participating in international trade and relations, social and territorial cohesion, and gains required for European governance, citizens, and businesses – not to mention the appearance and maintenance of more or less interconnected political structures shaping political stability, the regulatory environment, and the democratisation of European and member states.

Moreover, Europe's internal and external profits and losses are asymmetrically distributed over time through rigid contracts, entitlements, and guarantees that are more or less contingent on the outcomes and results of governments. What are the trends in the private placement industry in Europe in the current context? The significant funding gaps that have not been or could not be filled by traditional finance and controlled banking activities have not been and will not be compensated by private placements. Moreover, the inequalities and asymmetries

of treatment of agents within the EU are impressive depending on each agent's type and geographic area. Suppose the main principle of the EU is to be efficient and to maximise welfare by using market mechanisms. In that case, it should strive to achieve regulatory consistency between qualified investors throughout the European Economic Area to facilitate the development of private markets, mutual funds, or other long-term co-investment vehicles. The text briefly presents changes to the regulation and the prominent market trends for private placements in the Eurozone.

7.3. Asia-Pacific

We expect the field to be an area of the broader process following increased reinsurance penetration across many Asian markets. Up to now, this has been chiefly a North Asian interest rate story. Still, proactive regulatory policy from various Asian regulators may increase interest in debt capital markets and associated hedging strategies as market interest rates rise. Asia's insurance industry is expected to grow significantly, driven by robust economic growth and increasing disposable incomes. Government regulation and the transition to a more market-driven economy will drive significant demand for new risk transfer solutions. Eliminating specific prohibitions and introducing new rules in other high-quality financial development markets where the availability of risk-free insurance structures will enable insurance companies with in-house asset management to significantly reduce average hedging costs compared to international market rates while improving returns. Data disclosure standards in these new markets are improving and are expected to lower transaction paper costs further. Significant inbuilt asset leverage is expected to attract new market entrants before rising interest rates.

8. Challenges and Future Outlook

The managers agreed that numerous challenges, pitfalls, and downside risks exist for those who invest in and for those who manage private credit funds. - Investors have designed portfolio goals that the assets might not support. Despite limited liability structures and difficult-to-quantify risks, these limitations do not attract commensurate compensation for some investors. - Fund managers face the risk of a compressed credit cycle that reduces opportunities and requires borrowers to rely more on public credit markets, impacting credit quality and independent underwriting. Flooded markets can impose their discipline by encouraging documentation rewriting and removing covenants. There is also a risk that fund

managers are too reliant on rising interest rates as a return generator should losses fail to materialise. - The risk-return trade-off has become less attractive due to a meagre cost of capital. Yet, market originators are getting compensation for transferring credit risk to private investors through significant equity cushions cushioned by senior secured debt, often creating a high hurdle to borrower default and thus to risk transfer. Challenges and Future Outlook

8.1. Market Saturation and Competition

I. Market Saturation and Competition: One of the most important trends shaping the development of the P&C insurance market over the last decade has not been cooperation in risk management but a drastic shortening of time horizons. The stock markets measure this by focusing on quarterly or even shorter-term results. Capital market risk transfer appears especially appealing to the capital market, as it is available at competitive prices and over very short time horizons. However, these markets' seemingly considerable potential for growth is not infinitely enormous. The private credit markets are already somewhat saturated with relatively small natural disasters being covered regularly, and several more significant cat bonds are becoming very good in terms of transaction costs relative to the size of the risk covered.

It is generally a good idea to ask oneself why others are not already taking advantage of a profit opportunity. In taking out reinsurance, the property insurer faces the difficulty of meeting high upfront costs and has to commit a significant fraction of its annual premium for the coverage. In securitisation, on the other hand, the insurer benefits from exactly this parallel, and there is no need for substantial equity backing. Therefore, an equivalent cat bond can be issued in a more highly leveraged manner. As each of the bond's buyers does not commit much but benefits from the high returns, we have the potential for the competition to drive expected returns towards the equity markets, corresponding to a risk level higher than the bond markets are willing to price competitively.

8.2. Impact of Economic Cycles

High volatility represents a significant and often profound impact that economic cycles can have on the private credit landscape. CLO (Collateralized Loan Obligation) managers must maintain strict discipline and adopt a rigorous bottom-up investment approach. This is especially true given the specific set of criteria and expectations that institutional investors have when participating in their transactions. The effect arising from the distance between different economic

cycles is such that many successful CLO managers have experienced and navigated through some form of default cycle at least once during their careers. Having a well-documented track record of investing in various sectors, especially during the downside of a default cycle, is paramount. However, most importantly, demonstrating the ability to emerge successfully from such challenging periods is of utmost importance today for CLO managers looking to attract investment. Moreover, owing to the bull market of 2016 and the complexities of the current market environment, past performance records cannot simply be transferred to new shops, with the expectation that they will automatically lead to substantial growth in assets under management (AUM). Developers and investors alike are increasingly demanding evidence of discipline, a solid track record, operational capacity, and, in some cases, even a commitment to being invested across the entire capital structure of a financial vehicle. This heightened scrutiny emphasises the need for CLO managers to showcase their achievements and demonstrate resilience and adaptability in a changing economic landscape.

While Europe appears to be in the early phases of the current private credit cycle, the United States has already begun to witness several initial indicators commonly associated with the early stages of a credit cycle. In numerous discussions we engage in with various market participants, we consistently encounter familiarities that highlight similar trends or developments reminiscent of those experienced during previous economic cycles before the onset of the crisis. These recurring patterns and signals often arise from the same regulatory frameworks, accounting practices, and reporting practices established over the years. The encouraging news is that most credit asset managers thoroughly understand the strategies and actions they must undertake to remain competitive and succeed in this constantly evolving landscape. Factors that play a crucial role for investors when considering lending to credit managers include the manager's track record, the investment commitments of senior and social employees in conjunction with outside investors, and the historical groupings of those who have successfully navigated the downcycle together. These elements are critical for any investor looking to make informed and prudent decisions in the private credit market.