Nelson Correa

Episode 258: Fixed Income Deep Dive: Understanding Private Placement Investments

GUEST Q & A

Stewart: Hey, welcome back. We've got a great podcast for you today. We're joined by old friends of ours. Today's topic is private placements. We're joined by Nelson Correa, head of private placements at New England Asset Management, otherwise known as NEAM. My old stomping ground. We're thrilled to have NEAM on, and thrilled to have you on, Nelson. Thanks for joining us.

Nelson: Thanks very much, Stewart. It's a pleasure to be here, and I'm delighted to be able to talk about private placements with you.

Stewart: It's great. We're thrilled. I want to get to know you a little bit. It's funny. I was listening to a podcast the other day. I was listening to the Ted Seides Podcast. It starts off by saying what the show was about, which I think is really remarkable. We've never done that.

I guess in the interest of that, what we're trying to do is educate the insurance investment community about different asset classes, with different managers, and different investment professionals that are in this space. All we talk about is insurance asset management. We're thrilled to be talking about private placements with you.

Can you tell us a little bit about where did you grow up, and what was your first job? Not the fancy one. And how you got to NEAM. You were fairly recently added to NEAM. I'd love to know a little bit more about that background as well.

Nelson: Sure, my pleasure. I'm a city boy. I was born in Brooklyn, New York. Lived there until I was 11-years-old when my family moved to Connecticut. But it was a great childhood to grow up in that environment. You grew up fast in Brooklyn, as you could imagine. My parents put us in parochial schools, where we were taught by nuns who were terrific teachers and wonderful disciplinarians, if you would call it that. I think some of those nuns missed their calling. They could throw an eraser with a curveball and hit their target with very little collateral damage. Not that I was the target for those great curveballs, but the guy that sat behind me was many times. I could feel the eraser just whizzing past my ear many times. But it was a great childhood.

When we moved to Connecticut, my very first job was working at a pharmacy. I was the stock boy, I manned the register. I was also a delivery boy. We would deliver prescriptions to homes, and nursing homes, and hospitals, and things like that. I remember the first day when I got my driver's license, they handed me the keys to the car and said, "Here's your delivery route. Go make deliveries." I got in the Volkswagen Beetle, and I quickly realized that it was a stick shift, which I had no idea how to drive. I taught myself how to drive a stick shift in no time flat. I actually learned to love how to drive that little car. Every time I see a Volkswagen Beetle, it reminds me of the first time I drove one, how I learned to drive a stick shift.

Stewart: What town was that? Where did you move in Connecticut? What was the name of the town?

Nelson: This was in Meriden. This was in Meriden, Connecticut.

Stewart: Oh, in Meriden.

Nelson: Right in the center of the state.

Stewart: Awesome, yeah. It's beautiful. I lived in Connecticut. I was fortunate to live in Connecticut for a while, and have some good friends there still today, including a lot of the folks at NEAM. Nelson, can you talk to us a little bit about what are private placements? Are they different than private credit? Why are they attractive for insurance companies in particular?

Nelson: Sure. Private placements are securities offered to qualified institutional buyers or QIBs under 4(a)(2) under the Securities Act of '33, and essentially exempt them from public registration. All this makes these securities easier for the issuer to tap the bond market.

Really, if there's one thing that you take away from this entire podcast about private placements, it would be this. It's that private placements offer additional spread to comparably rated public bonds, a similar risk profile, although with slightly less liquidity. That's really the key takeaway from this.

Insurance companies like these bonds because they're offered across a wide range of durations. They're senior obligations, and they have a great track record for performance and also recovery. It's a terrific asset class. It's been around for decades.

Stewart: That's interesting. Can you talk a little bit about joining NEAM, how that came about? And what that means for the private placement team, particularly given that NEAM's clients are almost exclusively insurance companies.

Nelson: It's interesting, because I've known Bill Rotatori, who's the chairman of NEAM, for probably 30 years. And David Czerniecki, who was the CIO over at Nassau also worked with Bill and NEAM for years when he was at another firm. It's interesting that these relationships have come back to really have this transaction happen.

It was really a strategic partnership between Nassau and New England Asset Manager, to really bring the entire private placement group to NEAM, and introduce the asset class to NEAM clients. Now NEAM formerly did not have this expertise in-house, so this is just another tool that NEAM can use to offer investment solutions to their insurance clients.

We're very excited. We're very excited to be here. It's been a great welcoming, and we've already started being introduced to NEAM clients. The reception has been terrific.

Stewart: Yeah. A little known fact, you and I talked about this prior, but Bill Rotatori, who was my boss at NEAM as well, actually started in the private placements area at the Travelers, I think. Is that your recollection as well?

Nelson: That's right. That's where I first met him. Yeah.

Stewart: You were there as well?

Nelson: No, I wasn't at Travelers, I was at another firm. But we crossed paths during due diligence trips, and things like that. Yeah.

Stewart: Very cool. What differentiates NEAM's private placement offering in the marketplace? How can this help insurance clients achieve their investment goals?

Nelson: Sure. I think our biggest differentiator is that our team's experience averages around 25 years in private placements. We have a very experienced team that has been doing this for a long time, across every imaginable economic cycle, every imaginable credit cycle, geopolitical events, pandemics, and things like that. We've been doing this for a long time.

During that time, we've developed wonderful relationships with deal sources. We've been managing these assets not only at the initial underwriting stage, but also during the life of the transaction. We have strong underwriting capabilities. Our group makes all of our investment decisions as a team. It's great because we each have these little niches that we've specialized in over the years, and we bring all that collective experience together to make an investment decision.

Stewart: Private assets are generally less liquid than public assets. At least, that's the common wisdom. Is that the case? How do you work with insurers to determine how much liquidity risk is the right amount?

Nelson: Sure. This topic is probably the most frequently asked topic, and that's the topic of liquidity. Because a lot of people think that private placements are really completely illiquid, which isn't the case at all. They are less liquid than public bonds, but I would not call them totally illiquid. In fact, there is a secondary market for secondary private placements trades. It's not the same volume that you would typically find on the public bond side, but there is a secondary market. It will take you a couple days to trade a bond, and maybe several days after that to settle the bond, only because they're physical securities, and there's documents and custodians involved. But clearly, they're not totally illiquid like people have the perception that there is.

Stewart: That's super helpful, Nelson. I've always understood that private placements have more financial covenants that public bonds. How does that come to be? Are these deals negotiated individually? Can you talk a little bit about the covenants? Because those are the things that you can hold onto if things don't go quite the way that you had expected them to go, right?

Nelson: That's totally right, Stewart. These are privately negotiated transactions, typically for a very long period of time. Up to 20, 30 years at times. It's important to have a very robust financial covenant package in order to protect your investments. These covenants can include anything from a leverage test, to a minimum net worth requirement, debt service coverage, sale of assets, and even a change of control. Particularly important when you're dealing with private companies that might be family-owned, and if they opt to sell it or sell a portion of the business, you have a say at the table in terms of whether or not you want to remain in that transaction.

These guidelines, or these covenants, really are designed to serve as guardrails for your investment in order to ensure that the financial profile and the performance is similar five years from now to what you had when you made the investment originally. It really ensures that your issuers maintains a certain financial profile, hopefully an investment-grade profile. Really, it also allows the note holders to bring the management team to the table to talk about what's going on should they hit some sort of a rough patch and they need relief on some of their covenants.

It's a great way to stay updated. The company ensures that your original investment has a certain profile. It's just a great way to keep the lines of communication open with the company.

Stewart: The next question really speaks to all fixed income instruments, which is the best you can hope for is to get your money back and some interest along the way. Risk management and downside protection is really important in fixed income instruments. How do you mitigate the downside on private placements as you go out and look at the investible universe today?

Nelson: Sure. There's multiple ways to mitigate your risk profile, and it starts really with a very thorough due diligence process. Which is really important, that face-to-face meeting with the management team where you're allowed to ask questions that range everything from their financial results, to their business strategy, their market share, where they're taking the company five years from now. These are all really, really important things that really should be vetted out before you make your investment.

Next, I would say, is the structure of the deal. Understanding whether or not you're at the HOLC or the OPCO, by that I mean operating level or holding company obligation. Making sure that you're pari-passu with the other senior lenders in the transaction.

Third would be a thorough credit analysis of the company. Understanding the financials, where the cashflow is generated, how they've used it in the past, what kind of leverage profile or risk profile do they have on the balance sheet. All to make sure that the company has the capability to repay the debt that you've lent them. The terms, we've already discussed with the financial covenants.

Finally, really the recovery analysis. If something goes really wrong with the company, what do you have left to repay your debt?

Stewart: When you gave us an opportunity to define a term, you used the term pari-passu. For those who may not be familiar with the term, can you tell us what pari-passu means?

Nelson: Sure, sure. That means, for example, if the banks are senior lenders, that your debt obligation is equal in terms of the right of repayment to what the banks have. If the banks are senior lenders, you will also be a senior lender so that you get repaid at the same level in a bankruptcy should it ever happen to that.

Stewart: That's super helpful. Does the private placement market offer the same diversification across industries as the public market? Or do you see certain industries more frequently in private placements?

Nelson: I would say, generally speaking, it's similar to what you see on the public side. The differentiation that the private placement market may have is that you may see certain issuers in the private placement market that you would not see in the public bond market. These would be primarily issuers that are privately held, issuers with complex stories that are not easily understood on the public bond side, or structures or transactions that just require a more complex analysis. You'll see an LNG plant that needs to get financed with construction risk initially, then repaid over a long period of time. We've done even transactions where we helped the San Francisco Giants build their ballpark in San Francisco years ago. It's interesting. You'll see issuers here that you won't see on the public side.

But for the most part, I'd say there's a lot of similarities by sectors, by industry sectors, within the private market compared to the public market.

Stewart: When you look out today, where do you see opportunities? And I think equally importantly, are there areas of concern?

Nelson: There's opportunities in infrastructure and project finance that offer great value. There's also lots of opportunity ... I love privately held companies that are well-run, and are in second, third generation family-owned, and that have proven their metal, if you will, over a long period of time. Where are there risks? I would say there's some deals, new asset classes that could pose risks or that don't have the track record, I would say, for financial performance that I would consider somewhat risky.

Stewart: Are there particular maturities that are more available than others? Is the supply uniform from five to 30s, for example? What is the typical structure, or what would be a couple of common structures of private placements if we were going to go deploy capital today?

Nelson: Sure. Maturities can range anywhere from three to 30, or even 40 years, as you stated before. Some of it has to do with the industry and the issuer. For example, utility companies will typically come to market, and they will tap bullet maturities anywhere from 10 to 30 years. Then you'll have asset managers that will come to market with perhaps shorter duration, because I think the risk profile's a little bit different, and investors feel a little bit more comfortable having shorter duration or making shorter maturity commitments to asset managers or financials.

Stewart: Just from a definitions' perspective, when you say bullet maturity, that means that all of the cashflow comes due at the maturity date, and there aren't incremental payments along the way. In other words, the security doesn't amortize over its life.

Nelson: That's correct. A bullet maturity is a bond that really only pays interest during the life of the bond. Then it fully repays at the maturity date.

But I will tell you that there are plenty of amortizing offerings within the private placement market as well. You can have a 10-year bond with a seven-year average life, meaning that during the span of that transaction, it will make principle and interest payments so that you have a seven-year average life of the transaction, as opposed to a 10-year final maturity.

Stewart: You mentioned your experience earlier at the top of the show. I've got to think that sourcing and deal flow is an important differentiator for you. Can you talk about how these opportunities come to market? And how does someone like you and your group get access? Talk about how deal flow makes a difference.

Nelson: Sure. We've been in this market and active in this market for decades. I have a great team with lots of experience, and we've developed these relationships over a great many years. We're capable of sourcing a wide variety of transactions from many sources. We can actually track how we're doing relative to the market, because deals get published and we keep track of which deals we've seen. The bankers know what we like and don't like, so they filter what they show us. But for the most part, we're highly confident that we've seen most of the offerings that are out there. We've also developed some relationships with boutique shops that are not widely syndicated. And actually, we're having conversations with another shop about joining their direct source transactions.

We have multiple ways of sourcing deals, from the broadly syndicated transactions to boutique shops, and also private platforms.

Stewart: If someone needs to sell one of these, what does that process look like compared to a publicly traded bond? Is it grossly different? Talk about how the relationships that you're talking about helps on the liquidity side.

Nelson: Sure. We have relationships with secondary trading desks, as well as the primary desks. We will call one of the shops with the bond that we would like to reduce our exposure to. That could be for a variety of reasons, including portfolio rebalancing, or a subsidiary gets sold and we need to sell some of the private side there. That broker will reach out to probably the existing investor base for that transaction. We will say, "We have five million of XYZ Company for this maturity date. We'd like to sell it." They would reach out to the existing investor base and see if there's interest in there.

Typically there is, because a lot of times investors don't get their full allocation on these transactions. If there's an opportunity to add to an existing holding, it's probably the easiest way to get exposure. That may take a couple days to reach out this investor base. Then if you agree to terms, a settlement happens probably over the next several days, to maybe up to two weeks. That's only because there's documents to be signed, and these are physical securities involving custodial banks, so you actually physically have to take the bond, move it from one custodial bank to another.

Stewart: What about the visible supply coming into the market between now and the end of the year? And then, what are you seeing in 2025? Do you think that there's going to be ample supply, given the demand from insurers for this asset class? Can you talk a little bit about that dynamic?

Nelson: Sure. The supply, years ago, a $50 billion year was considered a good year for private placements. More recently, it's been in the $70-$100 billion range, depending on your reference. But I think the peak was $81 billion or so a couple years ago. We expect that this year will be a good year. It may approach 70-plus billion when everything is said and done. This year was a little different because of the election, some of the transactions were front-loaded before the election. Curious to see what'll happen after the election, or whether or not we'll have a quiet November and December post election. In talking with bankers, they have some issuers that have paused and don't really want to come to market after the election, but they have several deals in the pipeline that will be launched in January of next year. We expect this is a very robust market, it's been around for a long time, and I fully expect it to keep growing.

Stewart: I've learned a lot today about private placements from you. I really appreciate you being on with us. I've got a couple of fun ones for you out the door, if you're game. Hopefully you are.

You and I have both been at this for a minute. I was in front of a class of seniors in finance at a public university a couple of weeks ago. When I reached out, and I asked them to raise their hands about who had jobs and who didn't, about 20% of the hands went up, and the other 80% are still looking for jobs around May of '25. The question I guess I have is what advice would you give to a 21-year-old Nelson Correa coming into this market today? With all the changes that have taken place over the course of our careers, this industry has changed a great deal, insurance has changed a great deal. What advice would you give a young person starting out?

Nelson: I would say several things. First, the job market today is vastly different from what it was when I was younger. But one of the things I will tell people is, during the course of my career, some of my peers have taken a very circuitous to get to where they are today. By that I mean you didn't even need to necessarily have a finance background to land the job in investments. I've met engineers, I've met people in other professions that have expanded their horizons through education, or even from sitting for the CFA Level One exam, which I think is really important.

I would say expand your universe, be good at what you do. Be open to things that come your way. Don't have tunnel vision that, "I have to go down this path or I'm not going to make it." Honestly, when I first started this, I had no idea what private placements were.

Stewart: You and me both, brother. You and me both.

Nelson: I got into the investment department of a company where I was doing money market analysis, and public bond analysis, things like that. Then people started talking about private placements, and I was like, "What the heck are those?" Then I realized that they were really nothing more than private bond transactions, another form of fixed income securities.

I would say network. Develop expertise at what you're really good at. Sit for the Level One CFA exam, and I think that will differentiate you from others in your field. I can tell you that everyone on our team is a CFA. Not that I'm touting everybody get a CFA, but I think certainly, I don't think it hurts. I think, Stewart, you're a CFA as well, as I recall?

Stewart: Absolutely. Yeah. I'm a big fan, too. We're a big supporter. Particularly Chicago CFA Society does an awful lot to help the industry in a variety of ways. I think for sure that it's helpful to somebody getting into this industry. That it's challenging, but it also definitely shows initiative by the student or the person early in their career, that they're willing to take it on. And really, education is the great equalizer. It's not an expensive program, as far as compared to some of the MBA programs out there. But certainly, a really strong step forward.

Nelson: Absolutely. The only other thing I would add to all this is, as I was going to school, I actually got an internship with a bank. That exposed me to the first time I was exposed to any kind of financial analysis. In fact, I worked for the municipal bond group of a bank while I was going to school. That internship gave me a shoe-in into their bank training program and their credit analysis program, and that's how I started out as an analyst. Anything related to credit analysis or financial analysis is a great place to start.

Stewart: Yeah. I reviewed your background a little bit, and you got your MBA at the University of Hartford. I was fortunate enough to be on faculty at the University of Hartford for a minute. That's where I got my start teaching.

Nelson: Oh! Great.

Stewart: I was teaching portfolio management at the undergraduate level there, and really had a tremendous experience. My last fun one for you is who would you most like to have lunch with, alive or dead?

Nelson: I would say it probably would be people involved in the Civil Rights movement historically. Martin Luther King, people like that, that have really had an impact on our country, to have underserved and underprivileged, and people that have lived racial bias to have equal rights in our country.

Stewart: That's really cool. When I worked at NEAM, there was a gentleman who lived next door to me on Wood Pond Road. His name was Ray Gunter. Ray Gunter was a lawyer. He was the chief counsel for Shawmut, which is a bank that's been long, long out of business. In 1964, he was a very bright but not a huge man at all, he went to Mississippi to promote voting rights. I can't imagine the courage it took to do that.

Nelson: To do that, yeah.

Stewart: He's in law school in Boston, and he carts himself down. I think that's a really interesting answer. Martin Luther King, and some of the folks that were involved in the Civil Rights movement, to me, would be an amazing lunch. Well done, Nelson. I've got a great education on private placements. I'm thrilled. I obviously have a soft spot in my heart for NEAM, I worked there for a number of years and have a lot of friends there still. I'm thrilled that they brought you and your team in to add private placements to their capabilities. I really appreciate you coming on and giving us a great education. Thanks so much.

Nelson: Thanks so much, Stewart. It was a pleasure being here. Thank you for the opportunity. Appreciate it. It was fun.

Stewart: We've been joined today by Nelson Correa, head of private placements at NEAM. Thanks for listening. If you have ideas for a podcast, please shoot me a note at stewart@insuranceaum.com. Please rate us, like us, and review us on Apple Podcasts, Spotify, Google Play, or wherever you listen to your favorite shows. My name's Stewart Foley. We'll see you next time on the InsuranceAUM.com Podcast.