In The Know: Episode 69



What the headlines are missing on private credit

Announcement (00:00):

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Host (00:14):

This is In the Know, a monthly investment podcast brought to you by Magellan Investment Partners.

Eric Williamson (00:20):

We think the return for risk is compelling. In our view, there's a raft of positive investment features. It's asset-backed, it's fixed income, but it's got an enhanced yield above typical bond rates. It's inflation protected. It's a floating rate product.

Host (00:40):

That's Eric Williamson, head of private credit investments for Barrenjoey Private Capital. Welcome to In the Know. Private credit has attracted plenty of attention recently, but the term encompasses a range of very different investments. One of the more established, yet perhaps less understood, is asset-backed credit. In this episode, Simon Brinsmead from Barrenjoey is joined by Eric Williamson, head of private credit investments, and Eva Zileli, senior fund manager credit from Barrenjoey Private Capital. They unpack how asset-backed lending works, what actually sits behind these investments, and the structural protections designed to manage risk. They also explore the investment case, the strength of Australia's securitization market, and what investors should look for when assessing an asset-backed credit strategy. To kick things off, a welcome from your Host, Simon Brinsmead.

Simon Brinsmead (01:44):

Hello and welcome. I'm Simon Brinsmead from Barrenjoey Private Capital. And today we're going to talk about private capital, specifically asset-backed private credit. And joining me today is Eric Williamson, head of private credit investments at Barrenjoey Private Capital. And I also have Eva Zileli, senior fund manager for the Barrenjoey Asset-Backed Income Fund. Eric, Eva, welcome.

Eric Williamson (02:05):

Thanks, Simon.

Eva Zileli (02:06):

Thanks, Simon. Great to be here.

Simon Brinsmead (02:09):

Fantastic. Eric and Eva, before we jump into today's topic, it'd be great if you could let the listeners know a bit more about your background and what your roles cover day-to-day. Eric, we might start with you.

Eric Williamson (02:19):

Okay. I'll just be quick on this because I've got quite a long career. But I spent the majority of my career at National Australia Bank in senior roles in treasury, risk management, and then corporate finance. In 2020, I moved on from NAB to work for a large international PE firm and helping them build out their portfolio of non-bank lending companies within Australia. Subsequent to that, I then took a senior role in property funds management. And after that, went on to set up my own credit fund, focused on investing in asset-backed credit, which then transferred into Barrenjoey late 2025. So I'm now at Barrenjoey and very happy to be here.

Simon Brinsmead (03:08):

And Eva, what can you tell us about your background?

Eva Zileli (03:10):

Well, I started my career as a chartered accountant before moving to London to work for Lehman Brothers. After eight years, I moved back to Australia and started working for NAB. I spent 14 years at NAB. My first role was leading the bank's own issuance of RMBS, so securitized mortgages, eventually progressing to the head of funding role, leading all the bank's debt capital markets issuance globally. I joined a large MBFI as a group treasurer in 2019. Then I left that role in 2024, pursuing other opportunities, including working on the fund that Eric set up, which has brought us to this point, when Barrenjoey took over the management rights in November last year. I've also served on the Australian Securitization Forum's national committee. That's the industry body for securitization in Australia. I've served on that committee twice, representing the industry at various forums globally. Really pleased to be here and looking forward to the conversation.

Simon Brinsmead (04:17):

Fantastic. So asset-backed lending, let's start at the very beginning because asset-backed lending and credit is a hot topic at the moment. So for advisors and investors who know about corporate or real estate private credit, but haven't looked closely at asset-backed credit, can you explain what asset-backed lending actually is and how it's different from other types of private lending? And Eric, I might actually flick this one to you to answer.

Eric Williamson (04:42):

So essentially, corporate credit is lending against the business. It's lending against its profit and its balance sheet. If you look at real estate credit, it's lending against a building or a construction product. The term asset-backed lending is really reserved when we talk about lending against the specific ring-fence pool of financial assets, and each of those assets are relatively small in size. So if you think of an example, think of a pool of assets of around a thousand residential mortgages of 500,000 each, and the loan to value ratio on those might be about 65%. So that's an example of an asset-backed facility. And in the case of asset-backed, the asset pool is providing the security to the investor. The cash flows which the investor received from the pool are coming from those assets, and they're not dependent on relying on the credit standing at the corporate level.

(05:43):

So if you think of a balance sheet, on the left-hand side, you've got the assets, highly diversified pools of financial assets. And then on the liability side, there's various notes which are funding those assets, and each of those layers provide a different level of risk and return to the investor. At the top of the house, there's a corporate entity who's managing that pool of assets, services the loans, originates the loans, sells those loans into this vehicle, which is typically a trust. And that corporate entity on the liability side holds a first loss piece at the bottom, providing protection to investors. So that's a typical setup for an asset-backed vehicle in Australia. And what I'm essentially describing here is the non-bank lending sector in Australia, and it had a long, well-established track record. And in terms of size, it's about 300 billion. So relatively small relative to the banking system, but still very significant.

(06:46):

The types of investment product which flows from this sector can either be public credit or it can be private through what we call debt warehouses. I have alluded to this, about 70% of the market and the underlying assets is residential mortgages. And some of the players in this space, you'll recognize their household names, Latrobe, Liberty, Pepper, Bluestone, Resimac, Latitude, where Eva previously worked. So that's from a Barrenjoey point of view. And the fund that we are running here, that's where the Asset Backed Income Fund focuses.

Simon Brinsmead (07:21):

And actually, Eva, you had roles funding a major bank and a large non-bank lender whilst at Latitude Financial. So just following with Eric's description there, so at a 50,000-foot level view, how does a non-bank lender's funding model compare to that other bank?

Eva Zileli (07:36):

Well, Simon, the funding models are very different. Banks fund their lending mainly with customer deposits, and this can be up to 80% of their lending activity funded by customer deposit, and it's supplemented by wholesale funding. Non-banks, by definition, don't have access to customer deposits. In order to take deposits, you need to be regulated by the Australian Prudential Regulation Authority. And only when that happens, can you call yourself a bank, so hence the name non-banks. They're lenders, but they don't take deposits. So non-bank lenders raise funding directly from wholesale investors and institutions primarily using securitization as a tool, whether that's public markets, private, or in warehouse arrangements. So this funding is a really critical function for non-banks because that's where they get their source for their lending activities. At Latitude, I only had one funding tool, and that was the securitization warehouses to fund the business, which we also termed out. So really, it was quite a big move from NAB where I had a very large toolkit of debt securities to choose from, to essentially only one at Latitude.

(08:54):

And look, what that results in is greater transparency as a byproduct. Because a non-bank must repeatedly prove their loan book quality to third-party investors and rating agencies to fund itself and run its business, it tends to produce more granular standardized disclosure than you would typically see from a bank. The other difference is the actual model. So banks lend and usually it sits on balance sheet, whereas MBFIs have an originated distribute model. So a bank holds the loans on its own balance sheet, funded by deposits, some wholesale debt. A non-bank generally can't hold at scale. So it's constantly accessing the capital markets to fund origination. From that perspective, funding is a key part of the MBFI business model, it's not a support function. So they're some of the key differences, Simon.

Simon Brinsmead (09:54):

Now, as an investor in this segment, can you paint a picture about what is sitting behind these asset pools that back these investments and what do they actually look like in practice? I'd also be interested in just the aspects of the security downside protection as well.

Eva Zileli (10:10):

Yeah, look, there's quite a variety of asset pools behind the asset-backed investments. It really depends what we choose to invest in, and we look to diversify, so we do invest in a broad range. But as an example, for RMBS, residential mortgage-backed securities, as the name would suggest, the securities backing these bonds are residential properties. The pools are granular in nature, and they'll be made up of residential properties across Australia of different sizes, different loan-to-value profit profiles, different characteristics. ABS transactions can be backed by cars or equipment loans or both, or they could be backed by personal loans or loans to small and medium enterprises. The securitization structure will have a first-ranking security interest over the underlying asset or receivable. In terms of the downside protection, there's multiple sources of this. The first one is over-collateralization. And when we talk about over-collateralization, what does it mean?

(11:16):

It means there are more assets supporting the loan than the amount lent. So this provides a buffer against potential losses whereby if the property needs to be sold, then there's excess value there to pay back the loan to the originator and then ultimately investors. The other key protection is the net income in the securitization structure, known as excess spread. And further downside support is provided by subordination. And that means junior notes that sit below our investment absorb losses first. Now, the diversity of loans within these granular asset pools, typically many smaller loans, and that spreads the risk rather than being reliant on the performance of a small number of larger loans. So that in itself is a protection. There's other structural elements that are built into these investments, such as independent oversight. An independent trustee holds a security on behalf of investors and monitors the compliance with the transaction documents.

(12:22):

So this is a structural check separate from the originator or manager. And the granularity isn't just mini loans, it's spread across regions and borrower profiles, which matters for how localized stress affects the pool. So quite a few layers there that are built into the structure of what these transactions are.

Eric Williamson (12:43):

At a macro level, in the non-bank lending sector, it's very mature. It's been around for a long time. It's run in a very disciplined fashion. It's dependent on this ultimate access to the capital markets for its viability. So that goes back to the discipline around how these businesses are run. The other thing I would point out that the non-bank lending sector plays an important role alongside the banks and it often has higher risk appetite than the banks to lend. So the classic example would be if you're a self-employed person and you're looking for a residential mortgage, the non-bank lenders would be the natural place to obtain that mortgage. And the credit performance of those underlying loans might be strong. So that's an example of where the non-bank lending sector steps in. And also in products like auto finance, unsecured personal loans, they play a significant role. So in terms of the productivity and the importance to the Australian economy, it's very high.

Simon Brinsmead (13:47):

So I wouldn't mind now just moving to how you think about assessing the deals. And I guess how I'd ask that is, once you've got a deal in front of you, how would you actually work out what is a good one? What separates what you would call a strong asset-backed deal from something you'd walk away from?

Eva Zileli (14:05):

Well, we use our own credit risk assessment factors. There's 10 factors there, and we grade every investment, public or private, against each of these factors and come up with our own credit score. The first aspect we look at is the transaction sponsor. That will include the management and the board. We consider the financial position of the MBFI, and then we delved into quite a number of other matters, such as the borrower quality. What are the origination standards? The income serviceability verification, the credit scoring by the originator, the loan purpose, and importantly, the originator's track record through prior cycles. So the performance and history of the origination is important to us to make sure that they've operated through various different market conditions. We look at the asset quality, the valuation methodology, the loan-to-value ratio distribution, and the diversification across geographies, so being Australia. We look at the security strength, make sure it's a first ranking registered security interest, that it's enforceable.

(15:18):

And we look to the structure of the actual investment in terms of the structural protections. What excess spread is available? What is the sizing of the subordination? So the junior notes are beneath us, and that's relative to the pool's expected loss profile. So we're not just looking that subordination exists, but is it calibrated to the risk? We're looking for alignment of interest, whether the originator retains a stake, or otherwise known as skin in the game, in the pool it's selling down. And we're also looking for independent verification, whether that's the

trustee, rating agency analysis, third-party legal, other portfolio review, rather than just relying on the originator's own representation. So we need to see good scores on all of those measures before we'd consider making an investment.

Simon Brinsmead (16:13):

So we've covered what asset-backed investing is and how you think about it. What I'd be keen to do now is zoom out a bit, and I'd be interested to know your perspective on what the actual investment case is here. What's the asset class trying to give an investor, and particularly what they're not getting from other asset classes or other exposures in a client's portfolio? And Eric, I'll hand that one to you because I'd be keen for your thoughts on this one.

Eric Williamson (16:36):

So we think the return for risk may be compelling from investing in asset-backed credit, and particularly in this non-bank lending sector that we've been talking about. And relative to direct corporate lending or real estate credit, we think it's a really attractive risk and return. And particularly, I mentioned before, there's various layers, particularly as you go down the layers and the structure. We think there's a raft of positive investment features. It's asset-backed, as we've talked about. It's fixed income, but it's got an enhanced yield above typical bond rates. It's inflation protected. It's a floating rate product. Most of the loans are underlying residential mortgages to Australian individuals.

(17:40):

That's an asset class, a product that we all understand very well. And typically the loan has a low loan to value ratio relative to the value of the property. And then the corporate and the manager, or the servicer of these vehicles, they have a first loss piece in the structure as an element of protection.

Simon Brinsmead (18:24):

And Eric, just to follow up on that, is there something about investing in this asset class, particularly in Australia, that gives you more confidence than investing in securitization or asset-backed lending elsewhere?

Eric Williamson (18:34):

At a system level, you look at Australia, our legal frameworks are strong. That goes to enforceability around security, obtaining clear title. We've got national registers for security. We've also got strong regulatory frameworks. So this sector is covered by ASIC, it's covered by APRA. And I think standing back from all of that, Australia's economic performance over time, it's a good place to do business. And that's evidenced by a lot of the international capital that comes to this market, including in this sector that we are talking about. The higher tranches on these, the non-bank lenders, the AAA, AA, it's global institutions that are investing in that. So it's a good place to do business. At a practical level, coming down from that system level, our philosophy really is to invest in companies and alongside people that we know. We know the market here, we know the players, we know the people. And if you try and do that overseas, it's very hard to match that proximity.

Simon Brinsmead (19:40):

Well, look, let's move gears a little bit. So given everything we've just covered, there's been a fair bit of media coverage on private credit this year, and some of it has been negative. We've seen more recently more talk on defaults, some rumblings on redemptions, and we're definitely seeing regulators paying closer attention. I'd be interested in your thoughts on what's driving this and whether the headlines we've been seeing have any relevance to what we're talking about now on asset-backed lending and what you do. And Eva, I'd be interested to your thoughts on this initially.

Eva Zileli (20:11):

Look, there has been and continues to be considerable media coverage on private credit. Most negative headlines this year relate to other parts of private credit, not securitization specifically. The media coverage has also highlighted the lack of transparency in some credit funds, including opaque related party transactions. In my view, none of the negative media coverage calls into question the structural features of asset-backed structures. However, where securitization has been drawn into the negative media coverage is where there has been deliberate fraud. And it has largely been an offshore story. Probably the biggest case is where there was double pledging of collateral in multiple funding vehicles. So that means there was an underlying security, but it was used in two separate funding facilities. So essentially you're borrowing twice on the same security. So that, it's something that happened offshore, it's fraud. And in response, the local securitization industry moved to act quickly, adopting voluntary additional standards to provide investors with comfort that this isn't happening in the Australian securitization structures and to give investors more comfort that it won't happen.

(21:35):

And that includes a voluntary audit, looking at all an issuer's assets and making that available to investors. And part of that is obviously to allay investors' concerns, but not just domestic investors, but offshore investors. So the securitization market in Australia has grown and is so highly regarded that we do have a considerable amount of offshore investors coming into this market. So asset-backed transactions are typically over-collateralized and amortizing. The performance is visible at the loan pool level rather than reliant on a single company's solvency. So again, in terms of some of the negative news, just the structural features of securitization are quite different too. So I don't think the noise is directly related to this space. Asset-backed credit is not risk-free, but the risks are different in nature rather than some of the media press that we're seeing at the moment.

Simon Brinsmead (22:36):

Well, just carrying on with that, I'd be keen to dig a bit deeper. Over the full credit cycle, what would you say the historical performance and loss experience of asset-backed lending will look like in Australia?

Eric Williamson (22:50):

At an investment level, the performance of the non-bank sector has been very strong. And here we're talking about a 25-year track record. Some of the private credit headlines and stories have been much more recent, but this sector's been going for a while. At an investment level, we are not aware of any losses on any note investments or any charge-offs to those notes. The other great thing about this sector is the transparency we get is extremely high. So each investment we make, we receive a detailed analysis of all the assets each month, how they're performing, what the cash flows are of the asset pool. So that allows us to see any emerging arrears or any emerging issues. But as I say, at the investment level, it's been strong. At an underlying loan level, it's also been strong. And that reflects the fact, as we've said a few times, the majority of the underlying collateral here is the residential mortgage.

(23:49):

There are losses at the underlying level, but the whole structure here is designed to absorb those losses. And an individual loss and an equipment loan or an unsecured personal loan will be absorbed by the excess income flowing through the trust. And then if need be, there's also the equity credit enhancement at the bottom of the structure. So the performance has been strong. I'd also point to the fact the practices in these firms in terms of underwriting and servicing collections is also strong. So when you see the economic environment turn, you typically see additional investment in collections and ensuring that arrears don't turn into losses. And so we've seen that time and time again through the GFC, through the COVID period where there was economic noise, but the performance has been very resilient. We do see the credit margins on the notes we invest in move in and out, but that's a function of risk appetite through the cycle and also the amount of liquidity looking to invest in this sector versus other alternatives.

Simon Brinsmead (24:56):

Putting aside anything fund specific, what would you say the genuine structural risk would be in this part of the market right now that people should be aware of, if any?

Eric Williamson (25:05):

When we use the word structure, my head initially goes to the structuring, the legal structure, the financial structure of the financing vehicle. But we've talked about that, that's mature, it's well-governed. There's lots of checks and balances around that. So I think the risks there are low. So then that brings you back to the economic cycle and how that impacts the underlying assets. So that just comes down to where the cash rate is and how that impacts arrears and how those arrears can flow through to losses and severe scenarios. The other big driver, and this is the one we probably watch the most, is the unemployment rate. We've seen very steady near full employment over many years, but if that was to spike dramatically, that would have an impact. But I think going back to the nature of this product and the protections, the performance of this asset-backed product in a significant downturn, relatively might be better than other forms of credit. So direct corporate lending, for example, or potentially real estate construction lending. So I think in a relative sense, it's less pro-cyclical than perhaps some other credit investments.

Simon Brinsmead (26:19):

Looking ahead, Eric, I'd be interested in your views on this. Where do you see this part of the market in two or three years time? Would you still say it's very much a growth story or do you see the structure of the asset-backed lending market changing?

Eric Williamson (26:33):

I've mentioned over many years a number of times, but the non-bank sector has just been growing steadily and consistently for a long time. It grows naturally as the economy grows. As the economy grows, you have system credit growth and so you have that natural expansion of the non-bank lending sector. And then over and above that, I think the potential is for the asset-backed segment non-bank lenders to grow above system. And that's really a function of banks are net-net tightening the risk appetite. And so that creates opportunities for the non-bank lending sector. And there are also some lending products or financial products where the banks don't have scale and it's not a focus for them. So I think that creates oxygen for further growth in the non-bank lending sector.

(27:20):

If you look at the private credit sector in Australia, ASIC I think estimated around 200 billion. Relative to the banking system, it's still very small. And if you look at other developed economies, it's much larger. So we would see over time that that gradually increases. And I think the works that's getting done by participants in this sector, such as ourselves, but also the regulators is all around setting up for that growth in the future to be consistent, high quality, and generate great investor product.

Eva Zileli (27:53):

The only other thing is the potential for new asset classes being added. So as the economy evolves, thinking of things like the growth of AI, data centers, we see a data center securitization. So I agree with the theme of continued growth. And as part of that, new asset classes potentially being added.

Simon Brinsmead (28:17):

So perhaps last question from me, and I will direct this to both of you actually. If there was one issue you would have in terms of what you'd wish advisors or investors to understand more about this space, specifically asset-backed lending, before they look at any specific fund or strategy as such, what would that be?

Eva Zileli (28:36):

One is hard. Can I pick more?

Simon Brinsmead (28:37):

Go for it.

Eva Zileli (28:41):

I'll pick number one first, is I would be asking what's actually inside a fund. Many funds hold asset-backed securities alongside other exposures. I would ask for the granularity of the asset breakdown. So I think that's important. But really, I also think things like related party transactions and what disclosure is available on these is important. Are related party transactions at market levels or on preferential terms? Understand the manager's track records specifically in asset-backed securitization markets, not just private credit. Generally, I would look at the fee structure and the alignment. So how the manager is remunerated, and that's management fee versus performance, and the governance around the manager itself. So not just the related party transaction disclosure, but broader governance. Who makes investment decisions, what independent oversights exist over the manager, et cetera.

Simon Brinsmead (29:42):

Eric, how about you?

Eric Williamson (29:44):

Similar, not surprisingly, but it's sort of like take the time to understand your investment and what's in there. There may well be asset-backed credit in the fund, but that can be blended with other types of exposure. So it may not be pure play in that regard. So get to know what's in the fund and also get to know your manager. And then I think more broadly at a portfolio level, just be open-minded around the valuable role that asset-backed credit can play in your portfolio.

Simon Brinsmead (30:16):

Very good. Eric and Eva, thank you very much for your time and really appreciate you sharing your insights on asset-backed credit. It's been very insightful. Thank you.

Eva Zileli (30:26):

Thanks, Simon. Been fun.

Eric Williamson (30:27):

Good job. Thank you, Simon.

Host (30:29):

That was Simon Brinsmead in conversation with Eric Williamson, head of private credit investments, and Eva Zileli, senior fund manager credit from Barrenjoey Private Capital. We trust you've enjoyed this episode. For more information on previous episodes, visit magellaninvestmentpartners.com/podcast, where you can also sign up to receive our regular investment insights program. Thanks for listening.

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