SNL Financial

Pine Brook Sees Opportunity in Credit Managers

Monday, May 08, 2017 2:57 PM ET

By Calvin Trice

➤ Credit management properties are undervalued because of risks associated with the financial crisis.

➤ Dodd-Frank regulation that recently took effect will make those managers attractive to private equity.

A group headed up by New York-based private equity company Pine Brook *in late March acquired Triumph Bancorp Inc.'s credit investment unit, Triumph Capital Advisors LLC. Bharath Srikrishnan, a managing director for Pine Brook, told S&P Global Market Intelligence that Dodd-Frank Act risk-retention rules that took effect in December 2016 will make credit managers attractive to private equity companies. The rule requires the manager of a securitization buy at least 5% of the underlying securities. Credit as an asset class is undervalued because of its association with the financial crisis, according to Srikrishnan.*

Pine Brook invests in financial services and energy companies generally in the $50 million to $300 million range, and Srikrishnan explained in an interview what made Triumph Capital an attractive acquisition.

S&P Global Market Intelligence: Explain why the new risk retention rules make managers of collateralized loan obligations, or CLOs, attractive to private equity?

Bharath Srikrishnan: Oftentimes, CLOs get lumped in with RMBS [residential mortgage-backed securities] and CDOs [collateralized debt obligations]. In fact, the performance of CLO debt and equity, which are really vehicles which finance bank loans, was outstanding through the crisis. There have been 6,100 tranches of debt rated and issued in CLOs, and only 25 of those have ever defaulted.

Part of what we found here is, it's a little bit of an under-discovered asset class. There are a number of investors who don't invest in it because they think it's something that it isn't. If you peel back the onion and look at the risk-adjusted returns, it's a really compelling asset class. The size of our investment is in response to this regulatory change, which is often what creates the need for a [private equity] solution.

What does Pine Brook look for in a financial services property?

We partner with management teams in growth-oriented situations. Usually that comes about from monitoring our sectors really closely, observing when capital needs are going to be created and being anticipatory. In this circumstance, we canvassed the market and had been very focused on investing in this area for some time.

What about Triumph Capital made it a good match for Pine Brook?

They are at about $2.5 billion of AUM. They've done five CLOs and are in the process of doing their sixth. So they're large enough to have a good name and presence in the sector and to attract a high-quality fully built-out management team, but they also are small enough to have substantial opportunity for further growth.

If we went for a smaller manager, it wouldn't have the attributes we were attracted to in terms of management quality, reputation and access to capital. If we went to a much larger manager, it would probably be harder to grow it over where it was.

Are there regulatory changes you are looking out for with the new administration?

We've certainly studied the potential for regulatory change in Washington. Our current point of view is that it's unlikely to have a materially adverse effect on the CLO business. Clearly there's a risk that something could happen, but we think that's a very, very low risk.

The pendulum pre-crisis was all about economic growth, then it really swung for the prior administration to be all about regulation. I think it's going to still be a regulated system, but the pendulum will shift a little bit back to having economic growth in the equation more so than it has in recent years. We think that Dodd-Frank will still exist in some form, but it might change a little bit. Our research has indicated that there's no political will to repeal risk retention. We also think that it's fundamentally a completely sensible premise that the creator of securities should own a little bit themselves.

Do you see any areas that you might be holding back from?

We're not that busy on new bank investment. We're really managing the investments that we have. That was really a product of the financial crisis. We made three bank investments right after the crisis and now those are in portfolio management mode.

Balance sheet insurance has been well publicized. There's a lot of capital chasing the same risks in insurance so ROE [return on equity] is really under pressure. So new investments in the balance sheet side of insurance is challenging.