

# Private Credit Under Pressure

## Separating Signal from Noise

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Private credit has grown from what was previously a niche institutional allocation into one of the dominant financing channels for middle market companies over the past decade. The asset class has attracted hundreds of billions of dollars from institutional investors, sovereign wealth funds, insurance companies, and, more recently, retail investors seeking income.

Against the backdrop of sector expansion, the negative headlines for private credit business development companies (BDCs) have shaken retail investor confidence this year. It is these BDCs that are garnering headlines with news of redemption gates, write-downs, and in some cases a sharp decline in the share prices of the asset managers who offer them.<sup>1</sup>



### BDCs (Retail-Oriented Vehicle)



### Institutional Direct Lending

<b>Structure</b>	Publicly traded or semi-liquid investment vehicles <i>Shares trade daily, similar to equities</i>	Closed-end, long-duration fund structures <i>Capital committed over multi-year periods</i>
<b>Investor Base</b>	Primarily retail investors <i>Flows driven by sentiment and income demand</i>	Institutional LPs (pensions, endowments, insurers) <i>Stable capital with no redemption pressure</i>
<b>Liquidity and Pricing</b>	Daily mark-to-market pricing <i>Share price can diverge from underlying loan performance</i>	No daily pricing or trading <i>Quarterly valuations, often with third-party validation</i>
<b>Volatility</b>	Equity-like volatility and high correlation to public markets (>80%)	Lower observed volatility <i>Returns driven by income, not market sentiment</i>
<b>Leverage</b>	Often levered up to ~2x <i>May include junior debt or CLO equity exposure</i>	Typically more conservative <i>Focus on senior secured lending</i>
<b>Key Risk Dynamic</b>	Liquidity mismatch: <i>Illiquid loans + liquid investor base = price pressure during outflows</i>	Credit performance driven: <i>Outcomes tied to borrower fundamentals, not investor flows</i>

\*For Illustrative Purposes Only

These headlines have prompted a range of concerns about private credit. They are not all the same question, and they do not all have the same answer. For institutional investors with direct lending exposure, the question is not whether to pay attention to these developments, but how to interpret them.

## The Concern

## Assessment

Will the BDC selloff spread to institutional funds?	Institutional direct lending funds have no daily redemptions. There is no mechanism by which retail sentiment pressure transmits to closed-end institutional portfolios. There is some asset overlap between BDCs and institutional funds is real; however, the vehicle dynamics are distinct.
Will higher default rates hurt returns in institutional funds?	This is a substantive risk. Vintage 2021–22 stress is real, interest coverage ratios have been under pressure, and spread compression means new deals carry less cushion. Realized losses remain limited to date, but this warrants ongoing scrutiny.
Will AI disruption impair software borrowers?	Software is a large component of direct lending portfolios. AI has disrupted assumptions about customer stickiness and competitive moats. Manager underwriting discipline is a key variable.
Will this trigger contagion? (e.g., another GFC-style crisis)	Private credit is generally structurally insulated from the systemic risks that amplified the 2008 crisis. Loans sit in closed-end funds with little or no repo financing, typically no short-term funding mismatches, and generally no securitization daisy chains. The interconnections that caused GFC-era contagion are most likely not present.

The most important distinction is between what is happening in the BDC semi-liquid retail market and what is happening in institutional direct lending portfolios. BDCs are structurally distinct from institutional direct lending funds, although they are both in the broad private credit sector. BDCs are often daily-traded vehicles with equity like volatility, and they are frequently levered up to 2x of the fund value. And when retail investors grow nervous, BDC share prices are likely to fall sharply regardless of how the underlying loans in the portfolios perform. Moreover, BDCs face a structural mismatch between medium term illiquid loans to borrowers on the one hand and daily mark-to-market pricing, volatile retail investor flows, and limited partial liquidity on the other.

In stark contrast, institutional direct lending funds operate under fundamentally different conditions. Institutional private credit funds are generally focused on senior secured loans, with institutional limited partners often making long-dated, multi-year commitments. Institutional private credit funds do not

suffer from volatile retail investor flows and daily mark-to-market pressures. Hence, the dynamics driving the recent selloff have no direct transmission mechanism into institutional private credit portfolios. That being said, like BDCs, institutional direct lending funds could be impacted by economic or credit events. The relevant question for institutional investors is narrower: are the underlying loans performing, and are reported valuations credible?

Deals originated in 2021 and 2022 appear to have the most stress at the moment. Deals originated before the recent cycle of rising interest rates have had limited time for earnings growth to offset sharply higher debt service costs. Interest coverage ratios in the pre-2022 vintage have recovered somewhat but remain below pre-rate hike levels for many borrowers.

Lending to the software sector warrants separate discussion. Enterprise software (SaaS) has become one of the largest sectors in direct lending portfolios. Direct lending has been attracted to SaaS companies

for a number of reasons, including highly predictable, recurring subscription revenue; high free cash flow margins relative to capital intensity; mission-critical platforms create high switching costs; and historically, limited sensitivity to economic cycles. More recently, artificial intelligence (AI) has disrupted the certainty previously ascribed to SaaS providers. Their competitive moats are harder to sustain when AI can replicate functionality quickly. Seat-based pricing models could be threatened by AI-driven cuts to headcount. Customer stickiness is less certain when switching costs fall. And importantly for lenders, the predictability of revenue (i.e., the core credit thesis) is now less certain.

That said, the AI disruption concern is not uniform. Lenders with portfolios concentrated in mission-critical platforms are better positioned; however, those with material exposure to point solutions or growth-stage companies not yet generating EBITDA face a more challenging environment.

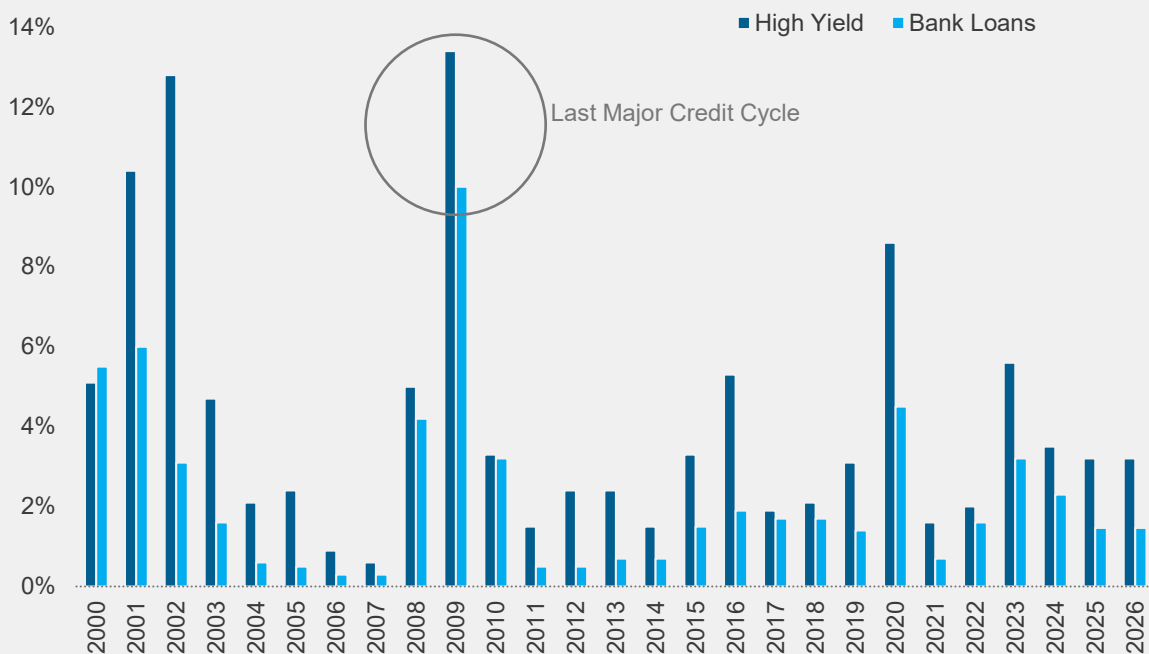
Actual realized losses in institutional direct lending have been limited thus far. Stressed credits have largely been managed through amendments, extensions, and payment-in-kind arrangements. However, these

measures reflect a deferral of loss recognition, not necessarily a resolution. If default rates do increase, it is reasonable to expect they will affect institutional investors.

Credit spreads and default rates in the public markets may provide useful “real time” information about where we are in the credit cycle. Default rates in high yield and bank loans would be a likely leading indicator of default rates in private credit. Current default rates in high yield bonds and leveraged loans remain well below historical peaks, even after rising modestly from their 2021 lows. The annualized default rate on US high yield bonds was approximately 3.2% in 2025, compared with a long-run average closer to 4.5% and crisis peaks exceeding 13% (see Figure 1). The current environment is not indicative of broad-based credit impairment. Rather, conditions are consistent with a normal mid-cycle environment, not systemic deterioration.

Separate from the BDC-specific issues grabbing headlines today, private credit manager valuation discipline deserves special mention here. Most institutional managers engage independent valuation agents to validate valuations, but the discretion general

**Figure 1**  
Public Credit  
Default Rates



Source: Reflects annual default rates for Moody's US High Yield bonds (issuer-wt, %) and LSTA leveraged loans (par amt, %). Sources: Moody's Annual Default Study; MSIM / PitchBook.

partners retain within that framework is meaningful. JPMorgan's independent decision to mark down certain software loan pricing based on observable secondary market proxies has exposed a gap between how some funds value their portfolios and how an arm's-length secondary transaction would actually transact.<sup>2</sup> The practical response for institutional investors is to press general partners on the consistency between reported marks and secondary market transactions, treating any material divergence as a signal worth investigating. It is worth noting that JPMorgan's mark-to-market collateral methodology is not standard practice. Most bank lenders use a mark-to-performance approach that requires observable triggers such as missed interest payments before reducing borrowing capacity.

For institutional investors with existing private credit exposure, the current environment calls for disciplined engagement rather than reactive repositioning. Portfolio reviews should focus on vintage year concentration, software sector exposure disaggregated by AI substitution risk, the general partner's valuation methodology, the use of leverage, and the structure of any bank credit facilities. Investors who are looking to allocate to private credit may benefit from considering the whole spectrum of strategies available in private credit, not just direct lending.

## End Notes

- <sup>1</sup> Sources: Financial Times, E. Platt, "BlackRock Limits Redemptions at Private Credit Fund as Outflows Swell," March 6, 2026; Financial Times, E. Platt, "Morgan Stanley and Cliffwater Limit Private Credit Withdrawals," March 11, 2026; Financial Times, "Private Capital's Stress Test," March 3, 2026.
- <sup>2</sup> Source: Financial Times, J.R. Shah and E. Platt, "JPMorgan Marking Down Loan Portfolios of Private Credit Groups," March 10, 2026. Most other banks use a mark-to-performance approach requiring observable triggers such as missed interest payments before reducing borrowing bases.

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