

Private credit - Should I be worried about the headlines?

Private credit has come under the spotlight recently, following two high-profile failures and concerns that further issues may be around the corner.

In this paper we provide an overview of the nature of recent issues, how it affects investors and highlight what you should do in response. The checklist at the end will help you to understand how you are specifically impacted by this news.

Why is private credit making headlines?

There are a wide range of private credit assets available, including private corporate debt (investment grade debt issued by large corporates), senior secured direct lending (loans to small and medium sized companies secured by assets), asset based lending (private loans secured by a pool of collateral) and mezzanine private debt (a lower quality mix of private debt and equity). The risk and liquidity of these different assets varies considerably.

The impact of the high interest rate environment on the health of the underlying borrowers means that the asset class has been under the spotlight for some time. In 2025 there were two particularly high-profile credit defaults: subprime auto lender Tricolor and then auto parts manufacturer First Brands Group. This raised wider suspicions in the market that further troubled assets might then come out of the woodwork, a concern that has gathered momentum.

These growing concerns have caused some types of investor to reconsider their private credit exposure. In recent weeks the media attention has widened from the credit quality of fully illiquid closed-end private credit funds, to issues faced by a number of open-ended semi-liquid private credit funds and business development companies.

▶ **Open-ended semi-liquid funds** are designed so investors can buy or sell the funds, typically on a monthly or quarterly basis, which is more often than the underlying assets would permit. A number of semi-liquid funds have hit headlines as they have seen a large number of redemptions which has led to a temporary restriction on investor withdrawals - known as "gating". Whilst this is a protection mechanism for existing investors, gating raises concern as it constrains the ability for investors to access their investment.

▶ **Business development companies (BDCs)** are another type of structure providing investors with exposure to private credit assets. BDCs come in both liquid and illiquid forms. The liquid forms trade like any other listed shares on a daily basis but their value fluctuates relative to net asset value as a result. BDCs have received the greatest press coverage recently, however institutional investors do not typically invest through these vehicles.

It is important to highlight that a lot of those investors redeeming, and the funds experiencing the liquidity problems, are from the retail sector.

A closer look into the market background

Private credit markets are showing some signs of stress for several reasons:

1

Growing market and eagerness to deploy capital:

Demand for private credit has increased steadily over the past decade. New players are entering the market and raising capital to invest, which introduces the possibility of some managers compromising on quality and due diligence standards when deploying capital.

2

PIK and shadow default rates:

Overall credit default rates have remained low, but in recent years there has been an increase in levels of PIK i.e. 'payment in kind', whereby borrowers meet interest payments by issuing more debt instead of paying in cash - which adds to the debt burden. This means that the 'shadow default rate' (which includes the impact of PIK) is higher than the actual default rate. It's important to note that PIK isn't necessarily negative - it can provide borrowers with flexibility, and some lenders accept PIK to attract borrowers and win deals. However, when lots of borrowers are failing to meet interest payments this could hint at an uptick in future default rates from their current low levels.

3

Stress in the software sector:

Another key factor in retail investors withdrawing capital from private credit has been concerns about the impact of AI on the software sector, with recent advances undermining software development business models.

4

Gating provisions:

A diversified open-ended private credit fund with prudent gating provisions can provide more flexibility in trading private credit, particularly as the number of market participants grows and assets are traded more frequently. However, there is still a fundamental mismatch between the liquidity of the underlying assets and the liquidity of the vehicle. In stressed scenarios, this can be a problem, and funds gate to protect investors. This has the effect that investors can't access their capital as quickly as expected.

Bringing these factors together with the headlines

Retail investors have rushed to exit publicly traded BDCs, leading them to trade at a material discount to their net asset value (NAV). Investors have also sold out of semi-liquid funds, a number of which have gated.

This highlights that credit investors need to understand the liquidity provisions their fund structure has in place and what this means for them in a stressed scenario - it is clear that private credit (even in an open-ended fund structure) should not be relied on for immediate liquidity.

Opportunities in the secondary market?

The secondary market provides scope for investors to buy and sell holdings in semi-liquid funds and fully illiquid funds at a time that deviates from the trading schedule of the funds, and at a price that differs from the net asset value. Institutional investors are increasingly using the secondary market to sell their private credit holdings for strategic reasons, rather than holding assets until liquidity becomes available. This market isn't required for liquid BDCs which can already be traded on a daily basis.

For a sale or purchase, the timeframe over which investors plan to trade on the secondary market is key. Investors looking to sell illiquid assets currently should be aware that general sentiment may influence pricing of this and adjust their expectations. It may be appropriate to pause on any potential sale and revisit this once uncertainty and media attention has lifted.

For potential buyers, this period may present disciplined investors with attractive buying opportunities. It's crucial, however, to conduct thorough due diligence and recognise that certain sectors might be more exposed to risks than others. Selectivity is essential, rather than viewing this period as a wholesale buying opportunity. In particular, we have observed that many secondary credit funds feature either a number of watch list or impaired assets, or have a few large holdings that dominate the portfolio. This stems from the Covid period, which influenced the investment phase of many current funds.

Long-term implications

The structural factors driving the growth of the private credit secondary market remain intact despite recent events. Therefore, because of the idiosyncratic nature of private credit, at a market-level, it can still be expected to continue to grow. Volume and prices are therefore likely to stabilise.

These developments have highlighted the risks that exist when investing in private credit. Although informed investors have always known this, recent news flow may lead to a longer-term change in how buyers price this risk. Certain funds may therefore not return to the record volumes and prices that we saw in 2025.

Summary and next steps

It is important to recognise that private credit, by its nature, is a collection of unique individual assets. Unlike the stock market, the performance of the wider credit market doesn't drive the individual private credit assets. You don't impair a credit asset because other unrelated credit assets are being impaired. Hence, we believe the headlines are of less concern to private credit investors than they might initially appear, although there may be disruption associated with liquidating a holding.

Private credit investors must be selective in terms of their investment manager and underlying private credit exposure. This is more so the case than other asset classes like listed equities, because the price you trade at is not public and therefore the chance of overpaying for an asset is an order of magnitude greater. It is not possible to invest passively in private credit.

Investors engaging in private credit trades on the secondary market should view media narratives with caution. Sellers may face short-term pricing adjustments. The news highlights what we already knew - that buyers should conduct rigorous due diligence and be mindful of the different risk profiles associated with different sectors. In the short-term, selective buyers could benefit from wider market uncertainty.

Actions for investors

All private credit investors should ask themselves the following questions:

- 1 Are you relying on open-ended private credit funds for immediate liquidity?
- 2 Have you done recent and detailed due diligence on your private credit investment including your manager's experience in underwriting i.e. someone with the expertise needed to manage risks effectively and select appropriate opportunities?
- 3 Do you know what your underlying exposures are i.e. any concentrations to specific sectors or regions?
- 4 If buying private credit on the secondary market, have you done detailed due diligence on funds you want to buy and do you understand any potential risks?
- 5 If selling private credit on the secondary market, have you considered the timing of your sale and how it could be impacted by wider market sentiment?

Any private credit allocation should be considered as part of a wider diversified portfolio of assets and account for any wider scheme-level liquidity and concentration risks. Well governed investment portfolios have reflected these considerations when investing, and should continue to monitor these, but can also enjoy the benefits of private credit as part of their wider investment strategy.



Glossary

Asset based lending - A type of private credit (also known as asset backed finance or specialty finance), referring to privately negotiated loans secured by a pool of assets.

BDC - Business development companies - vehicles which invest in private credit assets. These can be non-traded or public BDCs (which are listed on an exchange). BDCs are the primary method by which retail investors access private credit.

Closed ended - Fund structures locking investors in for six to eight years (or longer), whereby investors provide capital to managers for them to deploy over an initial 'drawdown period' and then receive capital back over time during a 'harvesting period' as the underlying loans mature.

Direct lending - A type of private credit which refers to privately negotiated loans made to companies, typically to mid-sized companies in the US or Europe.

Gating provisions - Restrictions on the level of redemptions that can be made from an open-ended private markets fund. Usually when redemptions exceed a fixed % of the fund's value (e.g. 5%) for a temporary period no further redemptions are permitted. This is designed to protect the remaining investors in the fund from the manager being forced to sell a material portion of the fund's illiquid assets.

Mezzanine private credit - Combines debt and equity features and is below senior debt in the capital structure.

Open ended - Fund structures which allow investors to purchase or redeem shares periodically (e.g. on a monthly basis).

PIK - Payment in kind - where borrowers issue more debt to meet interest payments rather than providing cash payments.

Private credit - Umbrella term covering a variety of privately negotiated loans which are not bought and sold on an exchange.

Senior secured - Loans at the top of the capital structure which are secured by collateral.

Find out more

For further information, please get in touch with Emma Coleman, James Kidd or speak to your usual XPS contact.



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