Cracks in Private Credit

Goldman Sachs Exchanges

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Allison Nathan: After a decade of rapid growth, the private credit market has come under pressure. Several high-profile defaults, concerns about valuations, and especially substantial exposure to a software industry vulnerable to AI disruption have fueled a surge in redemption requests, which has raised alarm bells for the asset class.

So are these concerns merited or overblown? And how will the current stresses shape the outlook for private credit in the years ahead?

I'm Allison Nathan, and this is Goldman Sachs Exchanges.

Each month, I speak with investors, policymakers, and academics about the most pressing, market-moving issues for our Top of Mind report from Goldman Sachs Research.

This month I spoke with Howard Marks of Oaktree Capital Management, Michael Arougheti of Ares Management, and our Chief Credit Strategist in Goldman Sachs Research, Amanda Lynam.

I started by asking legendary investor Howard Marks what fueled the rise of private credit.

Howard Marks: Private credit has probably always existed, which is to say the making of loans, that's what banks do. And there's been non-bank lending forever. Direct lending is just one subset under the broad heading of private credit. Direct lending is the label that has been given to private loans made by non-bank lenders to midsize private equity deals. And the private equity business has existed and run on the use of other people's money to lever up returns on equity on the purchase of companies and in the global financial crisis, banks lost a lot of capital and were chastened and became more harshly regulated, and the regulation was designed to reduce the banks' riskiness so that they wouldn't ever have to be bailed out again. So, they couldn't lend as much for levered transactions. There was a shortage and private lenders stepped in to fill the void. And because there were a few private lenders and a lot of private equity firms that wanted to borrow money, the private lenders could demand

high interest rates and good safety. But as their success was noted and other people flooded into the field, the available capital increased relative to the demand, which meant that the lenders could not demand as much interest or safety and that caused the lender's advantage, I would say, to be arbitraged away. But private equity was facing very strong demand for its product. It was raising a lot of money for private equity funds. It needed to borrow money to lever up its equity for transactions. So the demand for financing from private lenders was very strong in the amount. And that meant that if private lenders could raise money, they could do a lot of lending. They could develop a lot of assets under management. They could make a lot of fees for doing so. And so it caused very rapid growth in the size of the direct lending market, which probably didn't exist in its current form before 2011. And probably approaches $2 trillion today.

Allison Nathan: Howard, you actually described that growth as a gold rush. So, what are the similarities? And should we be concerned about that? We all know how the gold rush ended.

Howard Marks: Every upsurge in financial activity brings heated competition, more participants, perhaps some risky behavior to get in on it. So, let's say that today direct lending is $2 trillion, if you can lend $2 trillion and if you can charge let's say 1% fee, that's $20 billion in annual fees, so people want to get in on that. So everybody hangs up a shingle as a direct lender. That's a gold rush.

Allison Nathan: This growth means that private credit now plays an important role in financing businesses, as Amanda Lynam explains.

Amanda Lynam: When we just think about the core of private credit and the traditional lending model, in its earliest years of the asset class, it was really

reserved for companies that were really small, and really couldn't access public debt markets. But the addressable market of borrowers has expanded specifically since the financial crisis, and absolutely since the pandemic to include borrowers that could access the public credit markets if they wanted to, or in many cases have done so and are refinancing their debt into the private credit market.

So it's now grown to be able to write larger checks, fund larger deals, and it plays a role in this financing continuum. The financing continuum really has three parts to it. The first is the bank lending market. So in the US we track that through things called commercial and industrial loans from banks. The second part of the financing continuum is the public debt market. So there I'm referring to the syndicated investment grade bond, high yield bond, and broadly syndicated leveraged loan market. And then the third leg of the stool is the private credit market, directly negotiated loans to companies

that are either unrated or below investment grade. In many of these lending universes, so banks, public credit markets, private credit markets, there's a bit of overlap between the borrowers. It's also logical to kind of think through a company's lifecycle to say, as they've started out on their growth journey, maybe the private credit market was the best option for them. Maybe they needed certainty of financing, maybe they needed speed, customization. And then as they've grown older, they've accessed the public markets. And so these markets are all kind of working together and they're not as siloed as they were.

Allison Nathan: The current worries about private credit are focused on non-traded business development companies, otherwise known as BDCs. Lynam explains what these are and how concerned we should be about the recent surge in redemption requests.

Amanda Lynam: So the BDC universe, specifically the area that has been of most focus, the non-traded or evergreen BDCs, have really grown in recent years. And they've provided a way for retail investors to access private credit in ways that are different from the institutional community. And specifically, there have been some features of those vehicles that investors really liked, namely lower minimum denominations, so they could participate at a lower entry point, more simplified tax reporting, which historically had been a gating issue. And I would say probably first and foremost, the ability to become invested quickly.

If you look at estimates from PitchBook LCD that measures this, that retail BDC universe is around 15% of the traditional AUM in private credit. And if you include different parts of private credit like private asset-based finance or investment grade private credit, that number is actually then going to

be much smaller because you're going to be dividing it off of a much larger base. But if you assume that, okay, the 15%, it's important because there's a lot of focus on this part of private credit, but actually the vast majority of private credit AUM is in institutional capital, which has very different structures. Institutional capital is truly locked up and it's basically in these drawdown funds where you wait for an investment and then therefore the capital is called and it's deployed into an investment opportunity. There's a lot of focus on the redemptions in private credit and kind of when redemption requests have been above the typical 5% per quarter of NAV allowance, the market is very focused on that. But I would add that these 5% limitations of these structures, they are a feature, not a bug, and they exist to protect the integrity of the investments in the BDCs, these are illiquid investments. And so you don't want a situation where you are forced to liquidate investments at

depressed prices because you've got to meet large redemptions. And so while they've come in focus in recent years, this has always been a part of the structures. And these redemption gates, as they've been described in some forums, they're not new. They existed all along.

So I think there's been probably a disproportionate amount of focus and attention paid on those different structures because they are a small part of AUM in private credit. And then more importantly, the dynamics of those retail-focused BDCs do not translate into the dynamics of the funds in the institutional community where the vast majority of the AUM lives.

Allison Nathan: Michael Arougheti of Ares is also not concerned about the surge in redemption requests or the bigger risk that they could trigger crisis-inducing fire sales.

Michael Arougheti: These funds were structured to allow for the opportunity for liquidity in what have traditionally been illiquid structures. And so the innovation that non-traded BDCs put forth was, up until then, you could have daily liquidity in a traded BDC, or you could have illiquidity in a 10- to 12-year private commingled fund. And what the non-traded BDC structure was set up to do was to say, You're owning illiquid assets the same way you would if they were in a co-mingled fund, but to the extent that you need liquidity, there is a structured path to liquidity of 5% per quarter, 20% per year. And it will self-amortize so that you will get all of your money back without any forced liquidation of assets. And the 20% was not pulled out of thin air. It was actually designed to track the weighted average life of the underlying loan portfolio. What's happened now is people, rather than orienting to, I had an illiquid asset with the option for liquidity, they're acting as though these are fully liquid instruments,

and they're fundamentally not. And so I take issue with the term gate, it's not really a gate. Meeting the contractual 5% is exactly what the structures were designed to do. And typically, there's about 20 to 30% of these portfolios held in liquid securities for this reason, right? So to the extent that there's a redemption, you have a 90-day redemption window, and you can sell liquid securities, which are typically going to be loans, bonds, or high-grade investments to generate cash. And you have loan facilities where you can borrow to the extent you're underleveraged to meet your redemption. Those two features are prominent because you don't want to be in a position to liquidate private assets below their intrinsic value. So there is no asset liability mismatch, there is no run on the bank in these funds.

And non-traded BDCs represent less than 10% of the market. There's adequate dry powder in the market to

resolve those portfolios in an orderly fashion without any disruption to pricing. If you were to look at the size of the non-traded BDC space and basically assume that they all sustain their maximum redemption limits quarterly, that would be about $5 billion of loan sales out of their tradable bucket every quarter to meet those redemptions over any 90-day period, and if you look at just the loan market, about $85 billion of loans trade in the syndicated loan market every quarter. So even if you start to think about, okay, what are the second-order effects of people not liquidating their private credit portfolios, but liquidating their syndicated loan portfolios, you're $5-ish billion on $85 billion over a 90-day period into a market that also has a significant amount of liquidity. So even if that initial liquidity is coming from the liquid bucket, I don't see it changing the supply demand dynamic in that part of the market either.

Allison Nathan: But while the liquidity constraints of non-traded BDCs should prevent forced sales,

Marks finds some retail investors' apparent disappointment with this feature problematic.

Howard, we've heard it said that the limited liquidity is a design, it's a feature of these vehicles, not a flaw. So there shouldn't be an expectation of liquidity. What do you think of that?

Howard Marks: Well, it's absolutely true, Allison. And by the way, one of the most interesting words in the English language is should. So if people should not expect liquidity, but they're disappointed when they don't have it, where does the disappointment come in? And so question number one is, were they adequately informed in advance that they wouldn't have liquidity? Did the person who sold them that fund adequately disclose that? Number two, did the buyer do their job of understanding the terms. If it's there in plain letters and if the let's say salesman describes the limitation on the liquidity, then it is the investors' responsibility to understand that.

Liquidity is a problem whenever a vehicle that invests in private assets promises liquidity. Much as liquidity limitations on non-traded BDCs are preventing fire sales, it's still unpleasant for the investor.

Allison Nathan: Unpleasant for the investor, but what about for the industry itself? Could the industry experience significant pain? Lynam doesn't think so. She points out that the underlying fundamentals of the private credit market appear relatively healthy and expects them to remain so as long as economic growth holds up.

Amanda Lynam: A lot of the focus on the headlines [are] actually occurring against a backdrop where the fundamentals of private credit have actually been pretty resilient. When you look at realized losses, what you find is that through year-end 2025, so data's on a lag, through year-end 2025, realized losses are below the historical average and are

tracking generally in line with the public credit markets, high yield, and leveraged loans. So long as the growth environment is a trend pace or slightly better, actually credit's probably in a pretty good spot because the yield backdrop is supportive.

Other metrics non-accruals and payment-in-kind, we track those as directional measures. Payment-in-kind can be included at the origination of a loan. Say you're lending to a high-growth company and they want to preserve the ability to invest in their business. It may make sense for them to use payment-in-kind if they're trying to conserve cash for, say, an acquisition or a large-scale investment. You may have decided on that as a lender. You may put some guardrails around how long and how much of the coupon can be PIK-ed. You may demand some compensation for that feature, but you knew that going into the origination of the loan and presumably you've priced it. The kind of bad PIK

is the PIK that's added after the loan origination, presumably because something has gone wrong and the company is experiencing financial stress. We do track both of those different styles of metrics. I would say in general, the proportion of bad PIK did pick up a bit after the Fed started its rate hiking cycle. Not surprising given that higher cost of capital was transmitted through, but it's not outsized. And when we look at all PIK, so good PIK and bad PIK, what you find is that over the past several quarters, PIK has been around 7 to 8% of overall income for those BDCs. And it's actually off of the peaks that we've seen at various points over the past few years. So it's not deteriorating and it's not becoming outsized. Non-accrual rates, we see a similar backdrop where non-accrual rates have basically been in a pretty tight range for the past several quarters. So we're watching those as directional indicators of potential deterioration, but we're not

seeing a lot that's outsized at least through year-end 2025.

And the leverage in a lot of these private credit funds is actually really modest. The leverage limit for BDCs, for example, is two to one debt to equity. And many BDCs are well, well below that. It's actually less leverage than what's used if you take simple leverage metrics in the banking system.

Allison Nathan: Arougheti generally agrees.

Michael Arougheti: If you look at the private credit portfolios, or if you look at bank credit portfolios or credit card charge-off ratios, there's nothing that we are seeing generally, indexed across the credit markets, that says we're entering a credit cycle. Defaults will happen as you get later and later in a credit cycle. And yes, you will see certain managers that are underperforming either because they're concentrated in the risk they're taking, or they did shoddy due diligence, or they're in the wrong

sectors. But that doesn't mean that the entire credit market is about to tip over.

Allison Nathan: But could the industry's high exposure to software companies, which look vulnerable to AI disruption, spell more trouble ahead? Some people believe so, emphasizing the outsized exposure to software in private credit compared to the exposure in the high yield bond and syndicated loan markets. This, they say, amounts to a meaningful amount of investor capital exposed to a sector that some people argue could see double-digit defaults. And, for those worried, the fact that private credit investors sit high up in the capital structure doesn't seem to provide much comfort. That's because even if private equity investors will be wiped out before private credit investors, they argue that private equity investors are still likely to see upside from some of their investments to balance out the zeros. But private credit investors can't afford the zeros, they say, since they only get par back even in

the best case scenarios. Simply put, private credit investments don’t have the upside of private equity investments.

All that said, Marks isn’t that concerned about private credit’s software exposure.

Allison Nathan: Howard, a lot of concerns seem to revolve around substantial exposure to software. Is that a cause for concern?

Howard Marks: Well, it's cause for concern for those funds. I don't think it's a cause for concern for the US financial system. So, what that means is, let's say that you've invested in a private credit fund that has made software loans. So let's say your loan is a senior loan, first-lien loan. So first, the value of the company would have to decline enough to wipe out the equity.

Then it has to decline enough to wipe out the junior lenders and the mezzanine lenders. That's a big

value destruction. It's not impossible, but it's a lot. And then even if the first-lien lender loses half his money, in a diversified portfolio, that's not too terrible. If you have a quarter of your investments in software and that happens to all of them, then you lose half your money in a quarter of your investments, so you lose 12.5%, you're not wiped out. If you're levered one to one, you lose 25% of your capital, you're still not wiped out. So these things are bad but they're not you know, there's an old saying that in times of crisis everybody panics and everything bad that could happen, is considered equally likely to happen. But losing a quarter of your capital because the whole software industry lost five sixths of its value is not abysmal. It's just bad. But it doesn't jeopardize the financial system of the country.

Allison Nathan: So, there's a wide distribution of views on the near-to-medium term outlook for

private credit. But what about the longer-term outlook?

Arougheti is relatively optimistic, arguing that the current stresses will likely shift market share within private credit rather than slow the industry's overall growth.

Michael Arougheti: I think it will shift market share in private credit. So what has happened and will happen is you'll have winners and losers like you always do. You'll have a dispersion of return and capital will find its way to the opportunity. And so whatever volatility is getting introduced by this narrative is actually creating fundamental opportunity for folks who are able to cut through the noise and understand what's happening in these markets. But my experience would tell me that, no, it will not slow growth. It will shift the growth to other parts of the market that are able to capitalize on the

opportunity. So it is likely you'll see slower growth in non-traded BDCs, and you'll see that capital get picked up in opportunistic credit, credit secondaries, direct lending funds, et cetera, et cetera. And then similar to what we saw with the real estate speed bump in the wealth channel three or four years ago, people will then get an opportunity to go back and evaluate how those structures actually performed. And then you'll start to see people reallocate back into the sector. So I think you will see slowing growth in wealth by definition, because there's just too much focus and emphasis on the redemption cycle right now. But I think the market will continue to find other ways to fund the needs of the markets, both primary and secondary. And I think that could create a huge opportunity for people who are structured the right way.

Allison Nathan: And while Marks is somewhat more cautious, he thinks experiencing a full credit cycle may ultimately lead to a healthier investment

environment for direct lending and private credit more broadly.

Howard Marks: First of all, the private equity industry, which is the main borrower, I don't think is growing that fast. So there probably is not going to be the same rate of growth and demand for loans as there has been. That's number one. And there was a surge and there's always a surge when you have a new form of financing where the people involved are able to ballyhoo it, and the flaws haven't been exposed. Now the flaws have been exposed. So it's unlikely to grow with the same headstrong quality. You know, Buffet says it's only when the tide goes out that you find out who's swimming naked. So now the tide has gone out a little bit on private asset vehicles sold to the public, you would think that in the coming months, public buyers of vehicles for private assets will be a little more circumspect in their approach, will be a little more deliberate. They

will do a little more research, will understand the contractual terms a little better, the liquidity limitations, and that there will be less of a rush to put up money for these things.

One of my partners, Bob O'Leary, says, direct lending is going to be okay. But it might take a cycle to get there. A credit cycle, a credit cycle means you go through easy times when it's too easy to borrow money. And then the ill effects of that too-easiness become the tide goes out, the errors are exposed, and then people overreact to the bad news and then it becomes too hard to borrow money and maybe that happened already, or maybe it lies ahead, but after you go through a full cycle, now people know something about the positives and the negatives, and they make better decisions the next time, and that may be what lies ahead at some stage for private credit or for direct lending. Well that

certainly sounds like a healthier investment environment.

Allison Nathan: Let's leave it there. My thanks to Howard Marks, Michael Arougheti, and Amanda Lynam.

And thank you for listening to this episode of Goldman Sachs Exchanges, which was recorded in April and May 2026. I'm Allison Nathan.

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