

Private Credit: Different Risks Than Often Cited

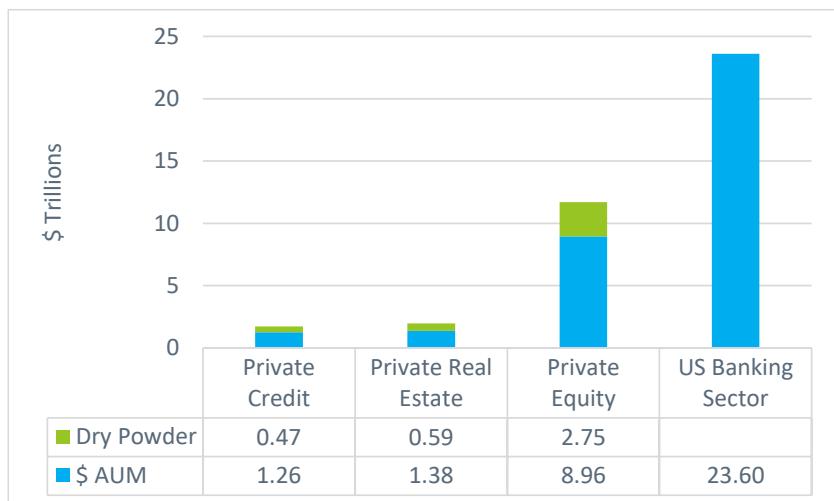
Private credit has grown steadily in recent years as investors seek higher yields and greater portfolio diversification. Rapid expansion has, in turn, prompted concerns about overallocation and systemic risk. We believe these concerns are overstated. Attractive, risk-adjusted opportunities remain for diligent institutional investors. That said, private credit is not without risks—particularly when viewed through non-traditional metrics of borrower health.

Below are answers to frequently asked questions about private credit and a summary of how we are guiding clients today.

Is private credit a less-regulated source of systemic risk?

Private credit is estimated at roughly \$1.7 trillion in assets under management, with the true figure likely higher when including separately managed accounts (SMAs) and business development companies (BDCs). By comparison, the US banking sector is approximately \$24 trillion (US Federal Reserve H.8 Release) and increasingly concentrated among large institutions. Banks borrow short-term and lend long-term, creating an inherent asset-liability mismatch and operating with substantially more leverage.

Figure 1: Private Markets and the Banking Sector



Source: Preqin and US Federal Reserve H.8 Release

Private credit vehicles, by design, more closely align the duration of their funds with the loans they hold, and most strategies employ little to moderate leverage (often 1–2 times, if any). While borrower credit quality in private credit can be lower than in traditional banking, the sector's relative size and structure suggest it is not a major source of systemic risk.

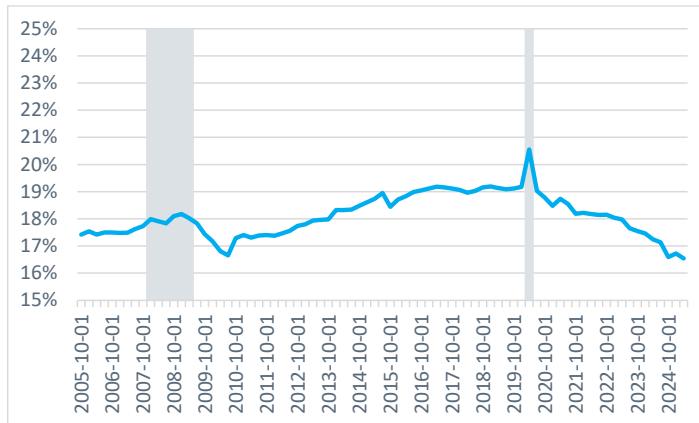
Is there a private credit bubble?

Headlines have characterized a handful of recent defaults as evidence of deteriorating private-credit quality. Given the apparent fraud involved and the disproportionate impact on conventional debt, we do not view these incidents as indicators of a broader bubble or private-credit-specific problem.

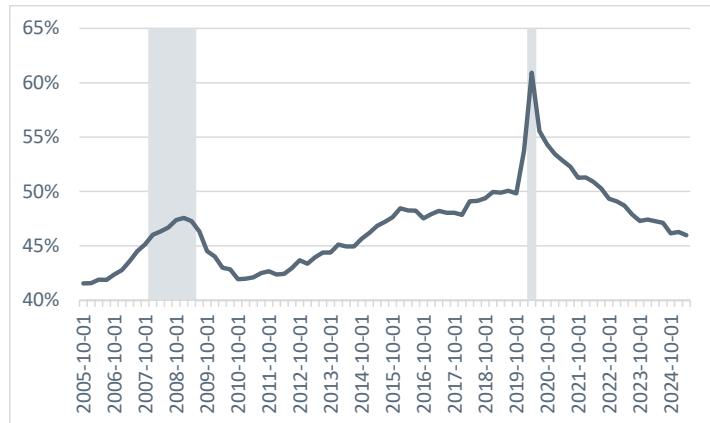
Historically, credit cycles—such as the Global Financial Crisis—were preceded by systemic deterioration in

underwriting standards and rising leverage. Today, household and corporate debt as a share of US GDP have declined from the highs reached in 2020, which points to healthier fundamentals and runs counter to a developing bubble narrative.

**Figure 2: Household Consumer Credit
(% of US GDP)**



**Figure 3: Non-Financial Corporate Business Debt
(% of US GDP)**

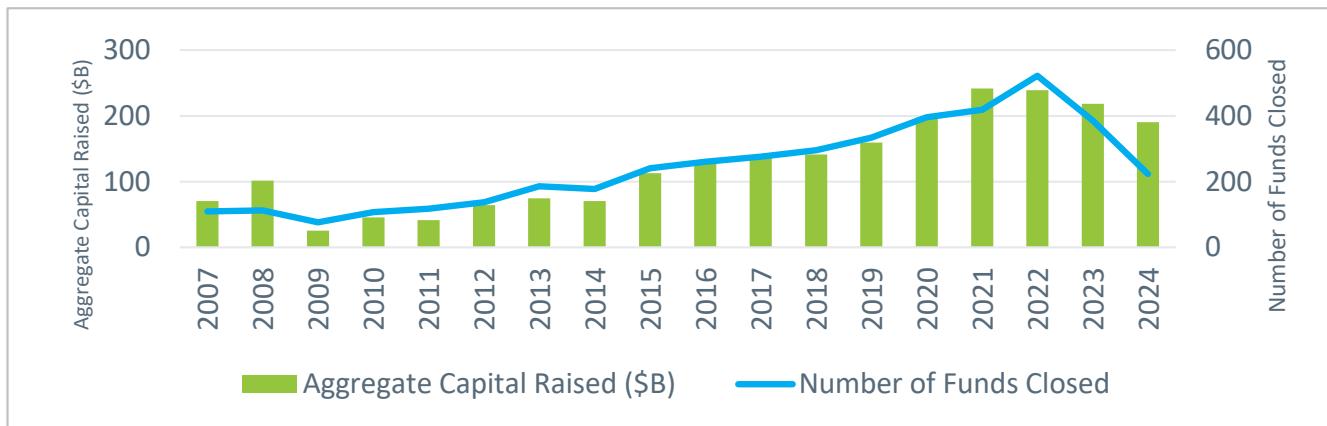


Sources: Fulcrum Asset Management, St. Louis Federal Reserve. Households and Nonprofit Organizations; Debt Securities and Loans; Nonfinancial Corporate Business; Debt Securities and Loans; Liability, Level, Billions of Dollars, Quarterly, Seasonally Adjusted. As a percentage of US GDP, seasonally adjusted. Gray bars indicate recessions.

Is there too much dry powder in private credit?

Dry powder in private credit has grown from roughly \$157 billion ten years ago to about \$470 billion at year-end 2024 (Preqin). The typical concern is that elevated undeployed capital can pressure managers to lend less selectively. Similar dynamics exist in other private markets. For example, when private equity deploys dry powder, loan demand in private credit may also increase because many private credit managers lend to private-equity-backed companies.

Figure 4: Private Credit Fundraising



Source: Preqin

Portland

Boise

www.RVKInc.com

Chicago

New York

In aggregate, dry powder appears proportionate across private markets: private credit accounts for ~12% of private markets' dry powder and ~11% of total private markets AUM. Of the roughly \$1.7 trillion in private credit AUM, 27% is uncalled—comparable to private equity (24%) and private real estate (30%). Fundraising has consolidated, with fewer fund closes and larger average fund sizes, consistent with a maturing landscape.

RVK seeks managers who maintain capital discipline and avoid certain vehicle structures that increase the pressures associated with dry powder.

What do borrower health indicators say?

Overall, direct-lending borrowers appear in reasonably good health. Spreads are near long-term averages (since 2013), while base rates are elevated, producing above-average all-in yields. Compared with public credit markets, where spreads are tight and near the 90th percentile, private credit spreads remain more attractive. Borrower leverage has moderated in recent years, interest coverage has improved toward long-term norms, and default rates remain below historical averages.

Figure 5: Select Private Credit Metrics

All-in Yields	Default Rates	Spreads	Interest Coverage	Borrower Leverage
Above Average	Below Average	Average	Average	Average
Elevated base rates with approximately average spreads	Limited default environment but LME activity may understate pressures	Average levels for private markets despite tight public market spreads	Approximate long-term averages, with an improving trajectory	Borrower level leverage is at averages
	Min	Average	Current	Max
Leverage	3.9x	4.6x	4.6x	5.0x
Interest Coverage	2.1x	2.7x	2.6x	3.3x
Spread	4.4%	5.1%	5.1%	6.0%
All-in Yield	5.7%	7.8%	9.9%	11.9%
Default Rate	2.2%	3.7%	2.9%	9.0%

Sources: LSEG LPC through June 30, 2025. Default Rates: Lincoln International through March 31, 2025.

What risks may be underneath current default rates?

While traditional borrower metrics appear healthy, non-default restructurings are taking place and default rates may be higher than what conventional data indicates.

Payment-in-kind (PIK) loans let borrowers defer part of their interest payments by adding them to the loan balance instead of paying cash. This helps borrowers preserve cash for growth or turnaround plans, while lenders earn a higher return and often gain stricter covenants. PIK terms can be built into loans from the start and are common in private credit, where flexibility is a selling point versus broadly syndicated loans (BSLs). Many BSL investors, such as collateralized loan obligation (CLO) buyers, cannot as easily hold PIK loans, giving private lenders an advantage.

The concern is the rise of amended PIK—added after origination. About 11% of loans tracked by Lincoln International pay PIK interest, and over half of those are amended, suggesting roughly 6% of loans may be under pressure. This indicates borrower health may be weaker than default rates suggest.

Figure 6: Investments with PIK (%)



Figure 7: ...of those, PIK after close (Bad PIK, %)



Sources: TCW and Lincoln International. <https://www.tcw.com/-/media/Downloads/com/Insights/2025/250818-The-Big-PIKture.PDF>

How is RVK approaching private credit?

We continue to monitor PIK and other metrics of borrower health. The important caveat remains that data availability is limited for the whole range of private credit strategies and much of this discussion focuses on direct lending as a proxy. We favor managers with strong workout capabilities and institutionally viable vehicles. Similarly, we recommend clients avoid BDCs where PIK income is especially problematic—it is considered taxable income and BDCs must distribute at least 90% of taxable income to shareholders in the form of cash. This can cause asset/liability pressures, including the potential for the forced sale of positions.

Conclusion

Private credit may help reduce systematic risk in the banking sector by more effectively matching risk and tenors to appropriate investor bases. Borrower metrics generally appear healthy; however, non-traditional approaches to restructuring may result in understated default rates. We remain selective, emphasizing managers with strong track records, deep borrower-level due diligence, and selective lending history. We also favor highly experienced teams that lead structuring for their own transactions and manage effective workouts. Private credit is not without risks, but the attractive yield potential is likely still worth the risk for many long-term institutional investors.

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