NexSky

CIO ANALYSIS

Understand the Asset: Private Credit

How it works, the five ways to own it, and where the risk sits.

1. Executive summary

Private credit is a loan to a company that does not borrow from the public markets. It is often sold to families in one sentence: equity-like returns with bond-like risk. That sentence does not survive contact with how the loans are built. The yield is real, roughly three to four points above public high yield, but so is the risk: leveraged borrowers, illiquidity of the loans, valuations that are estimated rather than observed, and an asset class of an estimated 1.5 to 2 trillion dollars that has never been tested through a severe downturn at its current size.

This note explains the asset from the ground up: what it is, why it expanded so fast, the five different ways a family can own it, the forms the loan itself takes, who borrows this way, and where the risk actually sits, in defaults, in the fine print, and in how much you recover when a loan fails.

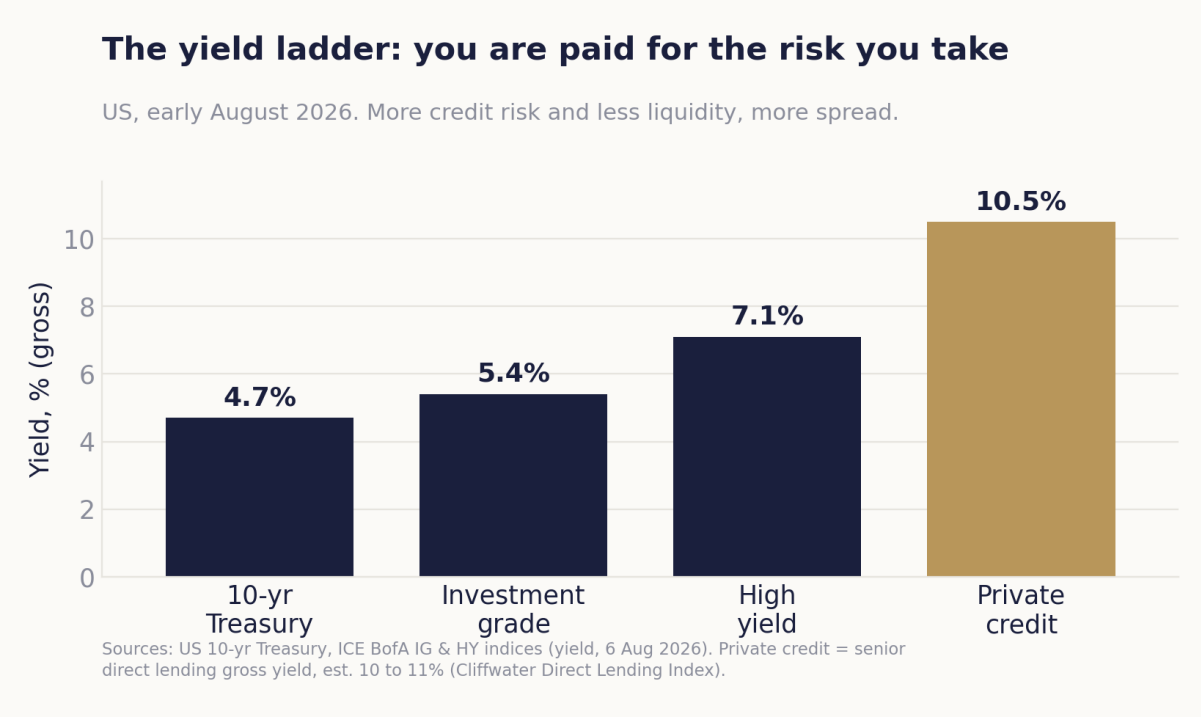
> **House view: neutral.** Private credit earns a place in a family's allocation, but as a satellite sized to survive being wrong and illiquid at the same time, chosen for a specific route, structure, vintage and manager, never as a core holding bought on a one-sentence pitch.
>
> What would change our mind: a genuine repricing that reaches the vintages already owned, not just new money, and hard evidence the asset can clear a real default cycle without the losses that are currently masked by distressed exchanges and payment-in-kind.

2. What private credit actually is

A public company can issue a bond that trades on a screen, or draw a syndicated loan arranged by banks and sold on to hundreds of investors. A private credit borrower does neither. It negotiates a loan directly with one lender, or a small group of them, and that loan is held rather than traded. There is no daily price and usually no exit before maturity.

The lender is paid in three parts. A base rate, almost always floating, so the coupon moves with short-term interest rates. A spread on top, the extra yield for taking the credit risk and for locking the money up. And fees, typically an arrangement fee at the start (often quoted as original issue discount, meaning the loan is advanced at slightly less than its face value) and sometimes a fee at exit. Put together, a senior private loan in 2026 yields a base rate of roughly 4.5 per cent plus a spread of 5 to 6 per cent, a high single-digit to low double-digit gross return before losses and fees.

Senior means first in line to be repaid if the borrower fails; **subordinated** (or junior) means paid only after the senior lenders are made whole. **Secured** means the loan is backed by collateral the lender can claim in a default. The more senior and secured your position, the lower the yield and the better the recovery. That trade-off is the spine of the asset class, and you can see it in the yield on offer.



The extra three to four points over public high yield is the price of leverage, opacity and the lock-up, not a free gift.

A ten-year Treasury pays about 4.7 per cent for almost no credit risk. Investment-grade company bonds add a little, high-yield bonds add more, and senior private credit sits at the top, around 10 to 11 per cent, because it carries the most credit risk and the least ability to sell. Whether that price is enough is the question the rest of this note works through.

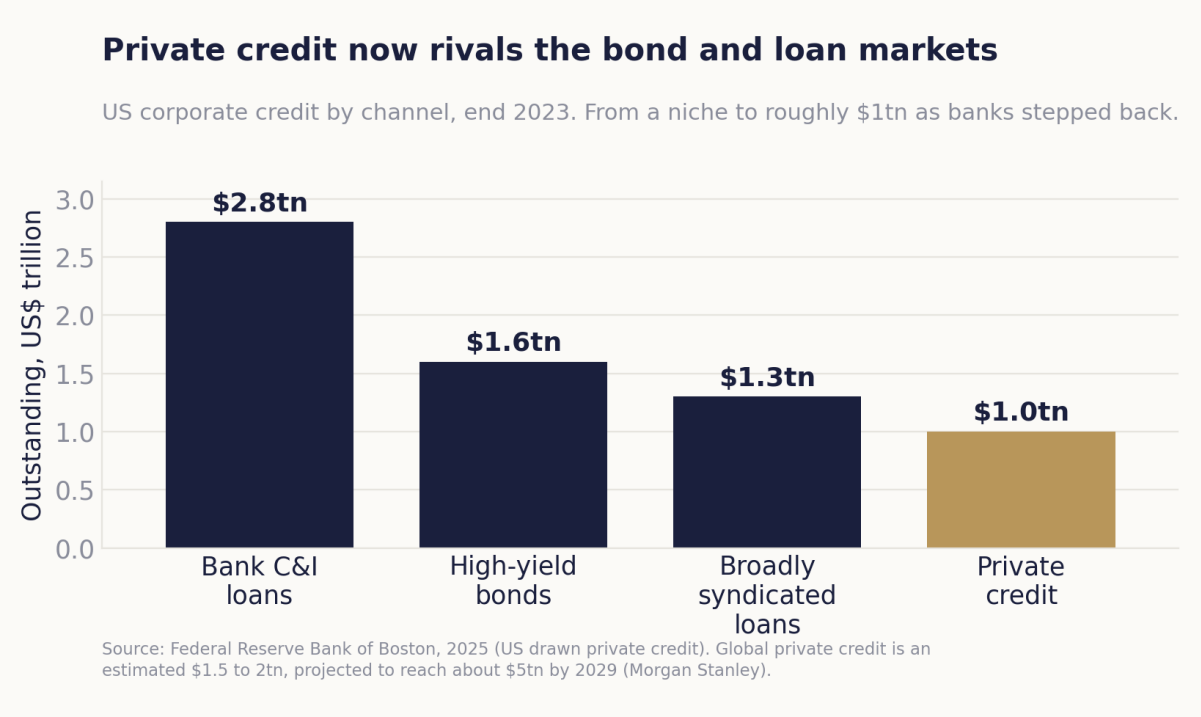
3. Where the money comes from

Private credit is not new. Insurance companies and specialist funds have lent to private companies for decades. What is new is the scale, and the scale has a cause on each side of the market: banks stepped back, and investors leaned in.

Banks retreated, and not by accident

After the 2008 crisis, regulation made mid-market and leveraged lending steadily less attractive for banks to hold. US supervisors issued guidance in 2013 that flagged any buyout loan above six times debt-to-earnings as a supervisory concern, pushing the most leveraged deals off bank balance sheets; that guidance was only rescinded in December 2025, long after the damage was done. Basel capital rules, and the proposed Basel III endgame that would raise the largest banks' core capital by around 16 per cent, made these loans more expensive to keep. The banking system also shrank: the number of US banks has fallen from roughly 14,000 in the late 1980s to about 4,500 today. Then came the shock. After Silicon Valley Bank and Signature Bank failed in March 2023, a net 51 per cent of US banks tightened lending standards to mid-sized and large companies, a reading normally seen only in recessions.

Something had to fill the gap, and private credit did. Direct lenders now provide the large majority of new buyout financing, and private-credit-backed buyout volume set a record in 2025. On the IMF's measure, private credit is now about 7 per cent of all US corporate credit, roughly level with the high-yield bond market and the syndicated-loan market it displaced.



From a niche to roughly a trillion dollars in the United States, level with the bond and syndicated-loan markets.

Investors leaned in, for reasons only partly what you would expect

You will often hear that the boom is investors moving money out of private equity and into private credit. That is partly true. On the demand side, private credit is now the single most-favoured private asset class for new money: around 45 per cent of large investors, and 32 per cent of family offices, plan to increase private-credit allocations, more than for private equity or real estate. And weak private equity performance is genuinely pushing capital across. Buyout Private Equity funds returned only about 11 per cent of their value to investors in 2024, a record low, with roughly 3.6 trillion dollars of unsold companies backed up in funds. Money that a decade ago would have rolled straight into the next buyout fund is now looking for yield it can actually collect.

But reallocation from private equity is not the main engine. The largest structural sources of new private-credit capital are insurance balance sheets, the annuity and life insurers. Several of them are now owned by private-capital firms such as Apollo with Athene and KKR with Global Atlantic, whose long-dated liabilities match private credit well. Then there is the private-wealth channel that feeds the evergreen funds, where the large managers are each targeting tens to hundreds of billions from individual investors. Pension funds substituting private credit for part of their bond allocation are a third.

So, in reality, the private-equity slump is a real and visible tailwind, most obvious in family-office surveys, but insurance and wealth capital are what actually fund most of the growth. If you are told the asset is safe because everyone is moving into it, that is a description of a crowded trade, not of low risk.

4. The five ways a family can own it

The same underlying loan can reach a family through very different structures, and the structure matters as much as the borrower. Here they are, from the most direct and concentrated to the most diversified and liquid.

1. Direct (bilateral) lending to a single company. You, or a vehicle you control, are the sole lender to one borrower. This is the purest form: full control of terms, full information, the entire spread and all the fees, no fund manager taking a cut. It is also the most concentrated. One borrower, one credit decision, and if it defaults there is no diversification to absorb it. It demands the ability to originate, underwrite, document

and monitor a loan, a specialist job, not a passive investment. Realistically open only to families with the deal flow and a credit team, or a manager acting for them.

Example: a family lends 25 million euros directly to a regional healthcare-services group it has known for years, secured on the company's assets, and holds the loan to maturity.

2. The club deal. A small group of lenders, often three to six, lends to one borrower on shared terms. Each takes a slice, so single-name risk is spread and larger loans become reachable. You still see the borrower directly and can negotiate the documents, but you share control with the other lenders and depend on the lead, the agent, to administer the loan and run any workout. The opportunity is access to bigger, better-documented deals than you could hold alone; the risk is alignment, because the other club members may not share your patience or your view when a loan goes wrong.

Example: four lenders each take 30 to 40 million of a 150 million loan financing the buyout of a software company, with one acting as agent.

3. Through an SPV. A special purpose vehicle is a company or partnership created for one purpose: to hold a specific loan or a small pool of them. Investors put money into the SPV and the SPV is the lender of record. It is a wrapper, useful for pooling several families into one deal, for isolating that deal's risk, and for cleaner tax and legal treatment across borders. The opportunity is a clean, ring-fenced way to co-invest in a named credit. The risks are the ones wrappers always carry: read who controls the SPV, what it is allowed to do, what fees it charges, and how you get your money back, because a wrapper can hide as much as it organises.

Example: a Luxembourg SPV lets five families co-invest 10 million each into a single 50 million loan to a logistics group, ring-fenced from everything else they own.

4. Through a private debt fund (closed-end). The institutional default. A manager raises a fund, calls your committed capital over a few years as it finds deals, lends to dozens or hundreds of borrowers, and returns capital as loans repay, usually over a six-to-eight-year life. You get diversification across many credits and a professional origination and workout team. You give up control and liquidity: your capital is committed and locked, drawn on the manager's timetable, and you cannot leave. You also pay for the team, typically a management fee plus a share of profit above a hurdle, though private-credit fees are usually lower than private equity. The central question is not the headline yield, it is the manager: origination quality, underwriting discipline, and how they behave when a loan sours.

Example: a 5 million commitment to a direct-lending fund run by a manager such as Ares, HPS, Blackstone or Apollo, or in Europe ICG or Pemberton.

5. Through an evergreen (open-ended) fund. A newer, fast-growing wrapper, marketed to private wealth as the accessible version. It has no fixed end date, accepts money on a rolling basis, and offers periodic liquidity, usually quarterly redemptions capped at about 5 per cent of the fund per quarter. It is simpler to buy, immediately invested rather than drawn down over years, and easy to hold in a private-bank account. The catch is that liquidity is the thinnest promise in the structure. The underlying loans are illiquid, so when too many investors ask for their money at once the fund fills redemptions pro-rata and the rest wait. Across 2025 and into 2026 several of the largest of these vehicles hit their caps and prorated withdrawals, exactly as designed. Semi-liquid does not mean liquid, especially when everyone reaches for the door together.

Example: the semi-liquid vehicles a private bank will show you, such as Blackstone's BCRED, Blue Owl's credit income fund, Apollo's ADS and HPS's HLEND.

The pattern down the list is consistent. As you move from direct lending to an evergreen fund, you gain diversification and ease and you give up control, information and the full economics. There is no free lunch in the choice, it is a tradeoff you should make deliberately and not by default.

5. The forms the loan itself takes

Within any of those structures, the loan can be built in several ways. These are the main ones, ordered from safest to most aggressive.

Senior secured and unitranche. The senior, collateral-backed loan and the bulk of the market. Unitranche simply combines what used to be separate senior and junior loans into one blended loan at one blended rate, which speeds execution because the borrower deals with a single lender. For example, the roughly 20 million to 500 million first-lien loan behind a typical mid-market buyout.

Second lien. Secured by the same collateral as the senior loan, but second in the queue to claim it. Higher spread, and materially worse recovery if things go wrong.

Mezzanine. Subordinated debt between the senior loans and the equity. Usually unsecured, with a high coupon and often an equity kicker (warrants over a small slice of the upside). For example, a tranche funding a family-owned manufacturer's expansion at a 12 to 14 per cent coupon plus warrants over a few per cent of the equity. Mezzanine is a bet the company grows: if it does, you are paid a high coupon and a little equity; if it does not, you are a long way back in the line.

PIK (payment-in-kind). A loan whose interest is not paid in cash but added to the balance owed, so the debt compounds and nothing is paid until exit. Legitimate for a genuinely fast-growing company preserving cash. Also see it as a warning sign when a struggling borrower switches to PIK to avoid a cash default: by doing so the borrower is postponing the stress, not removing it. By 2026, PIK and interest deferrals had become more than half of all private-credit default events.

Convertible debt. A loan that can convert into equity, usually at the lender's option and at a pre-agreed price, or a set discount to a future price. You collect a coupon like a lender, with the right to become a shareholder if the company does well. Commonly used in venture and growth situations. The line between debt and equity by design is blurred by design.

Bridge finance. A short-term loan repaid from a specific, identified event: a refinancing, an asset sale, an equity raise. For example, a twelve-month loan that funds a take-private today and is repaid when the company issues a bond next year, a bridge to bond. The whole risk is that the exit event does not happen on schedule, at which point a short loan quietly becomes a long one.

Revenue-based finance. Repayment is a fixed percentage of the borrower's revenue until a capped total is repaid, rather than a fixed schedule. For example, a lender such as Wayflyer, Capchase or Pipe advances cash to a software or e-commerce business and takes a set slice of its monthly revenue until repaid. The return depends on the revenue actually arriving, so the underwriting is about the durability of the top line rather than the collateral.

Adjacent to these sit venture debt (loans to young, equity-backed companies, usually with warrants, the market Silicon Valley Bank dominated until its 2023 failure) and asset-based lending (loans secured against receivables or inventory, and increasingly NAV loans secured against the whole portfolio of a private equity fund). The common thread is that the structure is negotiated to fit one borrower's situation. That flexibility is the genuine strength of private credit, and it is also why two loans described by the same word can carry very different risk.

6. Who borrows this way, and why

Companies choose a private loan over a bank or a bond for reasons that are usually about fit, not desperation.

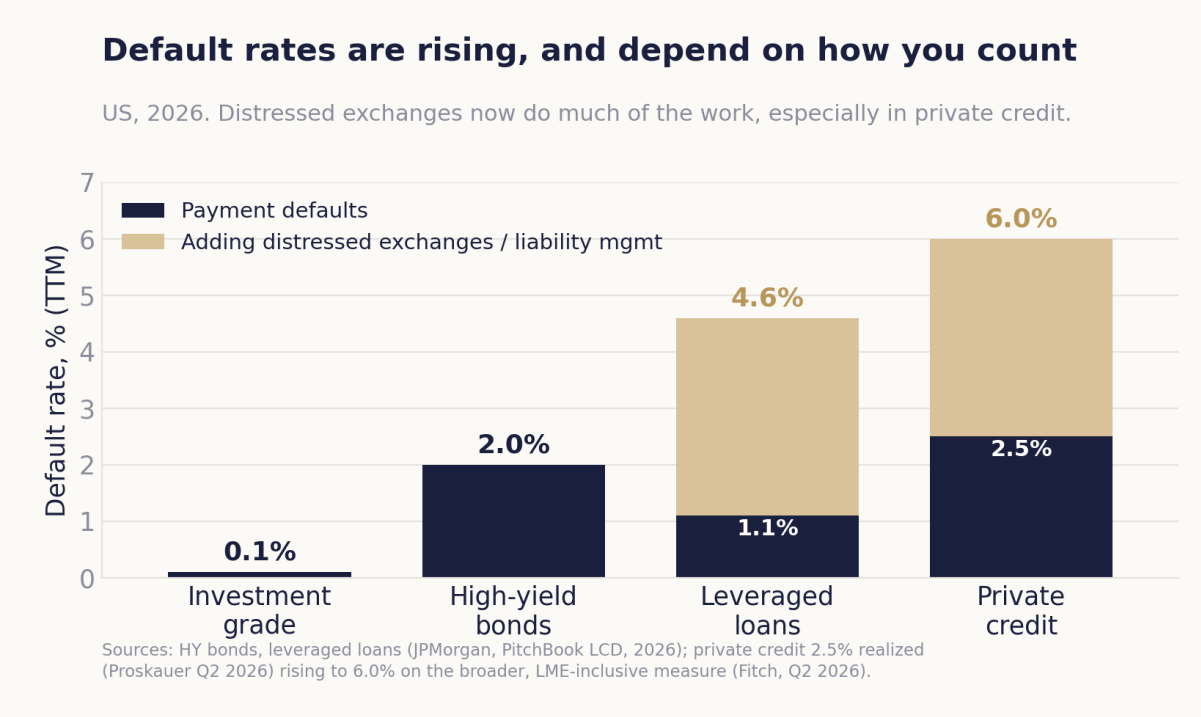
- **Sponsor-owned mid-market companies.** The largest source of demand. When a private equity firm buys a business it funds part of the price with debt, and private credit is the lender of choice for its speed, certainty of funding and confidentiality.

- **Founder or family-owned mid-market companies.** They are either too small to issue a bond economically, out of scope for commercial banks, and reluctant to cede control. These companies tend to value a single relationship lender over a syndicate of banks.
- **Companies that are complex or in a hurry.** A carve-out, an acquisition on a deadline, an unusual structure. Private lenders will underwrite complexity and move in weeks, and will of course charge handsomely for it.
- **Special situations.** Borrowers in or near distress, or in transition, where the lender is really pricing a specific event and often takes a more active role.

In summary, private credit borrowers, as a group, carry more leverage and lower credit quality than comparable public-market issuers. The Financial Stability Board said exactly this in its May 2026 report. That is not a flaw to be hidden. It is the reason the yield exists.

7. What it risks: defaults, covenants and recovery

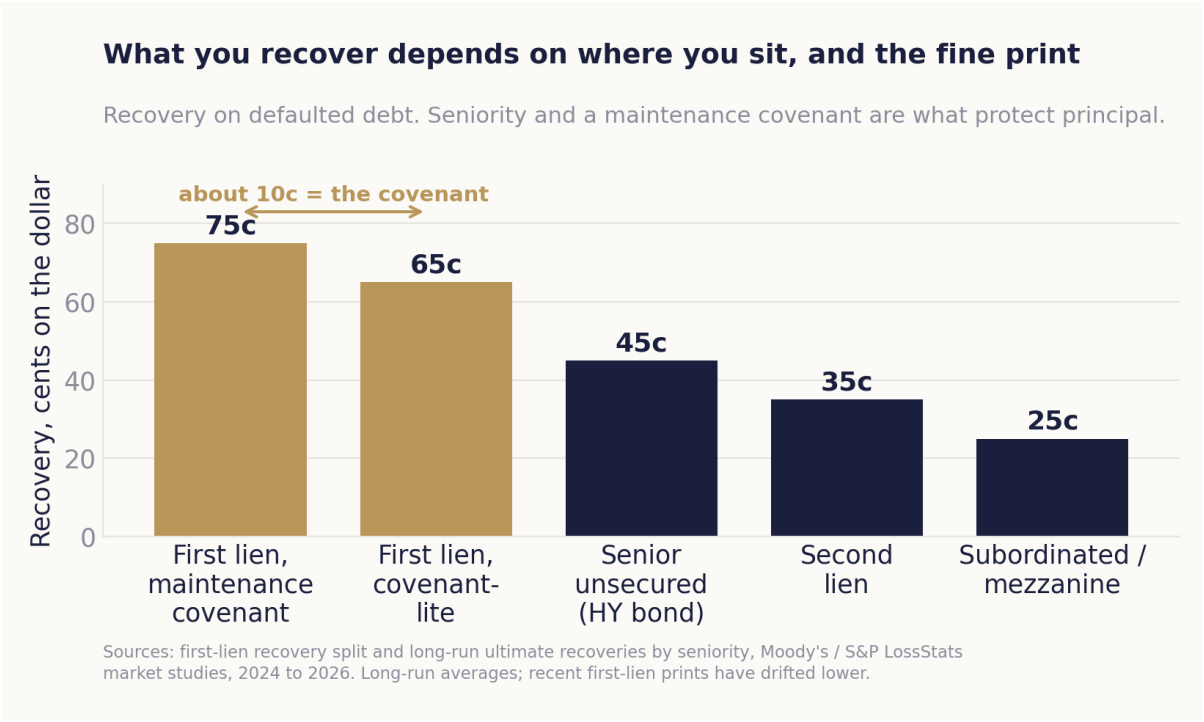
A high yield is only worth having if it survives contact with defaults, and here the picture is turning. How bad it looks depends on how you count.



On a strict cash-missed basis private credit is already running above loans and bonds; count distressed exchanges and it reaches a record 6 per cent.

On a strict, cash-missed basis, realised default rates in direct lending are running around 2.5 per cent, already above leveraged loans and high-yield bonds. But that understates the stress, because a growing share of trouble is handled quietly through distressed exchanges and liability management, where a struggling borrower's terms are reworked rather than allowing a formal default, and through the PIK switch. Count those in, as Fitch does, and the private-credit default rate reaches a record 6 per cent, the highest of any of these markets. The number matters less than the direction and the disguise: the losses are building in the part of the market that does not show up in a headline default figure.

When a loan does default, what you get back depends on two things: where you sit in the capital structure, and the fine print.



Seniority and a maintenance covenant are what protect principal; cov-lite costs about ten cents of recovery.

Seniority is the first driver, and it is intuitive: a first-lien secured loan recovers far more than a second-lien loan, an unsecured bond, or a subordinated mezzanine piece. The second driver is less obvious. A covenant is a promise written into the loan agreement about what the borrower will and will not do. A maintenance covenant is tested every quarter whether or not the company does anything, so a breach pulls the lender to the table while there is still a business worth fixing. An incurrence covenant is only tested when the borrower takes a specific action, such as raising more debt, so a company can deteriorate for a long time without ever tripping it. A loan with no maintenance covenant is called covenant-lite, or cov-lite.

Over 90 per cent of large-cap leveraged loans are now cov-lite, a record. The cost shows up precisely where it should: defaulted cov-lite first-lien loans have recovered roughly 65 cents on the dollar, against 75 cents or better for loans that kept a maintenance covenant. Ten points of principal is what the fine print is worth. It is the cheapest insurance in credit, and most of the market gave it away.

The protection did not vanish everywhere. In the lower middle market, covenant retention still runs near 98 per cent, alongside wider spreads and less leverage. But those funds are smaller, harder to diligence, and mostly closed to a family arriving alone. The best-protected corner of the asset class is the least accessible one. That is not an accident; it is the structure of the market, and it is why sourcing and vetting through a network matters more here than in almost any public asset.

8. The NexSky read

Put the pieces together. Private credit pays a real yield, three to four points above public high yield, because it takes real risk: leveraged borrowers, illiquid loans, valuations that are estimated rather than observed, and an asset class never tested through a severe downturn at its current size. The extra spread for locking money up compressed to multi-year lows across the 2023 to 2025 vintages, the loans sitting in many portfolios today, at the very moment defaults began to climb. Mid-2026 has brought a genuinely lender-friendly reset, spreads roughly 50 to 100 basis points wider and tighter documents, but that repricing helps new money and does nothing for the vintages already bought.

So private credit today carries the same risk than the riskier end of the corporate bond market, with far less ability to get out, and a higher default rate partly hidden by the way trouble is now managed. Our house view holds it at neutral for that reason. It earns a place in a family's allocation, but as a satellite sized to

survive being wrong and illiquid at the same time. Allocating to Private Credit also requires discipline in terms of what type of exposure best fits your investment profile and objectives. Family offices on average now allocate about 4 per cent to private credit, up from 3 per cent in 2023, and roughly a third plan to add more. The ones who do well will be the ones who know which type, which route, which segment and which documents they actually own.

Sources

Financial Stability Board, Report on Vulnerabilities in Private Credit, 6 May 2026. Yields: US Treasury, ICE BofA investment-grade and high-yield indices, 6 August 2026; private credit per the Cliffwater Direct Lending Index. Defaults: JPMorgan and PitchBook LCD (bonds and loans), Proskauer Private Credit Default Index and Fitch Ratings (private credit), 2026. Recovery: Moody's and S&P LossStats market studies, 2024 to 2026. Market structure and capital sources: IMF Global Financial Stability Report, Federal Reserve Bank of Boston, Federal Reserve Senior Loan Officer Opinion Survey, Bain, BlackRock, Coller Capital and Morgan Stanley, 2024 to 2026.

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