

Direct lending in private market, still desirable?

Private credit stands at an important juncture. It is for sure a structural evolution in nonbank lending but we should ask if its expanding market share rests on foundations weaker than its strong and bold hype suggests. This is the question investors and managers, on the two sides, should seriously address. Applauding growth and apparent merits or recycling easy critiques is misleading. What truly matters is a clear-eyed assessment of underlying risks and the sources of durable returns and resilience.

I am not opposed—“axed”, as someone phrased it—to the asset class. Despite analyzing and evaluating a significant number of credit portfolios and mandate-specific asset pools for LPs, I try to distance myself from the increasingly shallow narratives that either criticize or glorify private credit. Like any asset class, it includes both strong and weak credit managers. Some maintain “genuine investment discipline”; others, to put it diplomatically, operate with a “more flexible interpretation of it”. Any further remarks would be superfluous.

Occasional references to “cockroaches,” such as those highlighted by JPMorgan Chase in October 2025, should not be overinterpreted. Financial markets are interconnected ecosystems. Shared risk exposures and interconnected interests span the capital stacks, linking lenders, sponsors, and corporates. Borrowers frequently move between public markets and private credit depending on conditions, and there are no sealed compartments isolating one from the other. We have seen this over the last 4-5 years. The fact that borrowers are backed by private equity sponsors is not, in itself, a weakness. What matters is the underlying economics, leverage, and sustainability of capital structures. In three words: “responsible investment practices”.

A broader narrative, including recent anxiety around AI-driven valuations, has shaped financial markets and inevitably weighed on private credit sentiment. Yet I have never believed in markets divided by impermeable walls—the Great Financial Crisis remains the clearest example of how stress in one segment, the subprime mortgage market, inevitably can spread across the entire financial system. Public and private markets influence each other continuously. Valuations, refinancing windows, and risk appetite transmit across areas and

financing channels. Lending standards vary across markets, and often some asset classes become compressed and mispriced like the broad liquid leveraged loan market, due to the behavior and technicals of the CLO machine. The risk is not hidden but it lies with bad credit managers, not the asset class itself. The problems (and the losses) observed so far expose fundamental weaknesses in private-credit due diligence.

Some central premises must be acknowledged. The private credit, at its current scale and economic importance, has not yet been tested by a prolonged period of systemic stress. I deliberately avoid even using the word “recession”.

On another angle: investors and managers involved in the asset class do not always communicate and admit clearly the precise nature of their exposures. This limits price discovery, NAV fairness and accuracy, making a full assessment of risk and resilience more difficult, if not opaque.

While I cannot comment on specific portfolios I analyze for LPs, it is paramount to clarify what private credit truly is—and what it is not (please notice: I am discussing here about direct lending and not asset base lending and credit opportunities which involve other considerations).

Private credit has emerged as a significant investment avenue for many limited partners, particularly within the life insurance sector, driven by the search for enhanced yields. The prolonged low-interest-rate environment incentivized this shift, as insurers' liability costs remained relatively high after the GFC while yield on the assets compressed. Even following the sharp upward repricing of rates along the term structure in 2022 and the rise in official interest rates, demand for the asset class has persisted, reflecting its continued role in liability management. In the United States, private equity firms have acted as key catalysts in transforming the insurance industry globally, acquiring both majority and minority stakes in insurers. This phenomenon has contributed to a notable migration in insurance portfolio profiles toward private credit exposures. Moreover, robust capital buffers and post-Financial Crisis regulatory frameworks have further reinforced sustained investment in this asset class.

Regulatory oversight should ensure that insurers are appropriately de-risking their balance sheets while deploying capital in a prudent and efficient manner. Is this happening?

Insurers employ a spectrum of investment management approaches, ranging from the development of in-house sourcing capabilities to partnerships with asset managers, or the complete outsourcing of asset management functions to third-party providers (if the ownership is the same, do we have a conflict of interest? Or is synergy in motion?...). The ongoing migration of insurance

portfolios toward alternative investments has materially altered their composition and risk profile, raising important considerations for risk management and regulatory supervision (I am thinking about the need to apply more stringent disclosure requirements including independent verification of collateral, prices, and beneficial ownership transparency).

Direct lending is often presented as a “portfolio diversifier” (shall we talk about software and tech holdings?). However, its economic exposure is closely linked to leveraged risk assets. Performance ultimately depends on corporates EBITDA stability, access to refinancing markets, sponsor support, and valuation multiples of the financed targets. The apparent “stability” of returns from the asset pools often reflects the absence of daily mark-to-market pricing rather than the absence of economic correlation and structural fragilities, liquidity issues, tail dependencies. Consequently, equating low observed volatility, explained by prices marked and released by the manager, with stability and low economic risk (as someone tried to do) reflects a narrow interpretation of uncertainty and ignores multiple dimensions of risk. Flawed risk analysis (by people who probably never managed a credit book) is symptomatic of a deeper conceptual deficiency in both the understanding and specification of risk itself.

Portfolio classification in private credit frequently relies on internal or external rating systems that are not always transparent or comparable across managers. Recognition of credit deterioration and rating migration across buckets can therefore be not “effective” (how and how often the Probability of Default and Loss Given Default are calculated? Those metrics remain closely held by the manager). Many financings involve aggressive leverage multiples and companies with limited scale or diversification. EBITDA adjustments and optimistic projections can mask fragile debt service capacity, particularly in a higher-for-longer rate environment. Illiquidity remains a defining characteristic of private credit. In periods of stress, secondary markets are thin and do not work unless with deep discount versus portfolio valuations (which prices?). Realizable values may diverge from the ones reported by the manager, and portfolio adjustments become slow and complex (and painful).

Illiquidity may smooth volatility optics, but it does not eliminate fundamental risks, impairments, and corporate defaults.

Several arguments deserve more scrutiny.

Is direct lending truly a diversifier, or simply a less transparent extension of leveraged credit markets? Do borrowers in private transactions carry structurally higher leverage than comparable public deals? Is the correlation to public markets underestimated because volatility is not immediately

observable? Are returns properly adjusted for the true unit of risk assumed? Are the recovery rates upon default, prove themselves to be less robust than commonly assumed, especially when enterprise values are modest and capital structures are light? Do borrowers in private credit portfolios behave as a stress amplifier or like a proxy of the observable high yield credit markets- or neither of the two options?

Engaging with credit platforms and investment managers on these issues often yields answers that are vague and lack consistency and substance. This is the problem.

The presence of seasoned management teams and large-scale credit platforms does not, by itself, ensure higher investment selectivity. Given the differing criteria and opinions, advocating for diversification across factor-based quality portfolios and skilled managers is likely the optimal approach to the asset class. A similar dynamic is observed in liquid products such as the CLOs. As we can see, the interlinkages between public and private markets continue to operate.

Borrowers often pay a premium for the speed, certainty of execution, customization, and flexibility that private lenders can offer. This flexibility does not revolve solely around PIK structures; it can take many different forms depending on how the financing is engineered. The crucial point, however, is that such a premium is justified only if it adequately compensates lenders for the incremental credit risk (yes, there is more risk) they assume. The key question is whether such compensation remains adequate under conditions of pronounced shifts in corporate behavior and strategy—such as those posed by the emergence of artificial intelligence—particularly when refinancing windows disappear and equity buffers risk being eroded.

Private credit is neither inherently fragile nor inherently immune from financial turmoil. Its resilience depends on underwriting discipline, realistic leverage tolerance, transparency toward investors, and sponsor behavior under stress. The core vulnerability is not the existence of the asset class, but capital discipline during periods of rapid expansion. When capital under management grows faster than the availability of high-quality opportunities, risk tends to migrate into documentation flexibility, high leverage multiples, weak valuation assumptions, and optimistic recovery expectations. I have noted this across several portfolios of direct lending I have had the opportunity to analyze over a period of 8 years.

The decisive test has yet to come and the impact of any risk off depends ultimately on the driver. If finance conditions tighten for an extended period and exit valuations compress, the market will discover whether the private

credit equates to genuine solvency and whether reported stability reflects “economic durability or deferred recognition”. Only then will it become clear whether private credit represents a structural evolution in capital markets or an expansion whose true fragility has simply not yet been fully revealed.

For Actors and Regulators, the critical question is: at what point does credit expansion become detrimental, potentially increasing financial fragility across the broader credit markets? The Investors are waiting for answers. I feel that the grace period has expired.

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