



TOPICS:

Banking System

SOURCE:

European Capital Markets Institute

ECMI: Private Credit's Liquidity Facade is Beginning to Fracture

- The note analyses **emerging liquidity vulnerabilities in semi-liquid private credit funds** and outlines regulatory implications for the EU.
- The note highlights a recent rise in withdrawal restrictions across major asset managers, framing these not as isolated incidents but as structural signals. These events expose a core mismatch: **funds offering periodic liquidity** (e.g., quarterly redemptions) **are backed by inherently illiquid loan assets**. While such structures function under stable inflows and benign credit conditions, they become fragile when investor sentiment weakens or redemption requests concentrate. Gates and withdrawal caps therefore reflect structural stress rather than insolvency.
- A key regulatory concern is the **"retailisation" of private credit**. Increased participation by retail investors - via semi-liquid vehicles - introduces more volatile, procyclical flows compared to traditional institutional capital. International bodies such as the IMF and ECB have flagged that limited transparency, valuation opacity and loosening lending standards amplify these risks,

particularly as the credit cycle matures. Additionally, **interconnected exposures between banks and private credit markets** raise potential systemic considerations.

- From a policy perspective, the EU's revised framework under **AIFMD II** is viewed as a constructive step. It establishes closed-ended structures as the default for loan-originating funds, allowing open-ended formats only where liquidity risk management aligns with redemption terms. Complementary **ESMA guidance** introduces liquidity management tools and stress-testing requirements. However, the paper stresses that supervisory implementation will be determinative to effectiveness.
- The author proposes **three priority areas for regulators**: (i) strict interpretation of open-ended fund exemptions to prevent misaligned liquidity promises; (ii) enhanced, standardised disclosure on portfolio quality and valuation practices; and (iii) strengthened system-wide monitoring, including coordinated stress testing across EU authorities.

