

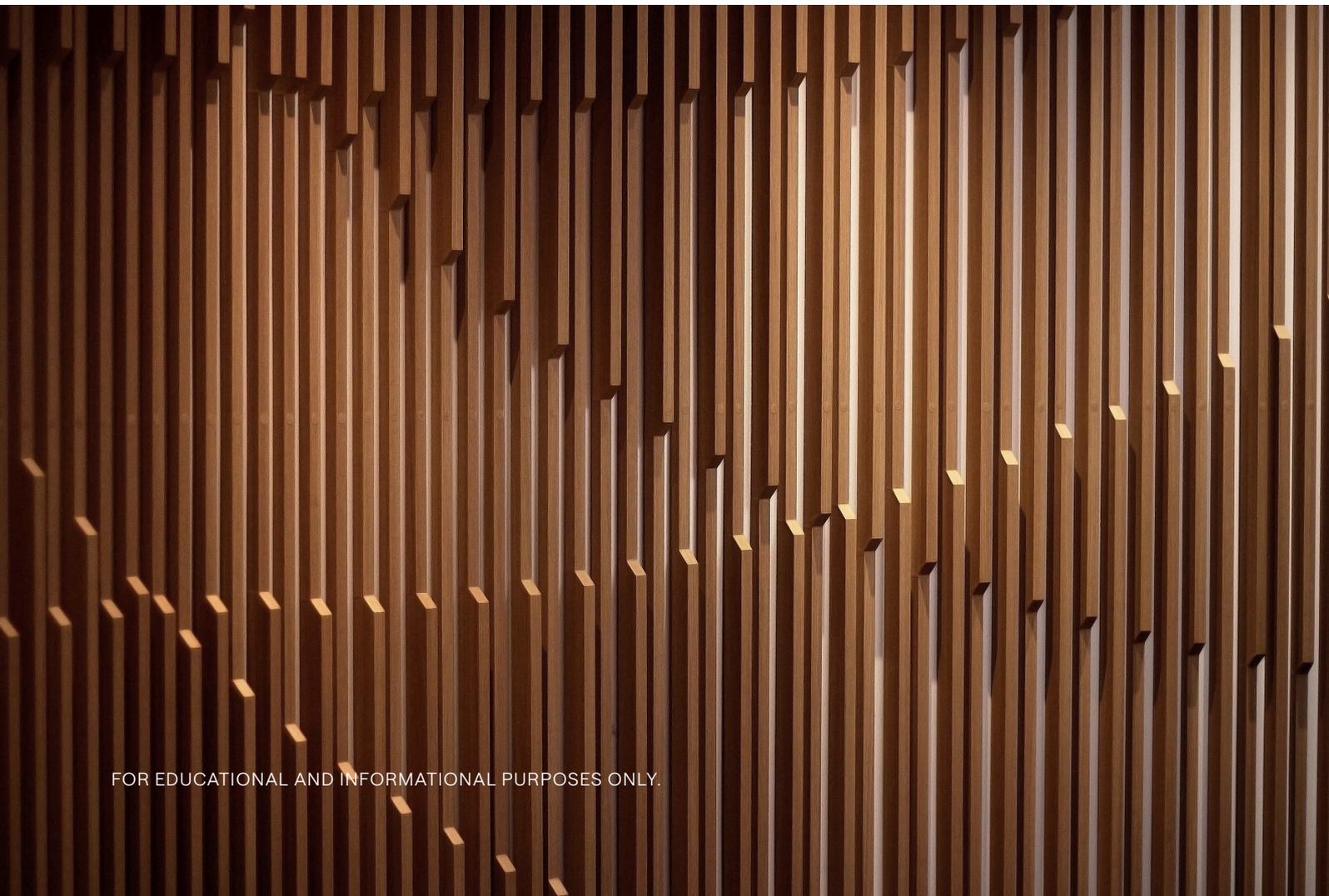
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# Eight Big Questions About Private Credit

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# Private credit, especially corporate direct lending through business development companies (BDCs) and similar lending vehicles, is facing scrutiny as investors question whether underwriting standards weakened during the market’s rapid growth.

While recent credit issues highlight risks inherent in sub-investment-grade lending, we don’t think they signal systemic stress in the asset class. Direct lending remains a valuable financing source for borrowers, and can offer investors attractive yields, though returns depend heavily on manager skill. Elevated interest rates and industry shifts—such as potential disruption in software—are creating greater performance dispersion among borrowers, which reinforces the importance of disciplined underwriting and may also create pockets of dislocation for opportunistic investors. We believe investors may benefit from diversifying private credit portfolios across complementary strategies. Despite these observations, private credit investments remain subject to credit risk, liquidity risk, and potential losses, particularly in periods of economic stress.

Here, we address eight common concerns investors are facing today.

## QUESTION 1: DOES PRIVATE CREDIT PRESENT SYSTEMIC RISK?

Regulators have largely achieved their post-GFC objective of shifting direct corporate lending risk away from banks toward alternative lenders, which typically operate with lower leverage and can offer more flexible capital. We believe the growth of private credit is ultimately good news for borrowers because it provides an additional financing option.

That said, banks still maintain exposure to the direct lending ecosystem through their financing of BDCs. However, this exposure is generally well protected. Bank lending to BDCs is typically senior and secured, benefiting from strong structural safeguards. In addition, many BDCs are investment-grade rated and raise capital in the unsecured market, where that debt ranks junior to bank financing, creating a meaningful cushion for bank lenders. It should also be noted that BDC leverage is capped at 2:1 by the U.S. law, and in practice most BDCs use less.\*

\*Actual leverage levels vary by manager and market conditions. Private credit investments remain subject to credit risk, liquidity risk, and potential losses, particularly in periods of economic stress.



**QUESTION 2:**

**IS PRIVATE CREDIT INFESTED WITH INTERLINKED CREDIT ISSUES?**

Several widely publicized credit issues have attracted attention in recent months, with some reportedly involving fraudulent activity. Neither the private credit market nor the broadly syndicated loan market has been immune to these developments. But we believe the current environment reflects a combination of idiosyncratic borrower issues and the broader credit pressures created by a higher-interest-rate environment. In some cases, this has been exacerbated by weaker underwriting standards among certain investors.

**QUESTION 3:**

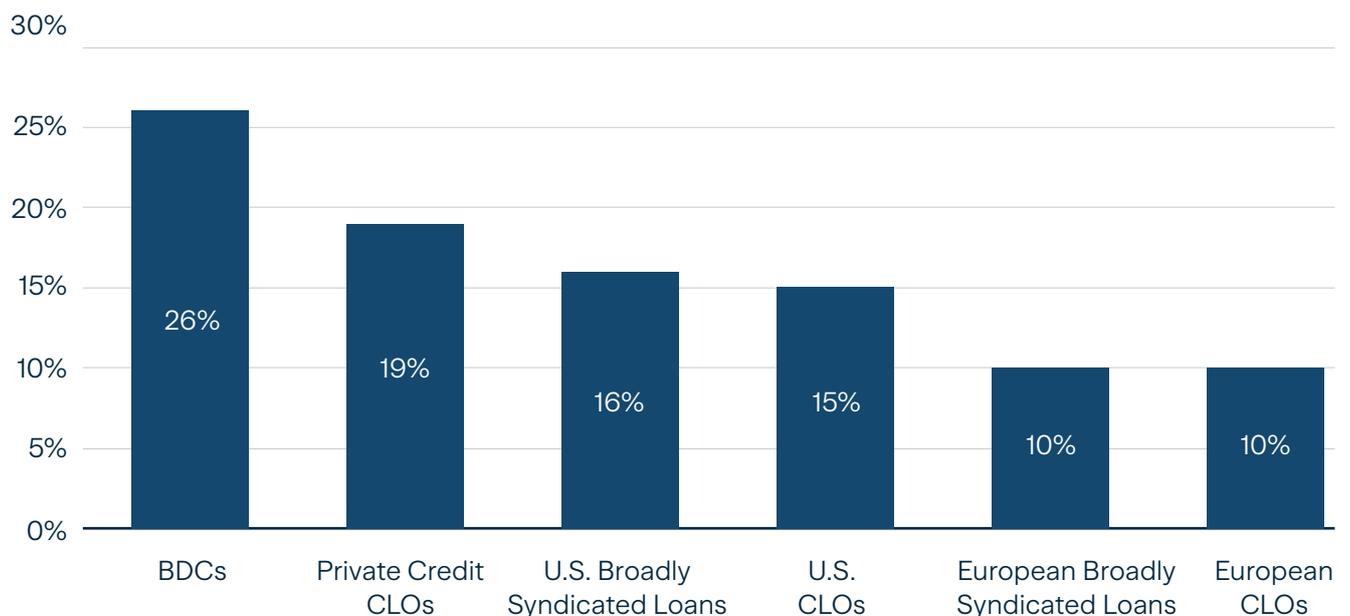
**IS PRIVATE CREDIT OVEREXPOSED TO LOANS TO AI-VULNERABLE SOFTWARE COMPANIES?**

Artificial Intelligence has significantly accelerated the development of enterprise software, lowering barriers to entry that many legacy providers historically enjoyed. As a result, the sector is increasingly diverging between stronger platforms able to adapt and weaker ones facing greater competitive pressure.

This has raised concern about the high concentration of software exposure in BDCs and other direct lending portfolios. BDC valuations in public markets appear to reflect this caution, with investors applying a perceived “software discount” as—even though many of these businesses are currently performing well—decreased valuation multiples may create loan-to-value ratios that preclude refinancing. We believe software loans underwritten before the launch of ChatGPT, and thus subject to less AI-disruption assessment by borrowers, may be most vulnerable.

Not all software businesses are created equal. A disciplined approach to software investing is key, prioritizing companies with entrenched customer bases, products embedded in daily workflows with high switching costs, credible AI roadmaps and diversified customer bases across multiple end markets.

Software Exposure Across Private and Liquid Loans



Source: Morgan Stanley. As of February 2026.

**QUESTION 4:****HOW SHOULD INVESTORS INTERPRET THE RECENT RISE IN REDEMPTION REQUESTS IN PERPETUAL BDC STRUCTURES?**

Perpetual BDCs are typically structured to offer quarterly redemptions of up to 5% of shares outstanding, with the flexibility to fulfill up to 7% without requiring an amendment. These limits are a structural feature designed to align the duration of investor capital with the illiquid nature of private credit assets.

Redemption requests increased in late 2025 and continued into early 2026, largely due to a combination of headline-driven investor concerns and modestly lower yields resulting from declining base rates and spread compression. Together, these factors have prompted some investors to rotate out of the asset class and into alternative opportunities.

Redemption features are subject to fund-specific terms and may be suspended or limited under certain market conditions.



**Funds that receive redemption requests above 7% have several options:**

1. Limit redemptions to 5-7%. Redeeming investors receive their pro rata share and unfulfilled requests may be resubmitted in future tender offer periods.
2. GP/employee support.
3. Increase the tender limit through an amendment.

**QUESTION 5:****WHAT ROLE IS PIK PLAYING IN THE CURRENT ENVIRONMENT AND WHAT ARE THE KEY IMPLICATIONS?**

Payment-in-kind (PIK) interest can sometimes mask stressed credits by deferring cash payments in favor of higher principal potential later. Usage varies widely across the industry, though public BDCs average roughly 10% of total interest from PIK, with perpetual BDCs lower at roughly 4%.<sup>ii</sup>

PIK usage rose in recent years but now appears to be stabilizing or declining as falling rates improve borrowers' ability to pay cash interest and managers become less tolerant of PIK. In addition, despite recent headlines, BDC non-accrual rates—loans where borrowers have stopped making interest payments—remain relatively low. The rate is roughly 1.5% for public BDCs and <1% for perpetuals, broadly in line with expectations for sub-investment-grade credit portfolios.<sup>iii</sup>

<sup>ii, iii</sup>Source: Oaktree analysis



## QUESTION 6: WHAT ABOUT PRIVATE CREDIT MARKS?

Investors appear unconvinced by the marks of loans in BDCs—this is one reason why public BDCs are almost all trading below their net asset values (NAV).

It's important to note a few facts about the market. BDC managers rely on third-party firms to value most of their assets, with each manager tending to use multiple firms. Also, valuations are refreshed either monthly or quarterly, depending on the BDC. And BDCs have independent boards of directors, who approve the valuations and the contents of their regulatory filings.

The biggest discrepancy in marks across BDCs is when there's uncertainty relating to the company (e.g., a restructuring process) or broader market volatility. We believe that when investors evaluate these situations, they must weigh the probability of each potential outcome—a process that can lead to a variety of different conclusions. Ultimately, we believe investors should select a BDC manager they trust to act prudently rather than chase high dividends through excessive leverage or lending to risky borrowers.

## QUESTION 7: WHAT OPPORTUNITIES DO RECENT CREDIT ISSUES CREATE FOR PRIVATE CREDIT INVESTORS?

While recent cracks in direct lending are not systemic, they may create an opportunity for private credit managers to differentiate themselves through disciplined underwriting and portfolio selection. We believe managers with sight across multiple credit markets, including both liquid and private, and both performing and distressed, are best placed to navigate the new era of dispersion. Strong underwriting helps preserve the contractual yield that underpins the asset class, while market volatility may also lead to wider spreads on new issuance after years of tightening.

Investors may benefit from emphasizing manager selection, diversifying across private credit strategies, incorporating liquid credit for flexibility, adding opportunistic allocations, and expanding exposure beyond the U.S.



**QUESTION 8:****WHAT ABOUT RECENT HEADLINES IN THE ABF MARKET?**

Some market participants are concerned that recent ABF bankruptcies indicate that managers have dropped their underwriting standards amid the chase for the “hot new thing.”

While it’s true that ABF hasn’t been immune from some of the more worrying-sounding headlines, we believe there’s one common factor: Bad actors.

The recent turmoil is a reminder that ABF investing isn’t just about good assets, but good originators too. In other words, ABF managers must diligence the originators they partner with, assessing a range of quantitative and qualitative factors, including the incentives of the originator and their risk management protocols.

When executed with discipline, (ABF) may provide exposure to self-amortizing assets tied to real-economy activity; however, ABF involves distinct risks, and its characteristics do not eliminate valuation, credit, or structural risks present across private credit markets.

We believe the recent bankruptcies highlight the critical importance of:

- Underwriting the originator as well as the assets;
- Having both qualitative and quantitative rigor in a manager’s investment process—for example, employing institutional insight rather than just relying on a data model;
- Managers exercising the freedom to say “no” to deals and being willing to step away from overly crowded corners of the market; and
- Building in adequate structural protection, including properly isolated SPVs.

ABF may offer relatively higher spreads and less crowding in certain areas compared to direct lending, but it is a specialist asset class with distinct risks, requiring disciplined underwriting, structuring, and ongoing post-deal monitoring.

## The Bottom Line

- **Private credit has helped move corporate lending risk away** from deposit-taking institutions, diffusing the interdependency that gave rise to the GFC.
- **Underwriting has been inadequate in some cases**, but this is a symptom of an extended period of “easy times” in sub-IG credit, not an inherent flaw of private lending.
- **The software sector will likely split into winners and losers**, and avoiding the latter will be critical. It’s worth noting discussions around software exposure are most pertinent to the direct lending market, not the likes of asset-backed finance or real estate debt.
- **BDC redemption limits are uncomfortable but serve a purpose**: preventing forced selling and protecting remaining investors.
- **Lenders should maintain a high standard** for accepting PIK, using it selectively rather than as a default option.
- **Recent stress around direct lending may create opportunities** for disciplined managers and investors to benefit from stronger underwriting, wider spreads and selective exposure to opportunistic and diversified credit strategies.

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