PRIVATE CREDIT MARKET UPDATE – MEDIA NOISE VS. STRUCTURAL RESILIENCE OF THE ASSET CLASS

Deutsche Credit

INTRODUCTION

Media interest in private credit is not a new phenomenon. The asset class more than trebled over the last decade, and now, with c. EUR 1.8trn of assets under management, private credit is comparable in size to the PE industry at the time of the global financial crisis[1]; such rapid growth naturally draws attention and scrutiny.

But in recent months, this scrutiny has increased and press attention has become a media frenzy. Fundamentally, however, very little has changed. In this paper, we take a closer look at the topics that have dominated the headlines and examine what they mean for institutional investors in private credit.

In late 2025 a few high-profile defaults in North America, Tricolor and First Brands, made headlines, followed by MFS in the UK early this year. As we explain below, these were never really "private credit" in a traditional sense, but their loose association with the term was enough to put the industry under the spotlight. On an aggregate level, neither default rates nor payment-in-kind ("PIK") use are outside of recent historical bands: nonetheless, the spotlight was turned up further as some market watchers started to link the disruptive power of AI advancements to private credit portfolios, which have non-negligible exposure to the software space, albeit not uniformly. These concerns and the active press coverage have led to some visible jitters in the US retail market, where BDCs ("busi-

[1] Based on assets under management; data sourced from Preqin, March 2026

ness development companies”) have struggled with withdrawals; the read across to institutional drawdown funds, particularly those in Europe, is limited by structural differences in how these vehicles operate.

More recently, the military conflict in Iran has raised additional questions about the vulnerability of the asset class. While it is perhaps too early to assess the depth and duration of the fallout, we draw confidence from private credit’s ability to weather previous crises, notably the full shutdown during the COVID-19 pandemic and the energy price spikes that followed Russia’s invasion of Ukraine 2022.

As Deutsche Credit, we can derive comfort from our strategy and approach which is designed to work across cycles. We focus on countries with particularly well-established creditor protections, and our ability to source non-sponsored deals allows us to maintain strong structures with low levels of leverage – both of which provide downside protection. Our ability to address the large universe of high-quality family-owned businesses also allows us to invest more broadly across sectors, avoiding the concentration risks that can result from a dependence on PE-backed deal flow.

HIGH PROFILE DEFAULTS, DEFAULT RATES AND MARKET STRESS

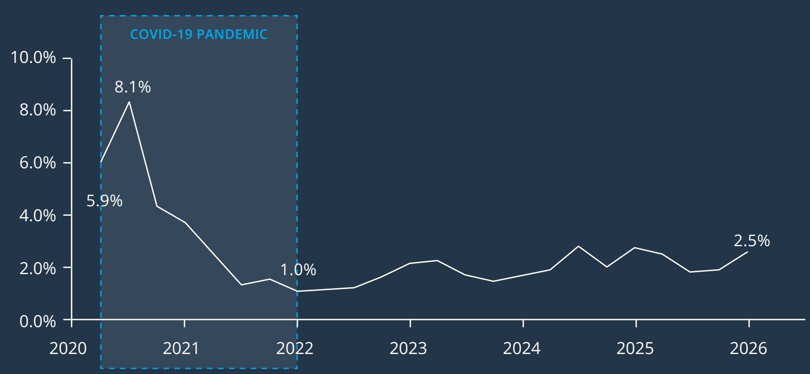
Defaults in private credit are not new and should be expected. Whether bank loans, corporate bonds or syndicated loans, defaults are part of credit investing. But with the growth in private credit and the recent push into the more regulated retail space, greater press scrutiny of high-profile cases should come as no surprise. We elaborate on some recent examples below:

Tricolor was a US subprime auto retailer and lender focused on financing "underbanked" consumers via an integrated dealership model. Its financing structure involved liabilities of more than USD 1bn including significant asset-backed securities, as well as warehouse facilities and subprime auto securitization. This is very different from the cash flow-based loans typically associated with private credit.

First Brands was a US automotive aftermarket parts manufacturer pursuing an aggressive acquisition-led growth strategy. The company's capital structure included liabilities of c. USD 11bn, including broadly syndicated loans as well as private credit.

MFS or "Market Financial Solutions" was a UK bridging and buy-to-let property lender pursuing an aggressive growth strategy. The company had outstanding liabilities in excess of GBP 2bn, including institutional warehouse credit facilities, funding from major banks, credit funds and unsecured loans from private investors.

Default rates in Direct Lending (%)



Source: Proskauer Rose Private Credit Default Index as of March 2026.

In all cases, these were not typical "private credit deals" the way investors would expect to find them in a direct lending fund, the borrowers' financial issues appear to be specific and idiosyncratic, and are connected to some degree with accusations of fraud (though to a more contested extent with First Brands). Legitimate questions can be asked about the quality of the underwriting, but the extensive involvement of broadly syndicated loans and other debt instruments undermines the narrative that these defaults are indicative of poor underwriting in the direct lending market.

This does not imply that there are no default cases amongst private credit funds; some such examples have come to light recently. As we state above, this is to be expected from any credit asset class. The more pertinent question for investors is whether these defaults indicate increased stress in the market. Based on Proskauer data, the private credit default rate stood at 2.46% in Q4 2025. This represents an uptick compared to Q3, which stood at 1.84%, but remains within the range of recent years and well below the peaks we saw during the Covid-19 pandemic.

A likely culprit for the marginal increase in defaults lies in how interest rates have developed since the departure from the ultra-low rate environment of the pre-2022 period: the increased burden of higher financing costs on variable direct lending loans eventually led to defaults, albeit with more delay than was observed in the broadly syndicated loan market. This should be reassuring to investors in private credit, as i) it does not indicate structural issues with underwriting quality in private credit portfolios and ii) the effect should wash-through relatively soon as loans written during the pre-2022 period reach maturity.

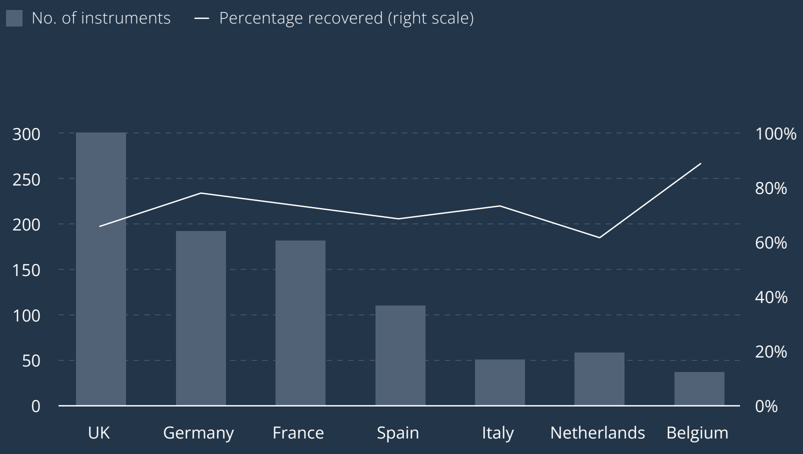
Some readers may note that the default rates we show in the chart (page 4) are materially lower than the direct lending default rates featured in some news reports, which cover a broad range up to a maximum of 9.2%[2] by Fitch, the ratings agency. Most, however, are lower, and Fitch now shows default rates edging down in their most recent statistics[3]. These differences come down to the details of the datasets used and the definition of default: direct lenders have the ability to avoid formal defaults by waiving contractual obligations, for example. Default rates are therefore an imperfect measure.

2 https://www.investing.com/news/stock-market-news/us-private-credit-defaults-hit-record-92-in-2025-fitch-says-4547650
3 https://www.fitchratings.com/research/corporate-finance/us-private-credit-defaults-ease-to-5-4-in-february-2026-18-03-2026

Nonetheless, by using a consistent source over time, we believe that the Proskauer default figures shown above provide a reasonable assessment of stress in the direct lending market relative to other periods in recent history. Aggregate default figures for direct lending are almost entirely derived from the US, where data is more accessible. While there have been some attempts to quantify the default rate in European direct lending, these are typically based on very sparse data; where statistics are reported, they generally indicated a lower default rate than we see in the US numbers[4].

For us at Deutsche Credit, the best protection against defaults lies in selecting high-quality, conservatively managed companies, and good structuring of loans. Our strategy also targets geographies with strong creditor protection, leading to high recovery rates. Moreover, by focusing on the non-sponsored market, we can avoid the aggressive capital structures and high leverage levels common in the PE-backed market; a clear-advantage, as leverage is a driving factor in default probability.

First-lien debt recoveries* by country (2003 – 2024)



* Recovery rates

Source: S&P Global Ratings: European Corporate Recoveries 2003-2024.

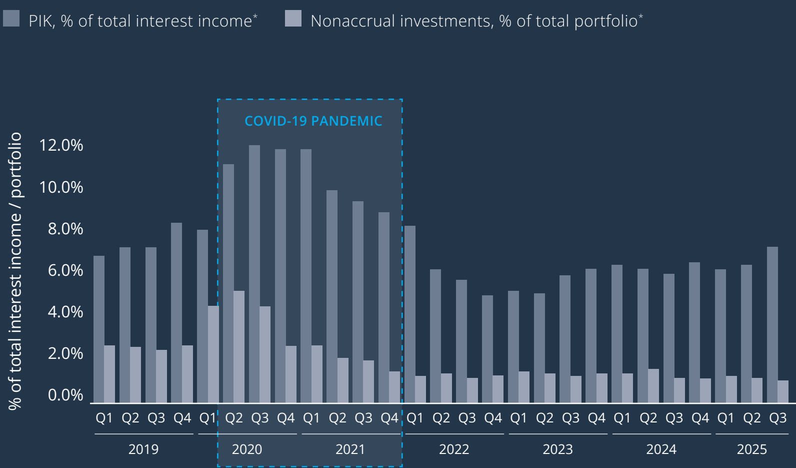
4 https://www.businesswire.com/news/home/20250404682715/en/KBRA-DLD-Forecasts-1.25-Default-Rate-in-2025-for-European-Direct-Lending-Market

PIK RATES

Amongst the alternative measures of stress in private credit, "Payment in Kind" has generated the most attention. In theory, the percentage of borrowers adding interest payments onto existing debt obligations rather than paying these in cash should be a good proxy for liquidity pressures. Again, however, we should differentiate: loans that are issued with PIK components may be higher risk, but can be used to finance companies when other credit structures might not be feasible. A greater use of such structures should be seen as a broadening of the private credit offering rather than a sign of market stress.

The more useful indicator is when companies switch from "cash pay" to PIK. This typically does indicate that the borrower is facing some liquidity constraints. How serious this is, depends on whether the ability to switch to PIK was a built-in feature at the outset of the loan ("PIK toggle") or was negotiated later because the borrower was unable to pay its contractual obligations. The problem in interpreting aggregate PIK data is that it is generally not possible to differentiate between the two. Nonetheless, we can look at the percentage of BDC income "paid" as PIK.

Stable PIK utilization is accompanied by historically low nonaccrual rates and rising recoveries



* BDC data

Source: Houlihan Lokey as of February 2026

The data paints a similar picture to the one we have already seen in default rates – we are still well within the normal range and below the Corona-era highs.

A further important point to note: PIK is of particular importance in the context of BDCs who are obligated to pay out 90% of taxable income. As PIK income still counts as income, it can cause problems for the BDC manager when borrowers stop paying in cash. This dynamic is, however, not present in institutional funds who can engage pragmatically with liquidity constrained borrowers without such concerns.

IMPACT OF AI

The idea that artificial intelligence is going to revolutionize or at the very least significantly disrupt many industries is now a commonly held belief. With time, winners and losers of the "AI revolution" are likely to emerge in many parts of the economy. For now, however, investors appear most concerned about the potential for AI to undermine business models in the software industry, which represents a material exposure in many private credit portfolios: data from Debtwire suggests that TMT makes up c. one third of European direct lending volume, closely mirroring the sector's representation in the buyout market. TMT does, of course, include deals in other subsectors, but the figure strongly suggests a significant software exposure in European private credit.

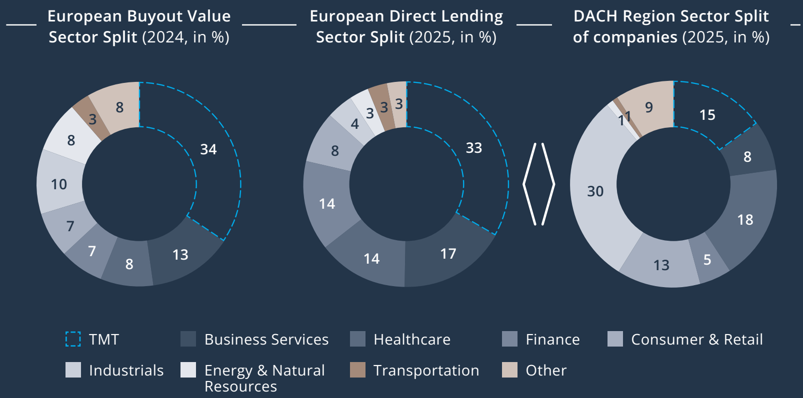
These concerns are valid but require some important nuance. Firstly, within the software space, not all companies will be negatively affected; firms with proprietary data, system-of-record status, or infrastructure positioning are generally considered to be resilient and may even benefit from AI advancements[5]. While we do not have visibility of business models across all private credit portfolios, analysis of software exposure in European CLOs by S&P[6] suggests that these defensive characteristics are common amongst borrowers in the continent's software sector. Looking just at the sector level may therefore materially overstate the risk of AI disruption.

Private credit's exposure to the sector is connected to it being a major area of PE activity in recent years: however, headlines have focused on private credit as critics of the space argue that buyout funds will hope to capture both the upside and the downside of this disruption while lenders could suffer from their less-symmetrical exposure.

5 https://www.goldmansachs.com/pdfs/insights/goldman-sachs-research/will-ai-eat-software/report.pdf

6 https://www.spglobal.com/ratings/en/regulatory/article/ai-risk-in-european-clos-software-exposure-beyond-the-headlines-s101673132

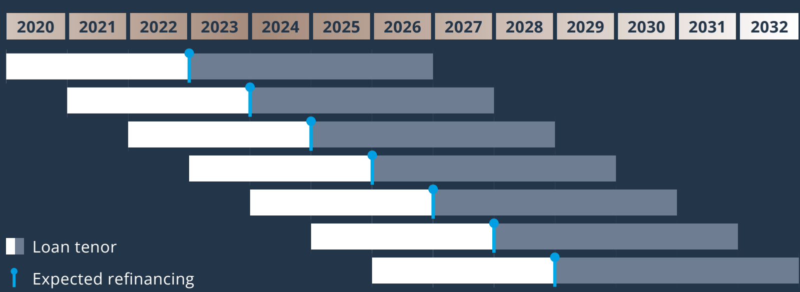
Buyout-driven market dynamics concentrate Direct Lending in TMT



Sources: Worldbank / World Development Indicators, ECB Economic Bulletin. Real GDP, Industrial Production Index; Debtwire European Direct Lender Rankings as of February 2026; PwC Private Equity Trend Report 2025 as of March 2026.

The issue with this argument is that it ignores the critical timing element. A traditional direct lending fund expects to be repaid in approximately three years when they are refinanced. This means that the bulk of direct lending exposure currently sitting in portfolios will have gone through an underwriting process in the last couple of years, a time frame in which the risk of AI should have featured heavily in the lender's due diligence. And where the advancement of AI adoption is having a greater-than-expected impact on the borrowers' business model, the question becomes whether customers can transition away within the term of the loan to such an extent that it makes refinancing challenging. Both the contractual terms and the bureaucracy involved in such decisions may offer some protection.

Direct Lending timeline



Anecdotally, we note that in the Fitch report on private credit defaults (see default section, above), no software defaults were recorded in 2025.

The concerns around the software sector serve as a good reminder that concentration risks can emerge by focusing solely on the easier-to-access sponsor-backed market. Decoupling from the private equity market allows us to deploy capital across a wider range of sectors, preventing unwise sector concentrations: in the case of TMT, the sector constitutes 33% of direct lending deals, but only 15% of companies in the DACH region.

Notwithstanding the above, we believe that recent advancements in AI has substantial potential, and AI disruption risk is not contained to software businesses but rather appears across economic sectors. At Deutsche Credit, AI disruption risk is incorporated into our sector evaluation model. In general, we believe that the best protection lies in good underwriting and business appropriate structuring, including lower-leverage where risks are higher: this, again, is easier to achieve in bilateral negotiations with company owners than in competitive processes for sponsor-backed deals.

THE BDC MARKET

Many of the datapoints we have highlighted so far come from the US market. More specifically, from BDCs, which are often treated as generalizable to private credit as an asset class. Yet there are significant differences between BDCs and European drawdown funds that extend beyond geographical focus.

BDCs are primarily US vehicles for private investors. Some (non-traded BDCs) offer quarterly liquidity while others (public BDCs) are traded on stock exchanges and work in a similar fashion to REITs. In the former, limits on withdrawals are imposed to prevent BDCs becoming forced sellers. Although these limits have always existed, the implementation of gating in line with the vehicles' documents has drawn much attention in recent months. For listed BDCs, more sellers than buyers simply result in a lower share price, as we have observed in 2026 so far. These mechanisms can be seen as the cost of offering an inherently illiquid asset class to an investor group which seeks liquidity. In both cases, the mechanisms in place incentivize investors to try to pre-empt other sellers: better to get out first rather than risk being gated or suffering share price declines if the situation deteriorates.

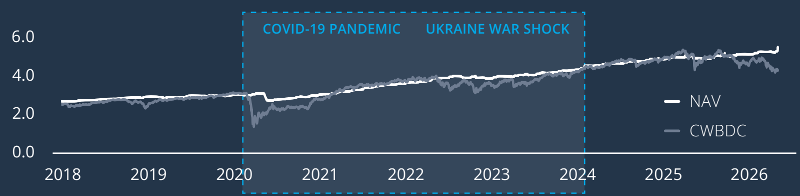
If we look at the recent market performance of public BDCs and contrast this with the NAV performance of the same vehicles, it becomes clear that the negative performance is not the result of NAV write downs. Rather, we observe a significant discount widening since late 2025. In other words, underperformance has been driven by investor sentiment. Discounts such as this have occurred in previous periods of stress, for example during the COVID-19 pandemic and at the start of the war in Ukraine. In both cases the discounts subsequently closed primarily through BDC prices rising rather than NAVs falling[7].

These historical recoveries are particularly insightful as the positions that were in BDC portfolios at the time will now be largely realized and hence are not dependent on model valuations.

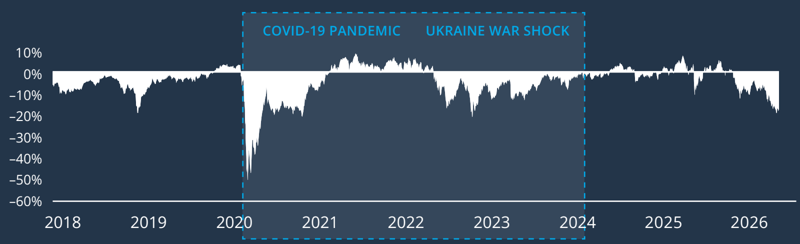
Discounts and gating mechanism are simply not relevant for institutional drawdown funds, where LPs commit to the term of the fund which is designed to accommodate the tenure of the underlying loans. For a typical institutional investor, it makes little difference what other LPs are thinking of doing[8].

BDC development

Cliffwater BDC Index ("CWBDC", total return, in thousand index points)



CWBDC / NAV discount (%)



Source: Cliffwater BDC Index as at March 2026.

7 As we note below, NAV values fell by c. 5% during the pandemic, before recovering within a 12-month period

8 While there is a developing secondary market for LP-stakes in private credit funds, the sale of an LP's stake does not affect the valuation or the liquidity available to remaining LPs.

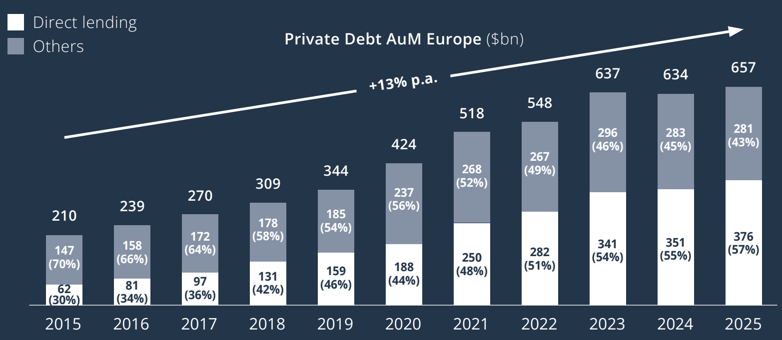
For European investors in particular, we should consider a further point: BDCs are typically leveraged at fund level, often with debt-to-equity ratios of 1:1 or above, which exacerbates volatility. Direct lending drawdown funds for European investors by contrast, generally operate without structural leverage at fund level, meaning that analysis of BDC volatility has little informational value to European institutional investors.

These structural differences provide some explanation for the divergence in sentiment between BDCs and the institutional market. AuMs in European private credit have continued to grow, led by direct lending strategies.

While fundraising amongst European private credit funds faced challenges in recent years, 2025 showed indications of a recovering market, with volume raised 50% higher than in 2024. More importantly, recent survey data points to continued support from institutional investors for the European private credit space: according to PDI's LP Perspectives survey, 52% of LPs want to invest more in private credit this year, 41% plan to invest at the same level and only 7% want to invest less[9]. Preqin expects fundraising to accelerate in 2026[10], too.

Of course, sentiment amongst institutional investors may turn more negative, but so far there is little indication of this happening. The issues in the BDC market appear to be specific to the vehicle structure rather than to the asset class of private credit.

Institutional investor sentiment is positive with Private Debt AuM growing since 2015



Source: Preqin as at March 2026

9 https://www.privatedebtinvestor.com/lps-look-past-the-negative-headlines/
10 https://www.preqin.com/insights/global-reports/private-credit-in-2026

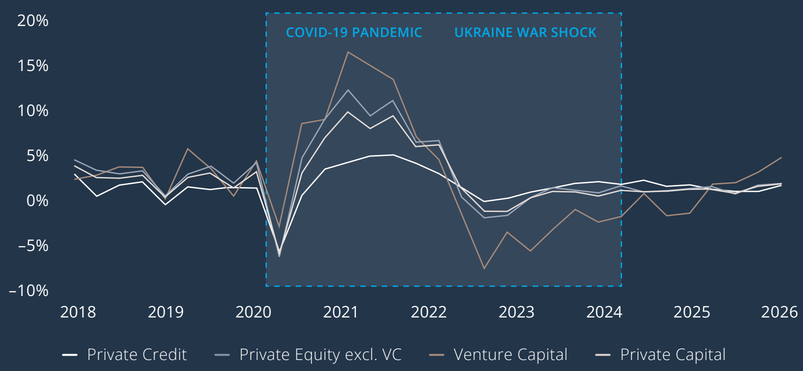
A NOTE ON IRAN AND HISTORICAL RESILIENCE

The Middle East has not been a major destination for private credit funds and the direct impact of the US military conflict with Iran is de minimis for private credit investors. Nevertheless, the regional conflict has global implications felt across asset classes. For us, two questions are pertinent: how has private credit performed in previous periods of geopolitical shock, and how are our primary target markets affected.

For the first of these questions, the greatest economic shock that the private credit industry as we know it today has experienced is the period of the COVID-19 pandemic[11]. We have already seen that public BDC share prices fell sharply as discounts to NAV widened. NAV values declined, but much less precipitously and recovered within 12 months. We can see from Preqin data that the performance of private credit drawdown funds has been remarkably resilient over time. In the first quarter of 2020, the start of the pandemic, we observe a performance of c. –5%, similar although not quite as severe as in other private markets' asset classes.

Unlike private equity, the index has posted no negative quarter in the six years since. As elevated oil prices are amongst the most discussed consequence of the current conflict, it is interesting to note this includes the first half of 2022, when oil prices peaked at over USD 110[12] / barrel in the wake of Russia's full-scale invasion of Ukraine.

Quarterly (Q-o-Q) return performance across asset classes (%)



Source: Preqin as at September 2025

11 It was only after the Global Financial Crisis that the direct lending market as we know it today began to develop. Private credit going into the crisis consisted primarily of strategies with higher equity components (such as mezzanine and distressed funds).

12 https://tradingeconomics.com/commodity/crude-oil

As we have already noted, institutional direct lending funds in Europe typically operate without structural leverage, the same is generally not true for BDCs or North American drawdown funds. European focused funds, such as those managed by Deutsche Credit, may therefore offer an even more defensive profile at times of heightened general macroeconomic and geopolitical uncertainty.

Among our target markets, we are particularly focused on how the conflict in and around Iran may transmit to the German business landscape, given Germany's position as Europe's largest economy and the historical importance of its export sector. As we highlighted in our White Paper last year, Germany is currently experiencing some economic tailwinds. Interestingly, while global crude oil and natural gas prices have risen in light of the conflict and will undoubtedly affect the country's industries, the direct impact on German energy prices has been more muted than in 2022, as the country derives only a small percentage of its energy from the Arabian Peninsula[13]. More generally, the economic recovery we are experiencing in Germany is unusual in that it is driven by fiscal stimuli rather than external factors[14].

Of course, Germany will not be immune to the broader consequences of the conflict. The closure of the Strait of Hormuz and other supply-chain channels in particular will likely be of some consequence to businesses based in the country. Fortunately for lenders, exposures can be examined during underwriting, including through historical case studies for resilience such as the COVID-19 Pandemic, Russia's invasion of Ukraine, and the US "Liberation Day Tariffs".

In summary, while some impact is unavoidable, we are confident that the German economy can weather the current conflict; a view shared by the German Institute for Economic Research (DIW Berlin)[15] and the IFO think tank[16]. More importantly, we continue to see a universe of approximately 29,000 businesses within our target size range offering a broad set of attractive, conservatively managed opportunities. And these businesses continue to benefit from the debt capital we can provide, allowing them to adapt and capture opportunities presented by the changing business landscape.

13 https://www.ifo.de/en/facts/2026-03-12/ifo-economic-forecast-spring-2026-consequences-of-iran-war-dampen-recovery
14 https://www.ifo.de/en/facts/2026-03-12/ifo-economic-forecast-spring-2026-consequences-of-iran-war-dampen-recovery
15 https://www.diw.de/documents/publikationen/73/diw_01.c.1003343.de/dwr-26-11.pdf
16 https://www.ifo.de/en/facts/2026-03-12/ifo-economic-forecast-spring-2026-consequences-of-iran-war-dampen-recovery

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