International Monetary Fund

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The Rise and Risks of Private Credit

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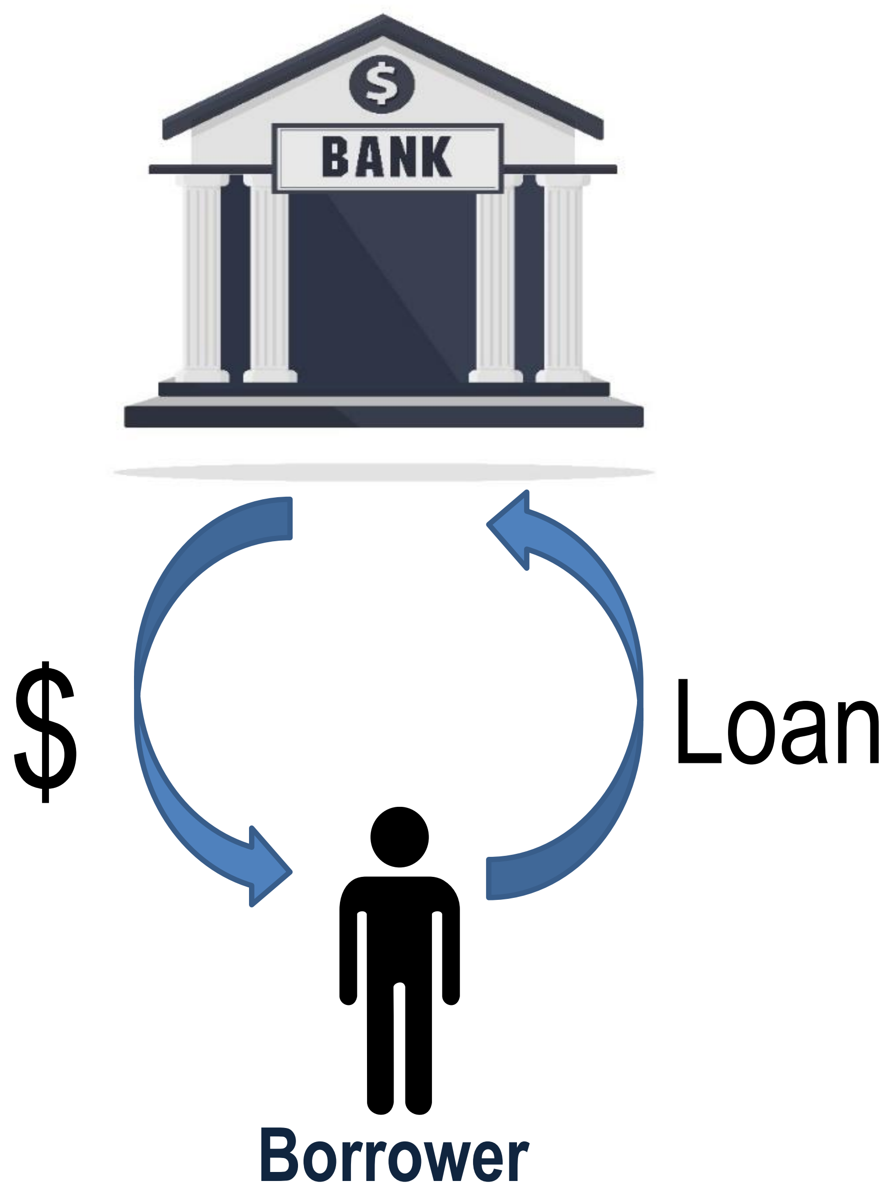
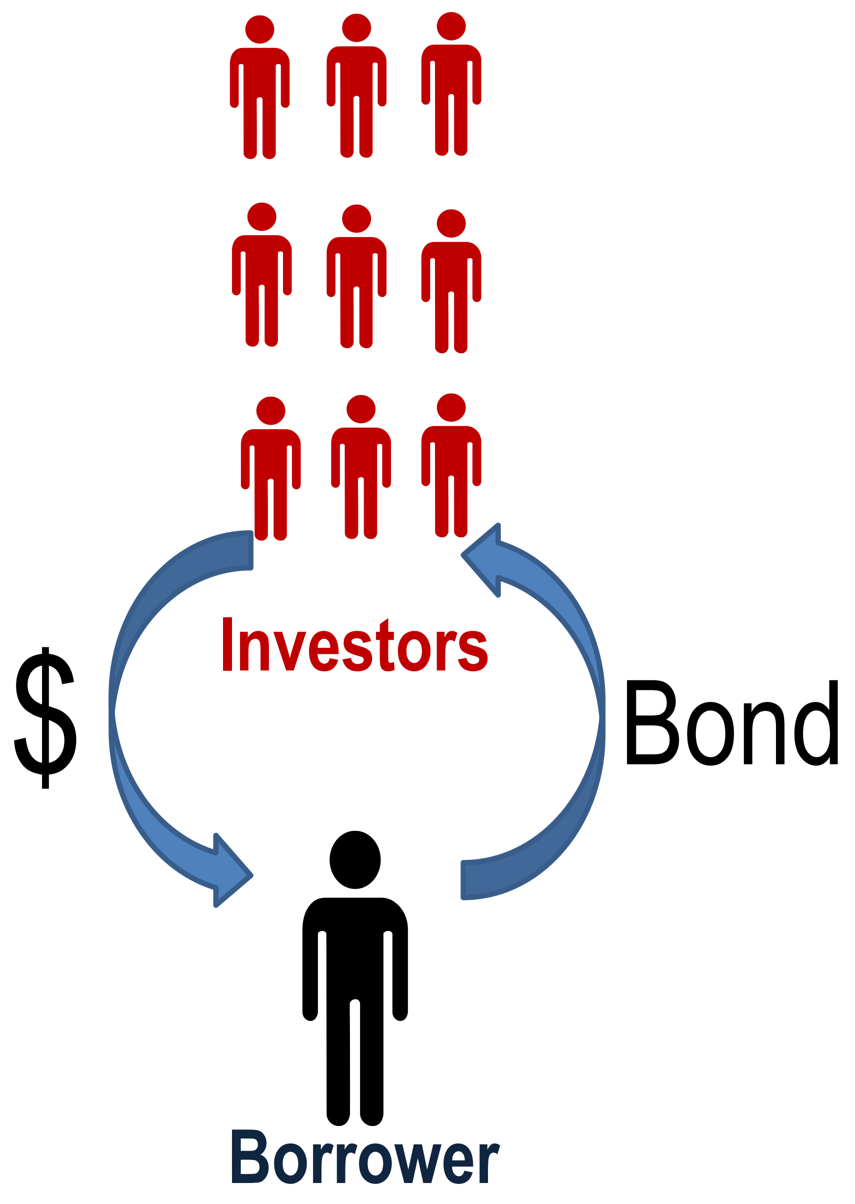
The Role Of Private Credit in Corporate Lending

Bank Loans



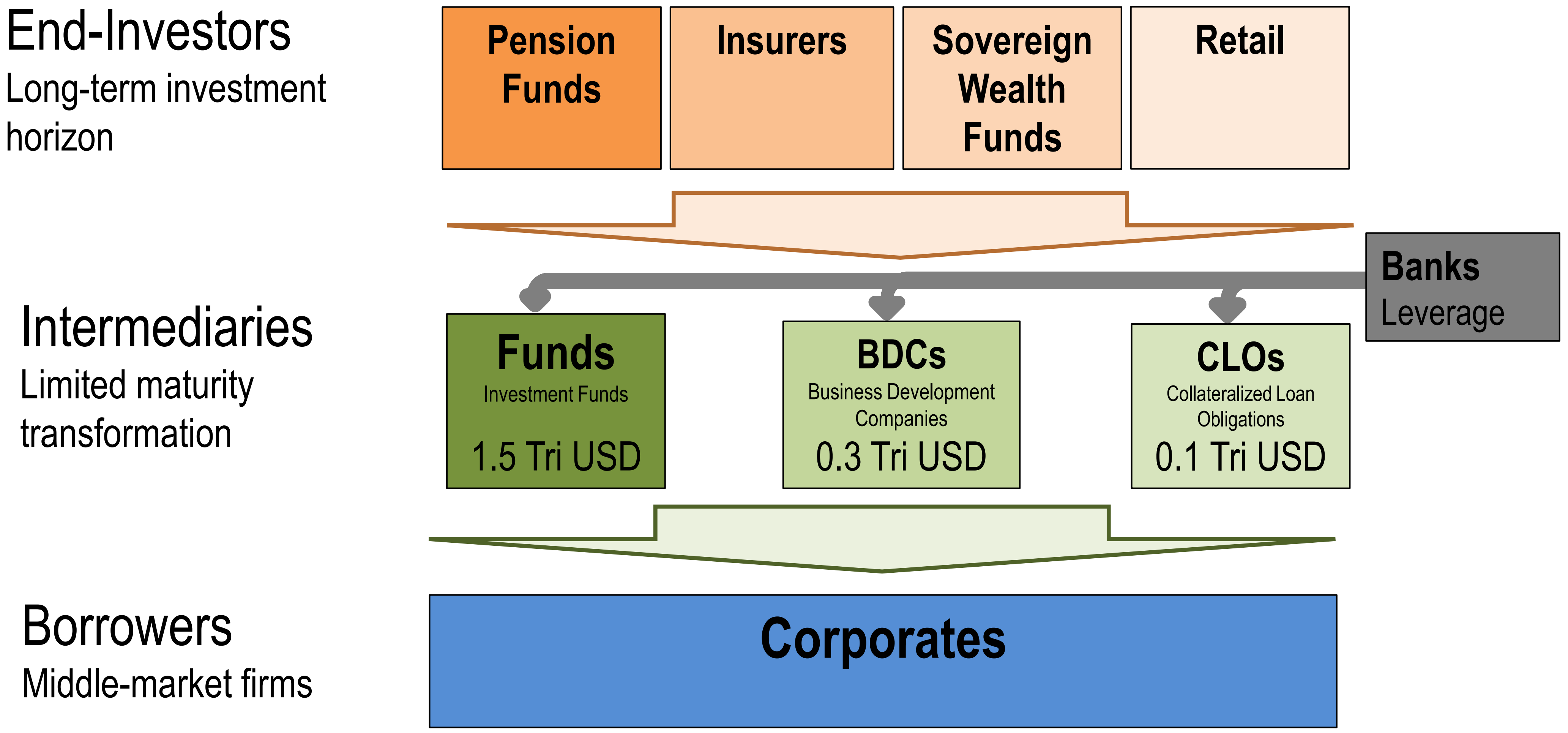
- Strong regulation and supervisory oversight

Bond Markets and Broadly Syndicated Loans



- Market discipline
- Price discovery

Non-Bank Private Credit (PC)

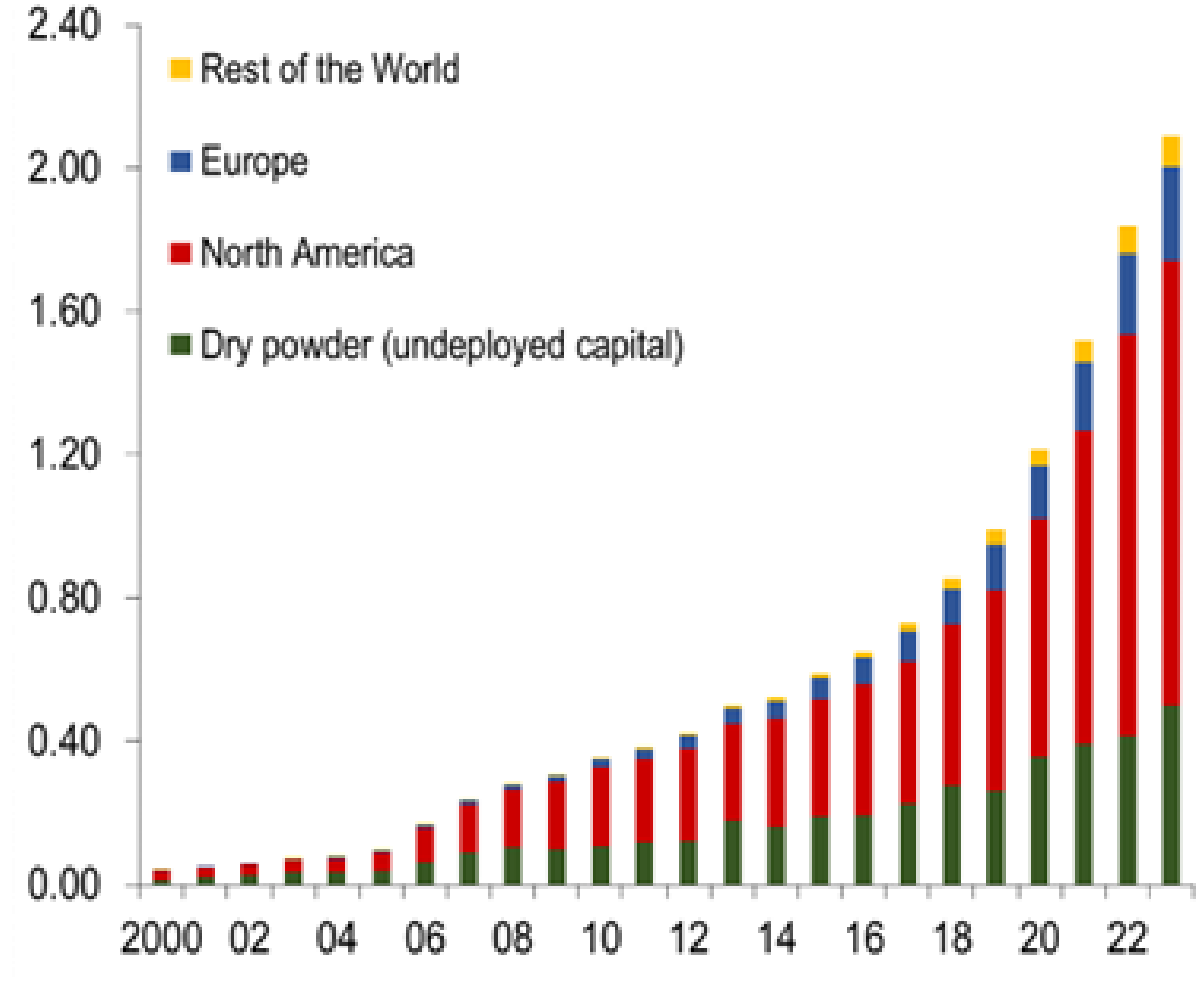


- **Limited prudential oversight or market discipline**

Private Credit has Grown Rapidly Into A Major Source of Corporate Financing

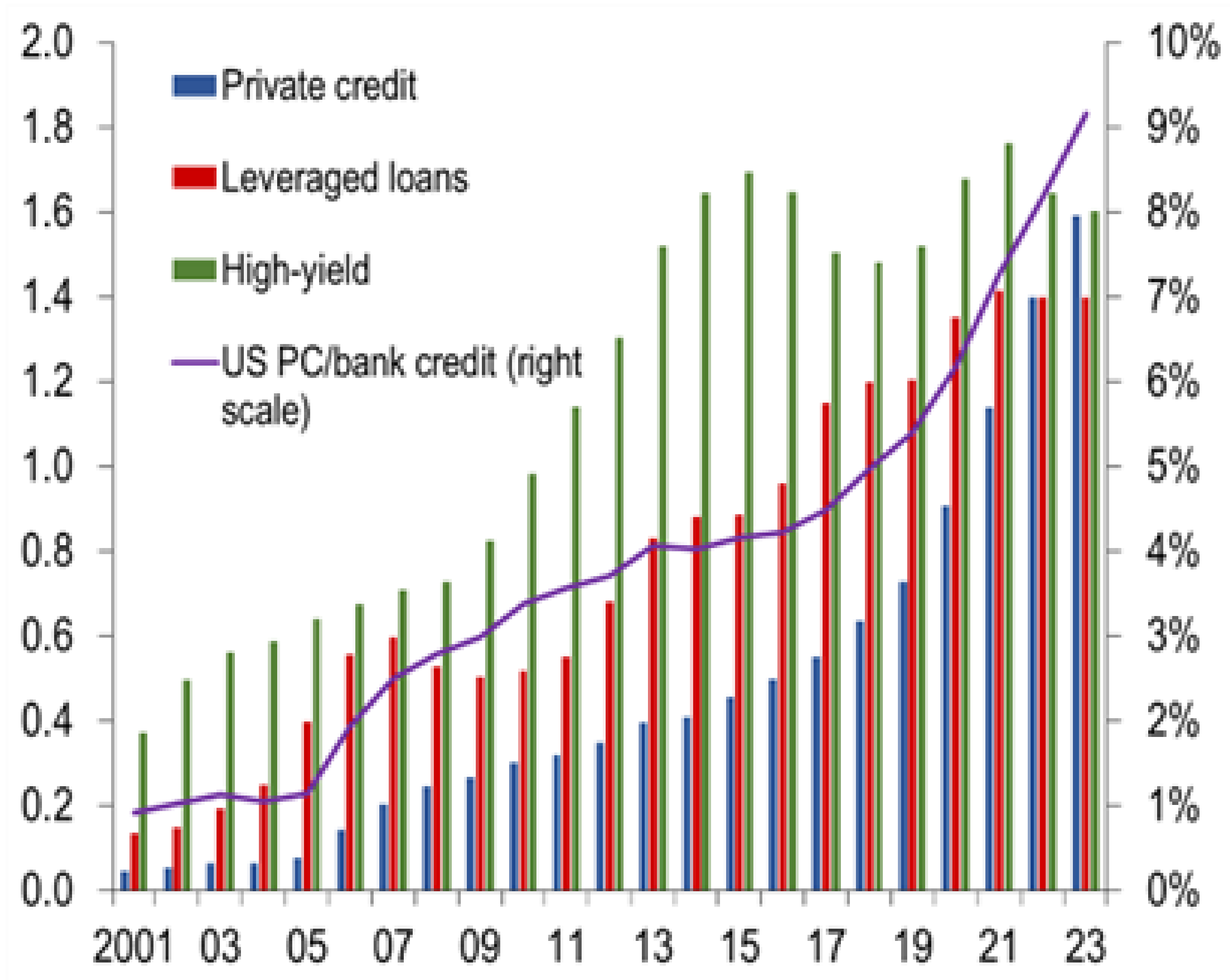
The asset class grew exponentially in recent years

Global Capital in Private Credit Market
(USD Trillions)



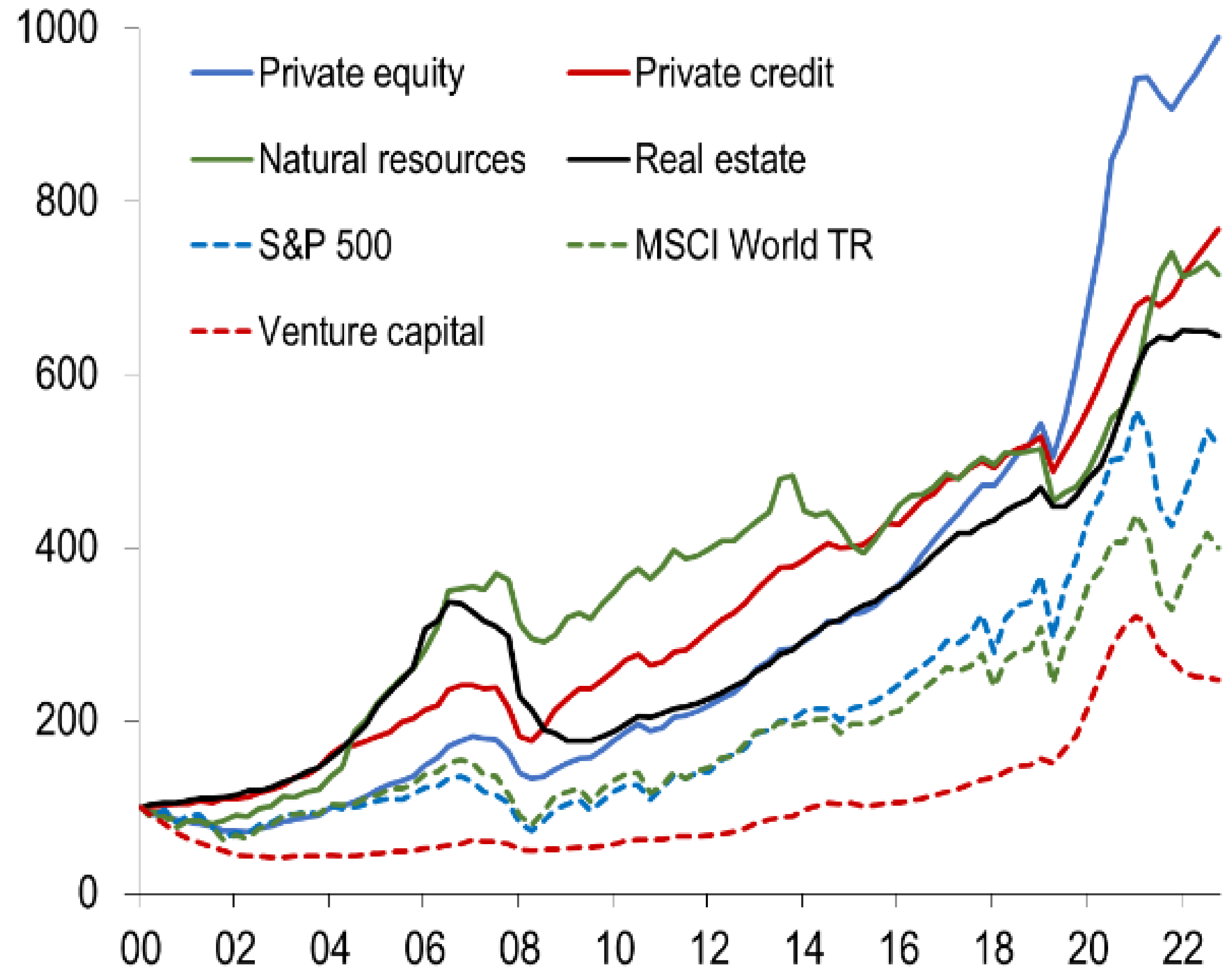
US Private Credit is now as large as high yield bonds and leveraged loans

Size of Private Credit Market in the US
(USD trillions, percent; includes uncalled capital)



Private credit returns surpassed those in many other asset classes

Returns of Private Equity, Private Credit, and Other Asset Classes (December 2000 = 100)



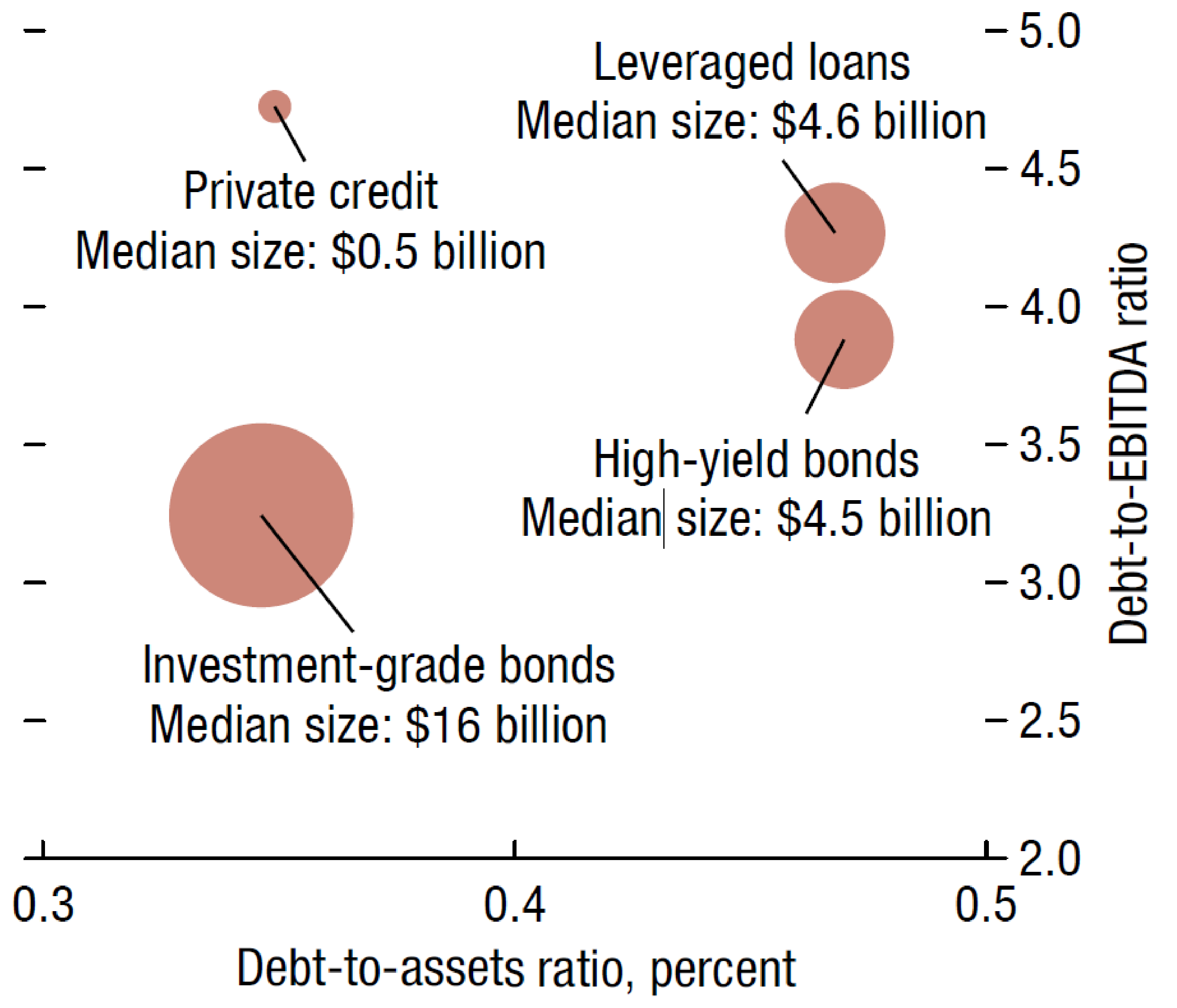
Stability Concerns: Key Dimensions

- Borrowers
- Valuations
- Leverage
- Liquidity
- Interconnectedness

Borrowers: Private Credit ones Riskier than Traded borrowers

Private credit firms are medium sized, and have high debt-to-earnings

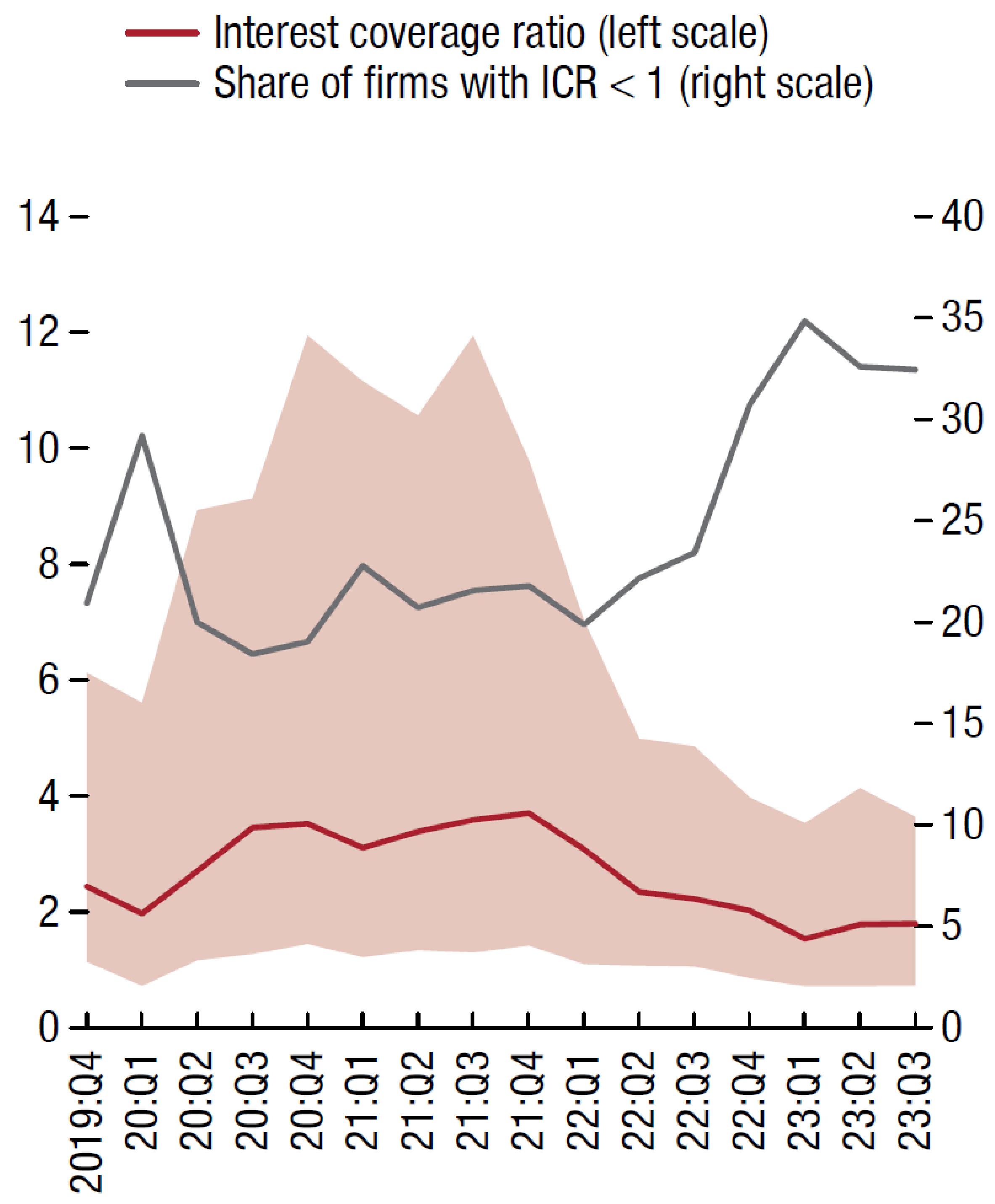
Median leverage and firm size of borrowers
(leverage ratios on axes, bubble size = firm size)



Notes: private credit firm fundamentals are based on a sample of private credit transactions from Preqin that have matching data in Capital IQ Pro.

Firms with size and leverage similar to private credit borrowers saw deterioration in their ability to pay interest

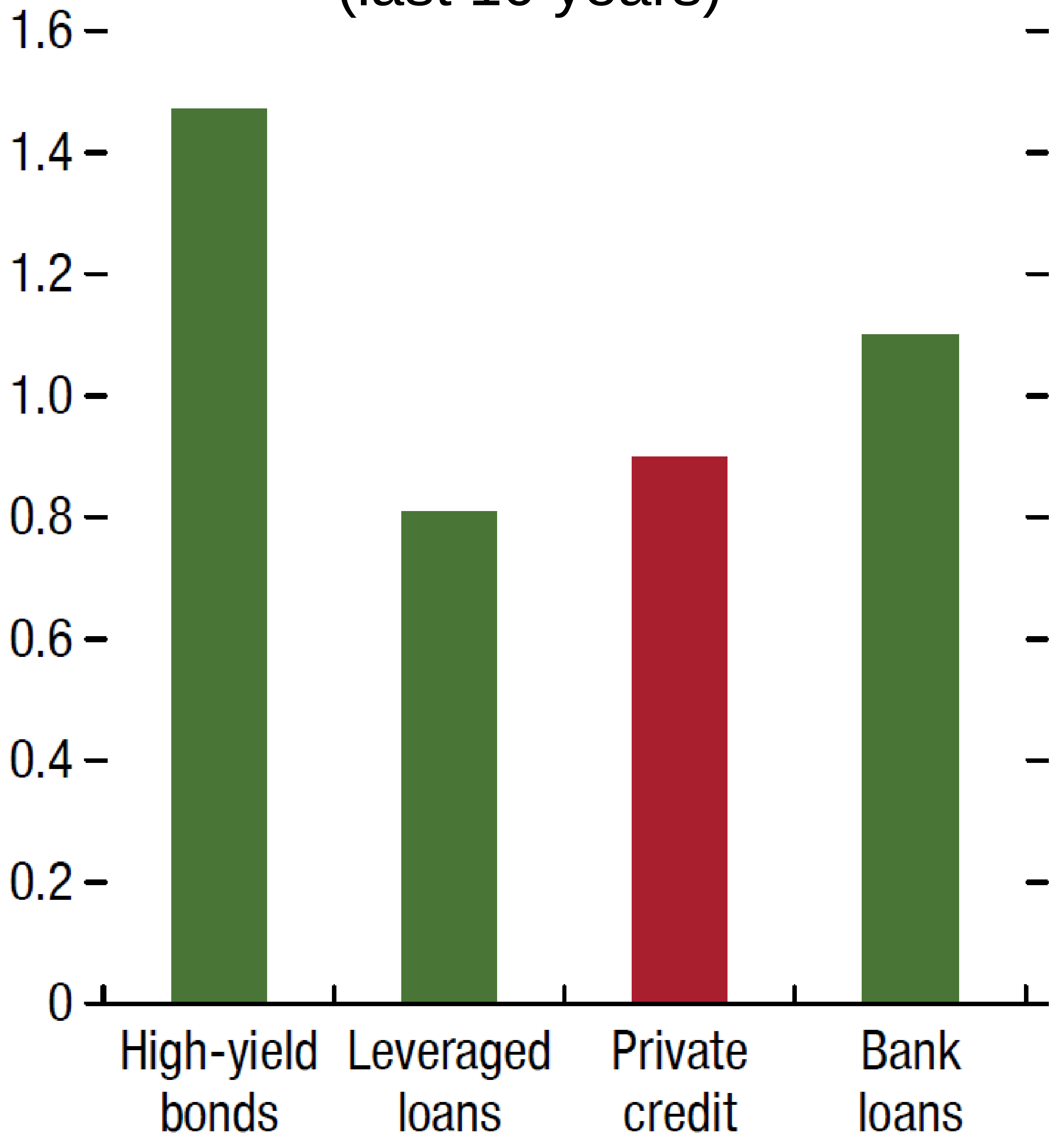
Interest Coverage Ratio
(ratio EBIT/interest expense; lhs: percent)



Notes: Statistics in panel 3 are based on a sample of public firms located in North America with size and leverage characteristics similar to those of borrowers in the private credit universe.

Credit losses in private credit have historically not been outsized because of risk mitigants

Average Annual Credit Loss
(last 10 years)

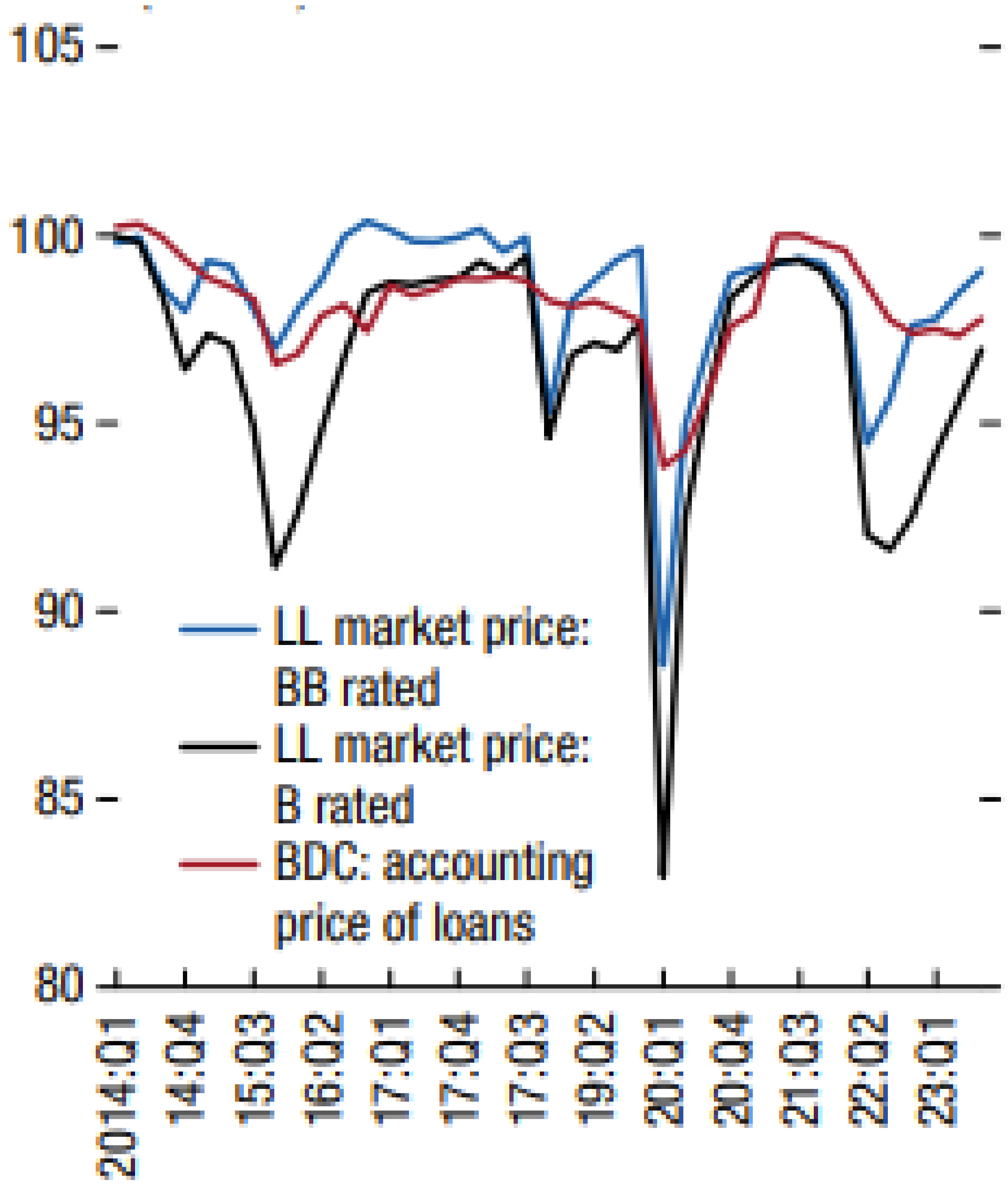


Source: Cliffwater. "Bank loans" refers to US banks' commercial and industrial business loans. Average annual credit losses are computed for a 10-year window between 2013 and 2022.

Valuation: Stale Marks Could Lead to Loss of Confidence in a Downside Scenario

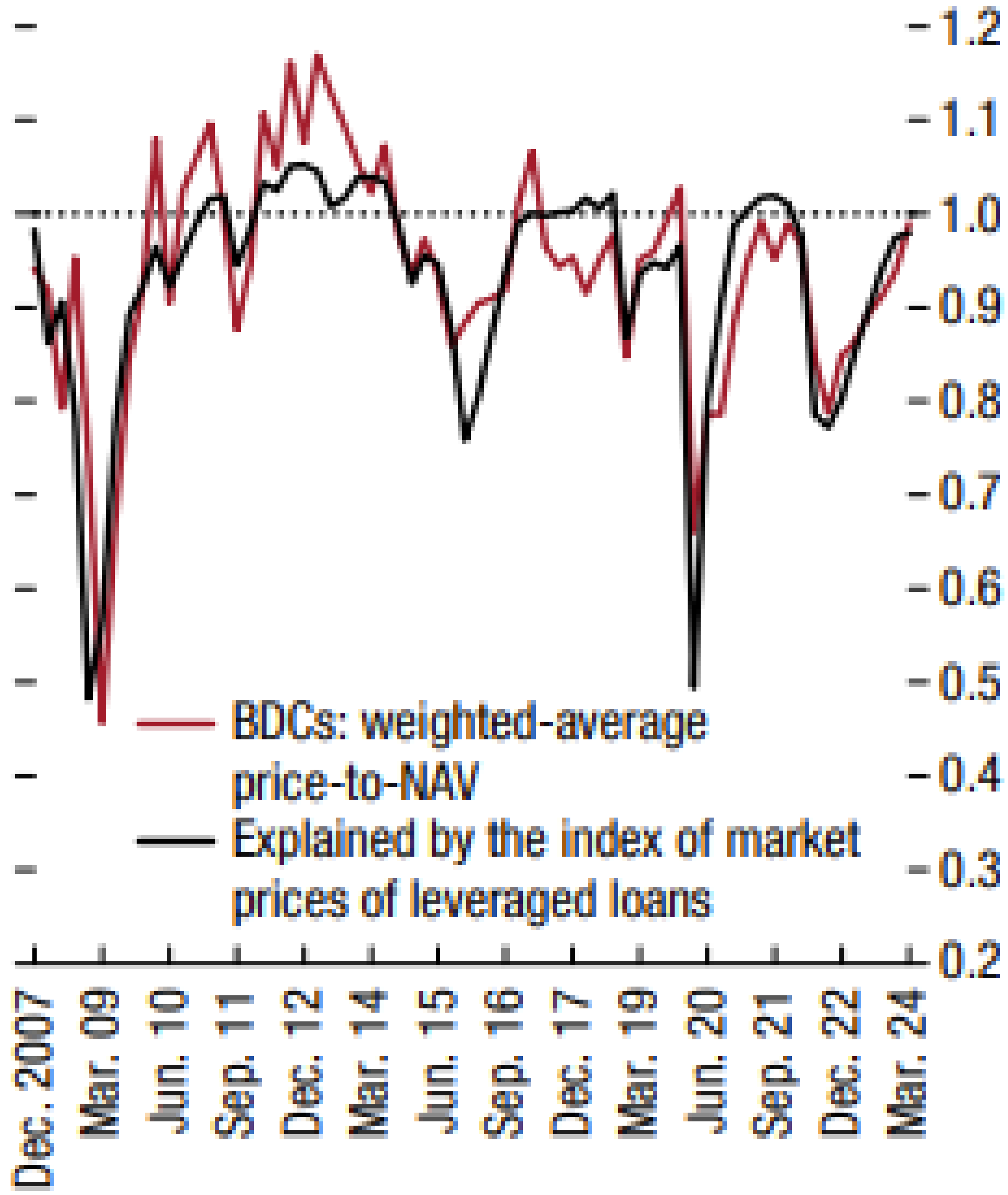
Private Credit exhibits substantially smaller price moves than leveraged loans

Accounting Fair Value of BDCs' First-Lien Loans
(price as percentage of face value)



Growing discounts to NAV in times of stress suggest marks do not fully reflect risk assessments

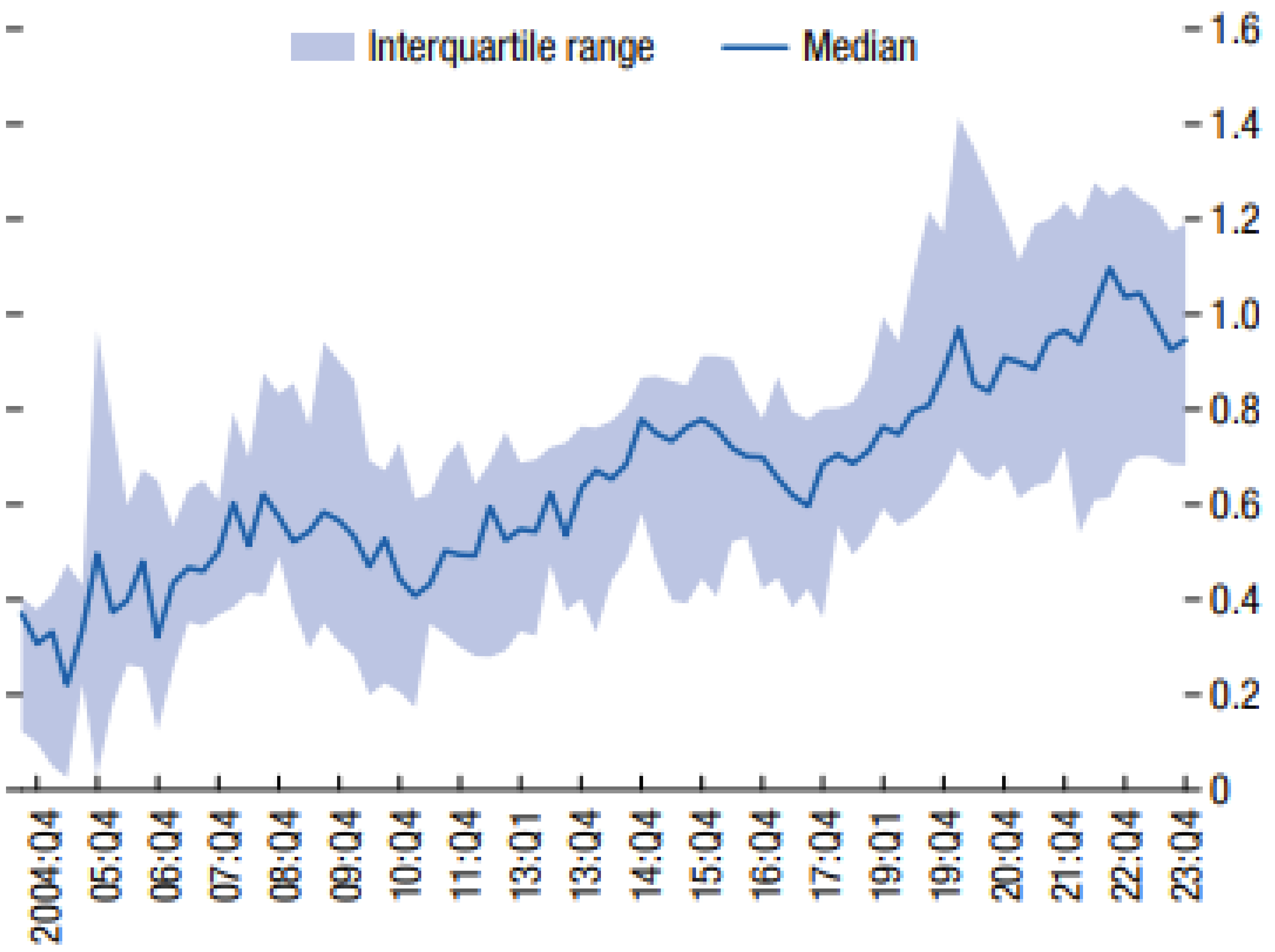
Public BDCs: Price / NAV
(ratio)



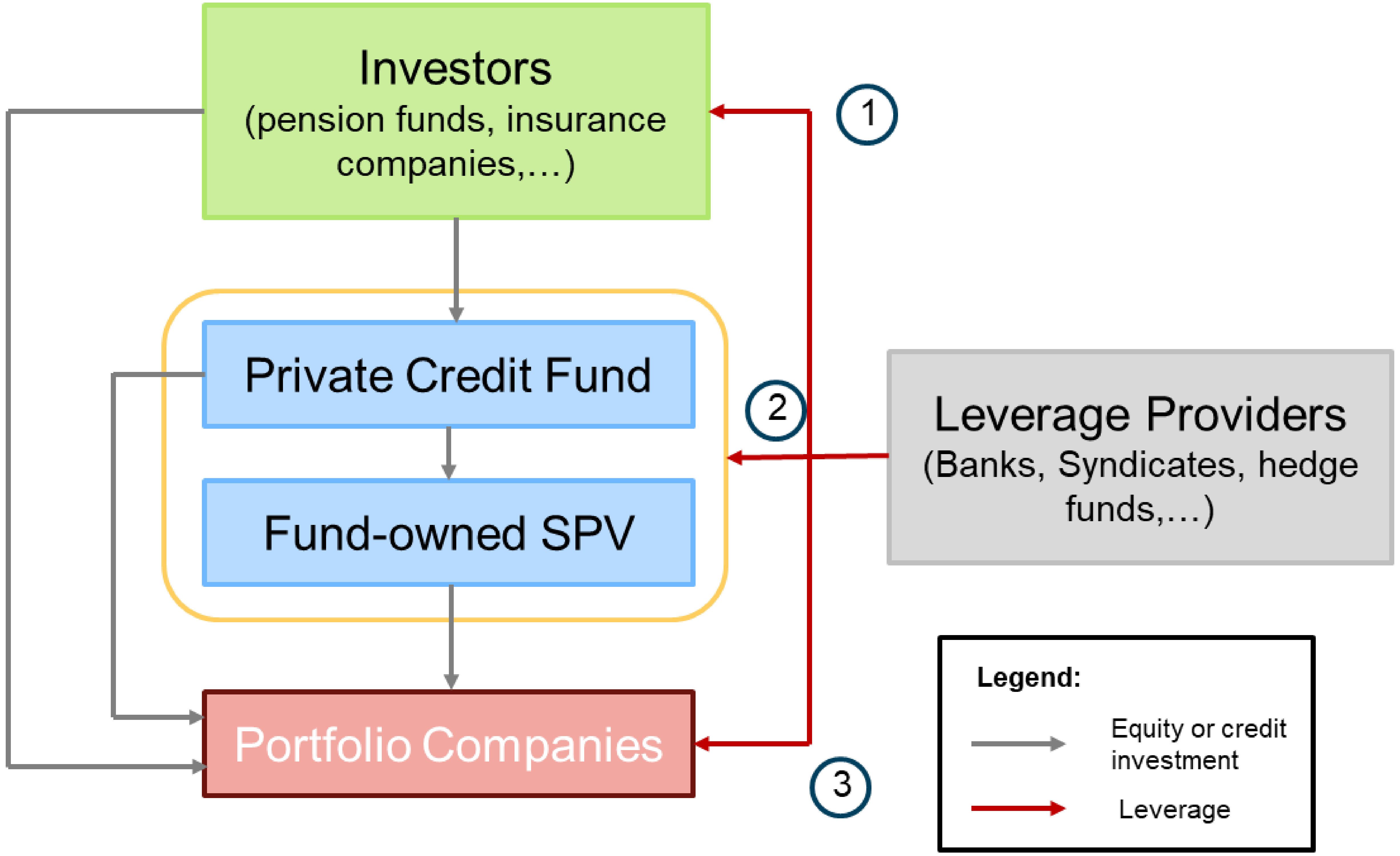
Leverage: PC Funds Appear to Use Limited Leverage, But Data Incomplete

Visible private credit leverage is modest…

Median BDC Leverage
(debt/equity ratio)



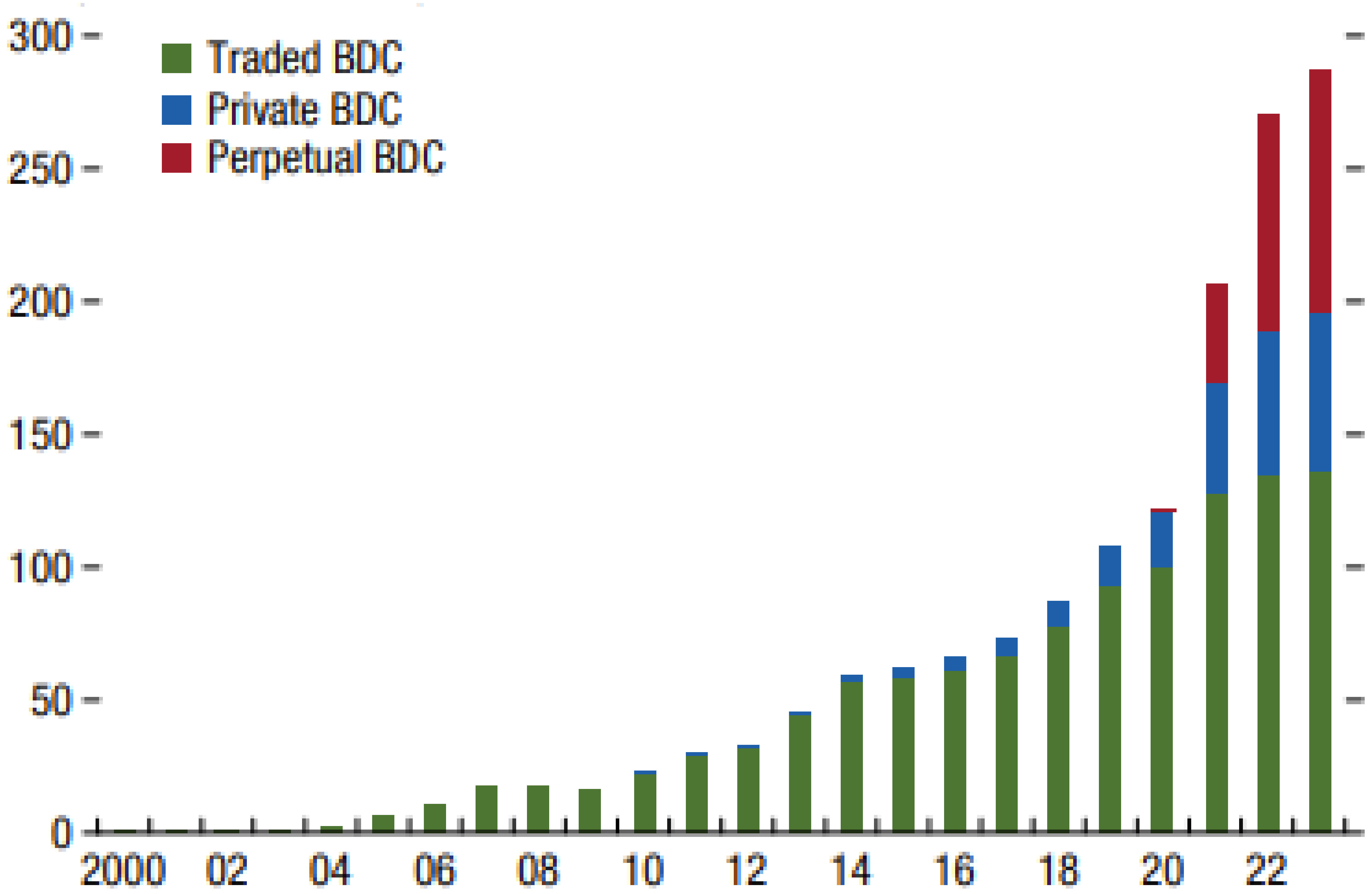
…But the system is complex and interconnected, with limited visibility and opaque levels of interaction



Liquidity: Mismatches Appear Limited but Retail Presence Growing

Private credit funds with greater redemption rights are small but growing rapidly

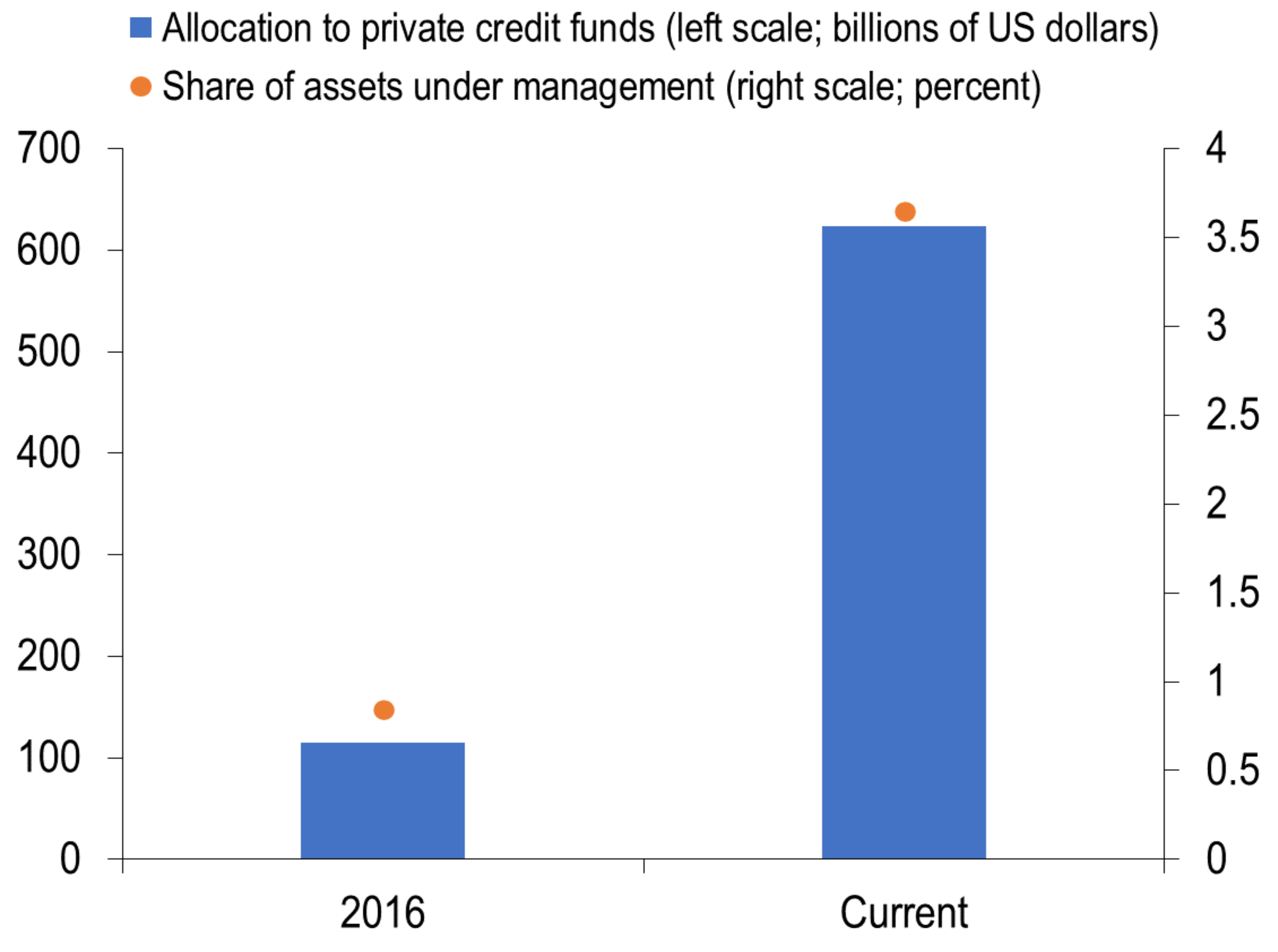
BDCs Assets Under Management
(USD billions)



Interconnectedness: Growing Exposure of Pension Funds and Insurance Companies to PC

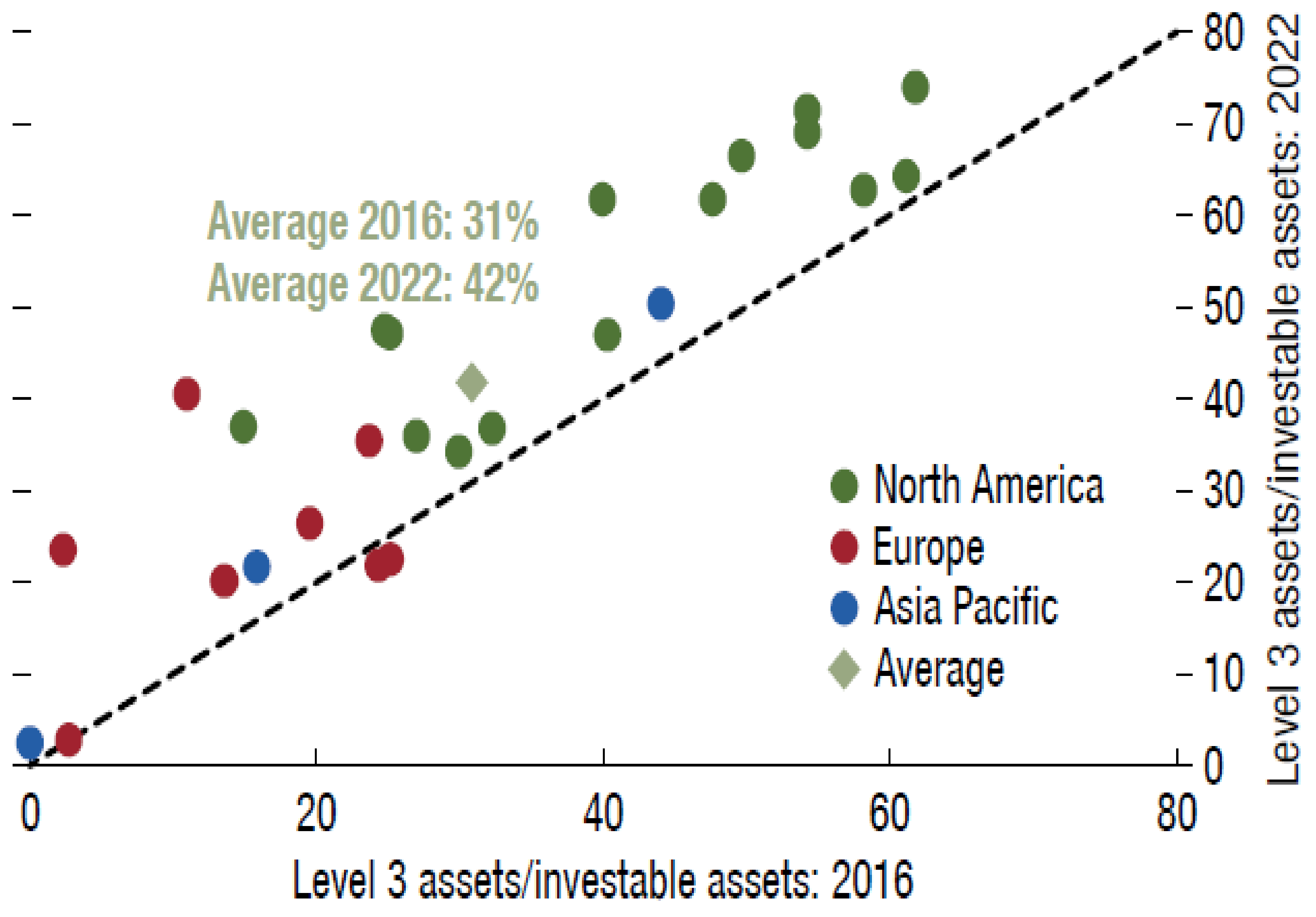
Exposures of PFs and ICs to private credit rapidly increasing

Investments in PC by Pension Funds and Insurance Firms
(billions, percent)



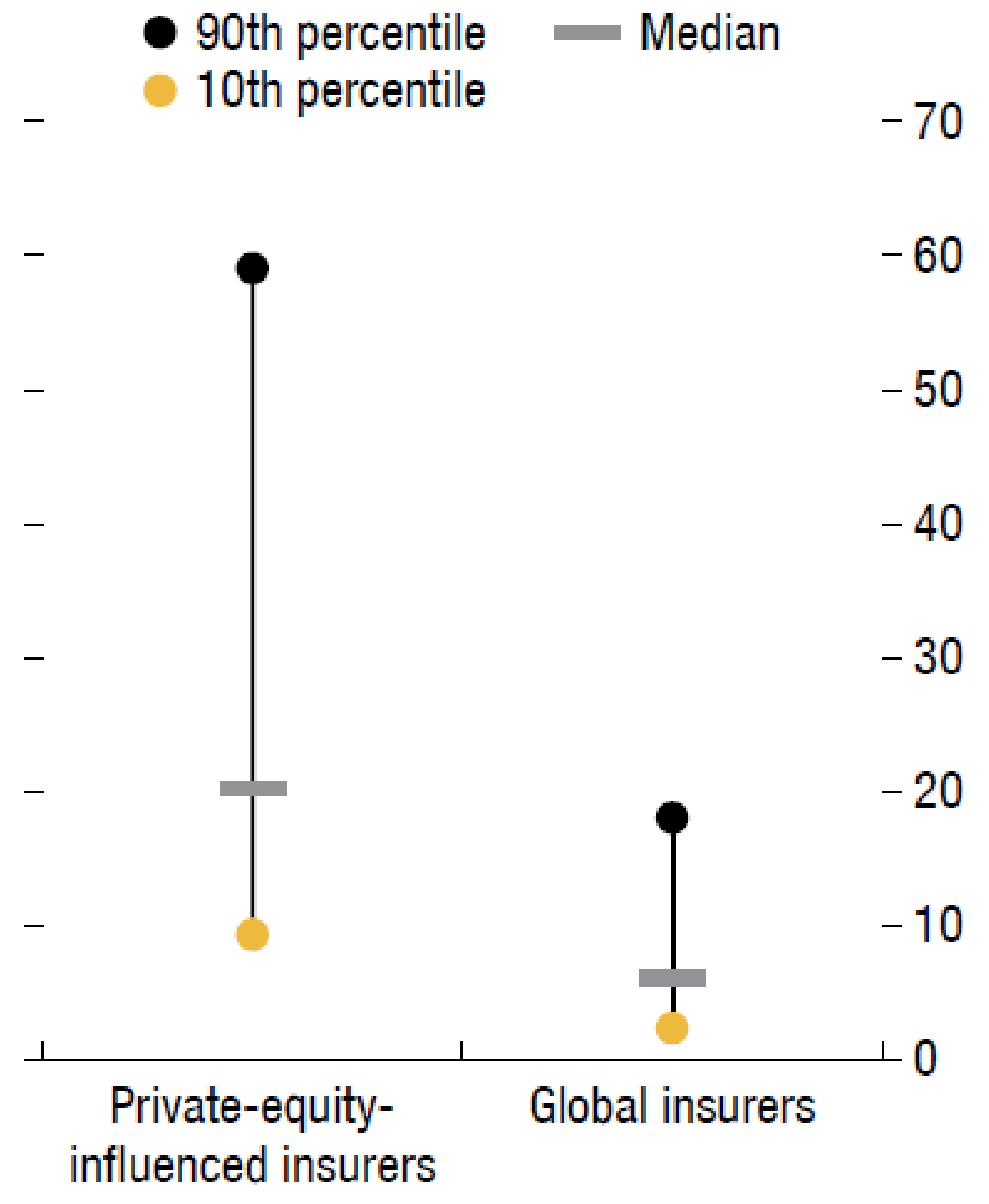
Growing exposure to PC increases share of illiquid assets at leveraged PFs

Share of Level 3 Assets of Leveraged Pension Funds
(percent)



PE-influenced ICs have larger illiquid exposures, including PCs

Insurers: Share of Level 3 Assets
(percent)



1/ The pension fund sample contains 26 large pension funds across North America, Europe and Asia-Pacific disclosing derivatives embedded leverage in their annual reports.

Vulnerabilities May Amplify Shock to Wider Financial Sector

Immediate risks to financial stability appear contained, but private credit is macrocritical

Potential Downside Scenario

Pressure to Deploy Capital
- Increased Competition with Banks
- Lower Underwriting Standards
- Increased Vulnerability to Downturn

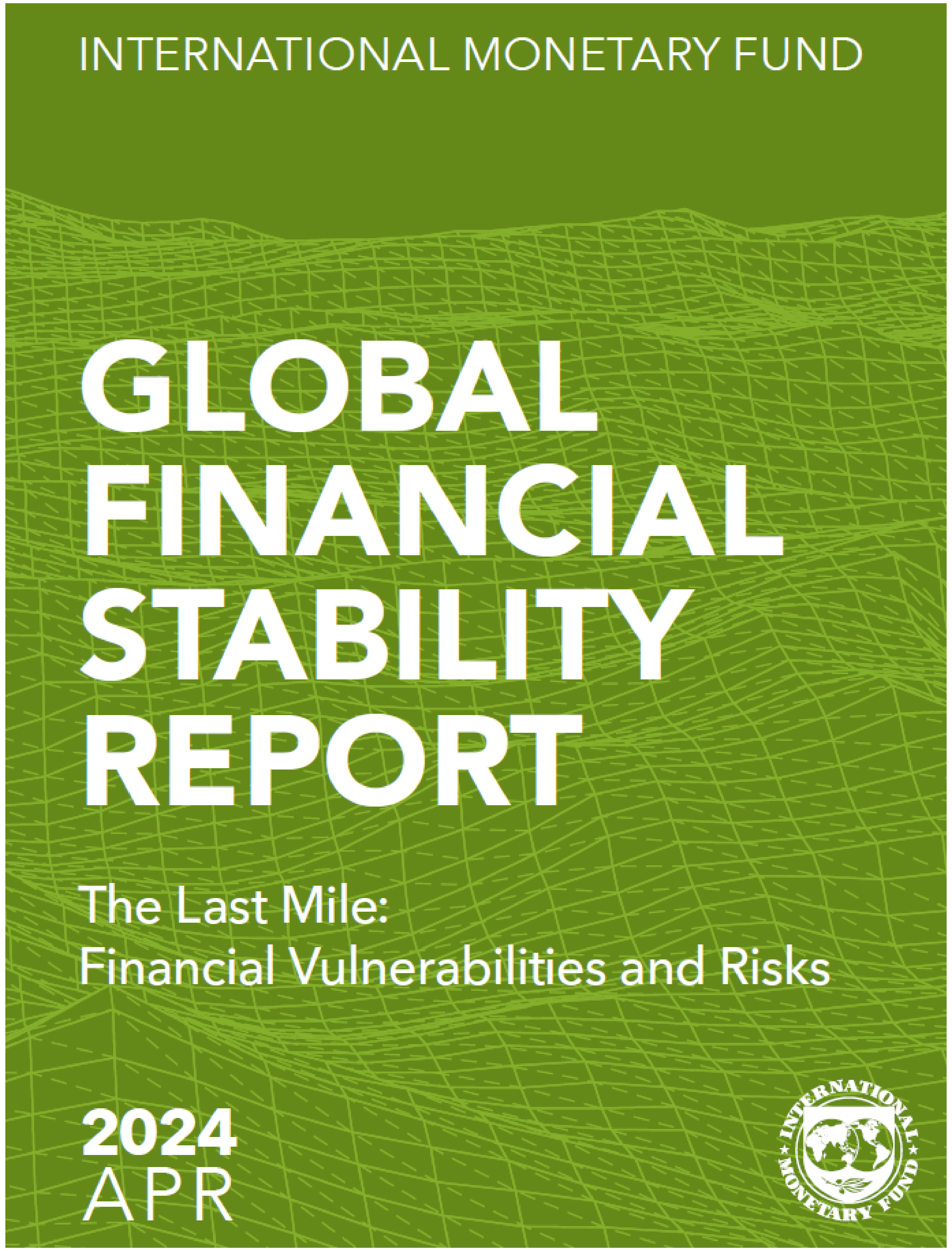
Severe Economic Shock Hits
- Lack of Transparency Mutes Initial Impact
- Sudden Spike in Losses and Defaults

Market Participants React
- Banks Curb Lending to PC
- Borrowing Firms Draw Revolvers
- PC Funds Face Liquidity Pressures

Interconnections Magnify Effects
- Retail Funds Face Large Redemptions
- PC Investors Forced to Sell Liquid Assets
- Spillovers to Public Markets
- Broader Credit Pullback by Financial Sector

Policy Recommendations

Enhance prudential oversight	• Consider a more **intrusive supervisory and regulatory approach** to private credit funds, their institutional investors, and leverage providers.
Close data gaps for comprehensive risk assessment	• **Close data gaps** so that supervisors and regulators may more comprehensively assess risks, including leverage, interconnectedness, and the buildup of investor concentration. • **Enhance reporting requirements** for private credit funds and their investors, and leverage providers to allow for improved monitoring and risk management.
Address liquidity and conduct risks	• Closely monitor and **address liquidity and conduct risks** in funds—especially **retail**—that may be faced with higher **redemption risks**. • **Implement** relevant **product design and liquidity management** recommendations from the Financial Stability Board and the International Organization of Securities Commissions.


INTERNATIONAL MONETARY FUND
GLOBAL FINANCIAL STABILITY REPORT
The Last Mile:
Financial Vulnerabilities and Risks
2024
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