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Has the Private Credit Maelstrom Arrived?

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Meet Your Presenters

Elan Kandel, Member, Bailey Cavalieri LLC

Anne Catapano, Vice President, Financial Lines, Ascot Group

Jennifer Cavey, Assistant Vice President, Financial Institutions Claims Manager at Zurich American Insurance Company

Kate Gookin, Vice President, Financial Lines, Head of Financial Institutions, Starr Companies

Anne Jarrell, Sr. Dir. & Counsel, Claims, Markel Bermuda

Dennis Van Dina, Director, Management Liability & Financial Institutions, Starr Companies

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What is Private Credit?

Private Credit is “**non-bank**” lending to companies.

- The most common type of private credit is “direct lending”, where non-bank investors provide loans to small/medium businesses and hold the loans themselves, typically to maturity, and are repaid from company’s cashflow
    - Private credit funds are limited partnerships with a defined lifespan
    - BDCs were created by an act of Congress in 1980. They are regulated as closed-end funds under the Investment Company Act of 1940 with the aim of providing access to capital to small and growing companies

Other types of private credit include:

- Distressed debt lending
- Bridge financing
- Mezzanine

What is Private Credit?

How it differs from publicly traded debt

- opaque
- Illiquid by design

Why It Matters Now

- **Retailization:** Access to private equity returns and risk is moving from professional investors to "main street" or the "retail" market.
    - ETFs
    - BDCs
    - Next up – 401ks
    - DOL's Mar. 2026 proposed rule would open 401(k)plans.
- Increased exposure to the retail market will attract heightened regulatory attention and litigation.

What is Private Credit?

1. ARCC – Ares Capital
2. OBDC – Blue Owl Capital
3. BXSL – Blackstone Secured Lending
4. MAIN – Main Street Capital
5. FSK – FS KKR Capital
6. GBDC – Golub Capital
7. HTGC – Hercules Capital
8. TSLX – Sixth Street Specialty Lending
9. OCSL – Oaktree Specialty Lending
10. CGBD – Carlyle Secured Lending
11. BCSF – Bain Capital Specialty Finance
12. TRIN – Trinity Capital
13. CSWC – Capital Southwest
14. PSEC – Prospect Capital
15. GSBD – Goldman Sachs BDC
16. BBDC – Barings BDC
17. KBDC – Kayne Anderson BDC
18. MFIC – MidCap Financial
19. FDUS – Fidus Investment
20. PFLT – PennantPark Floating Rate
21. NMFC – New Mountain Finance
22. SLRC – SLR Investment
23. GAIN – Gladstone Investment
24. MSIF – MSC Income Fund
25. GLAD – Gladstone Capital
26. CCAP – Crescent Capital BDC
27. CION – CION Investment
28. TCPC – BlackRock TCP Capital
29. HRZN – Horizon Technology Finance
30. SAR – Saratoga Investment
31. RWAY – Runway Growth Finance
32. SCM – Stellus Capital
33. PNNT – PennantPark Investment
34. TPVG – TriplePoint Venture Growth
35. WHF – WhiteHorse Finance
36. OXSQ – Oxford Square Capital
37. PFX – PhenixFIN
38. BCIC – BCP Investment
39. GECC – Great Elm Capital
40. OFS – OFS Capital
41. RAND – Rand Capital
42. EQS – Equus Total Return

What is Private Credit?

- Times have changed. BDCs now account for approximately 14% of the market and are often publicly traded and therefore open to retail investors
- Who are the borrowers?
- Borrowers are typically middle-market companies that are smaller and more leveraged than firms that access the leveraged-loan or bond markets

What is Private Credit?

- Unlike publicly traded bonds and broadly syndicated loans, loans extended by direct lenders are rarely traded
- Because these loans typically have no trading prices or market quotes, they are typically classified as “level 3” assets
- According to LSTA’s Private Corporate Credit Glossary, level 3 assets are defined as “assets and liabilities that are considered the most illiquid and hardest to value. Their values can only be estimated using a combination of complex market prices, mathematical models, and subjective assumptions”

What is Private Credit?

- International Monetary Fund data place the median private credit borrower at about $0.5 billion in total assets, compared with roughly $4.5 to $4.6 billion for high-yield bond and leveraged-loan issuers
- Borrowers often lack ready access to bank or public market financing
- The borrower side is closely tied to private equity. IMF estimates suggest that 70% of private credit borrowers are owned by private equity firms

Private Credit's Meteoric Rise

- In the traditional buyout era (1980s-2008) large PE firms' bread and butter were primarily leveraged buyouts
- Banks provided most of the acquisition funding. PE firms were primarily equity investors rather than lenders.
- Following the 2008 financial crisis, banks retreated and PE firms began creating large direct-lending businesses capable of originating loans without banks. This was the beginning of modern private credit.
- Largest alternative managers realize the credit has several advantages over buyouts: lower volatility of earnings, recurring management fees, faster capital deployment and less dependence on IPO markets

Private Credit's Meteoric Rise

- The private credit industry has grown tremendously over the past two decades
- Total U.S. private credit assets have increased from less than $200 billion prior to the Great Recession to over $1.6 trillion in 2024
- After the 2008 financial crisis, banks faced higher capital requirements and tighter supervision, making bank loans to smaller, levered, or harder to underwrite companies an unattractive proposition

Private Credit’s Meteoric Rise

- Unlike banks, private creditor direct lenders specialize in cash-flow based lending to PE-backed and intangible-heavy middle-market firms
- Private credit lenders also rely more on bond covenants, liens that tied to going-concern value of the borrow and industry specialization through their prior relationships with private equity sponsors
- Private credit lenders are also much more likely to defer payments on loans during times of distress (“payment-in-kind”)

Private Credit's Meteoric Rise

- In short, private credit's comparative advantage is its greater willingness and ability to lend against the enterprise value of highly leveraged firms
- Rise in private credit can also be attributed to the rise in private equity
- Private equity firms create a steady pipeline of leveraged buyouts, refinancing and dividend recapitalizations
- Borrowers want certainty and speed

Red Flags Begin to Emerge

- 2022: Federal Reserve begins aggressive rate-hiking campaign to combat inflation
- Private credit default rates starting climbing during the second half of 2022
- Were some losses deferred rather than eliminated?
- Many loans originated in 2020-2021 had been underwritten during a period of near-zero rates, aggressive leverage and "optimistic growth assumptions" (weak underwriting and intense competition to deploy capital)
- Post 2022, higher interest rates persist and borrowers had to refinance debt originated during the low-rate era

Valuation and Pressure Points

- By 2025-2026, the higher-rate environment had begun materially affecting borrowers
- Investors became concerned that loan defaults were increasing, software and technology borrowers were under pressure, refinancing costs were rising and some highly leveraged companies might require restructurings
- The pressure was concentrated in the semi-liquid retail/private-wealth vehicles (BDCs, interval funds, and perpetual-credit funds), not in traditional closed-end institutional funds
- As public credit markets weakened and certain borrowers deteriorated, some investors questioned whether fund NAVs fully reflected current credit conditions. Concerns about valuation methodologies became a recurring regulatory and investor theme.
- When redemption requests increased, many funds relied on contractual gates and repurchase caps instead of honoring all withdrawal requests immediately.
- Once investors saw large funds imposing gates and redemption caps, some investors rushed to submit redemption requests in future quarters to avoid being trapped later. Several reports describe redemption requests rolling forward from quarter to quarter when caps were reached.
- During 2026, several major funds reportedly experienced redemption requests well above their quarterly repurchase caps. Many of these funds used 5% quarterly repurchase limits while redemption requests were materially higher.

Has the Valuation Pressure Subsided?

- Is the redemption rush over?
- Elevated redemption requests persisted through at least Q2 2026
- Multiple major funds continued to operate under redemption caps
- Unfilled requests often rolled into subsequent quarters
- Efforts to stem elevated redemption requests: clampdown on payment in kind and tightening of lending standards
- Infills are still coming in

Private Credit Risks: Securities Litigation against BDCs

- Securities fraud claims are the dominant trend — Sections 10(b) and 20(a) Exchange Act claims remain among the most common theories, targeting BDCs, asset managers, and individual officers
- The securities fraud actions share a common damages theory. They allege that the defendant BDC provided a materially false representation of the health and value of its portfolio, particularly through inflated NAV figures, while concealing information about exposure. The alleged corrective disclosures—such as public earnings releases, short-seller reports, or sudden markdowns in NAV—allegedly revealed that portfolio values were lower than reported, causing a decline in share price and alleged investor losses.
- BDCs and their executives have seen an uptick in class action lawsuits bringing securities-related claims under Section 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. Plaintiffs who have brought such claims have argued, for example, that BDCs made material misrepresentations in their public disclosures about the firm's liquidity and net asset value, and the general health of the portfolio.

Private Credit Risks: Litigation Against Investment Advisers

- Section 36(b) of the Investment Company Act of 1940 imposes a fiduciary duty on investment advisers "with respect to the receipt of compensation for services."
- Unlike traditional securities fraud actions, plaintiffs do **not** need to prove scienter or reliance. The focus is whether the adviser's compensation is so excessive that it reflects a breach of fiduciary duty

Private Credit Risks: Litigation Against Investment Advisers

Defense Arguments:

1. Private parties cannot pursue valuation or fraud-based claims under the ICA
2. Section 36(b) claims only survive dismissal if they allege that an investment adviser "charge[d] a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining."
3. Plaintiff fails to plead the existence of any valuation impropriety, let alone systematic portfolio-wide inflation translating into such grossly excessive fees that fall outside the range of arm's-length bargaining.

Private Credit Risks: Fraudulent Transfer Litigation & Lender on Lender Claims

- Potential for litigation involving distressed private credit borrowers or borrowers in bankruptcies

Potential Claims Against Broker Dealers

Plaintiff's bar is already trolling for potential clients:

Unsuitable recommendations (FINRA Rule 2111). Brokers must have a reasonable basis to believe a recommended security or strategy is suitable for a particular customer, given the customer's age, risk tolerance, financial situation, and investment objectives. If non-traded BDCs or private-credit funds which carry limited liquidity and complex risk features were recommended to retirement-income investors, older clients, or others with short horizons, suitability problems can arise.

Failure to disclose material facts / omissions. Brokers must disclose material risks and conflicts that would have mattered to a reasonable investor. If a broker failed to explain redemption limits, gate provisions, or the degree of valuation uncertainty in NAV statements, that omission can form the basis of a claim.

Breach of Regulation Best Interest (Reg BI) duties. The SEC's Reg BI requires broker-dealers to act in a retail customer's best interest when making recommendations, including obligations around disclosure, care, conflicts of interest, and compliance. If a broker recommended private-credit BDC shares without adequately assessing the client's needs or disclosing conflicts (e.g., high commissions tied to the sale), Reg BI issues may arise.

Failure to supervise. Firms have an obligation to supervise their registered representatives. If a pattern of misconduct (e.g., steering retirement clients into illiquid private-credit BDCs) reflects weak supervision, the firm can be liable.

If sales material or in-person statements misrepresented liquidity or risk (for example, implying quick access to cash when the vehicle was illiquid), those statements can form the basis of a claim.

Private Credit: Regulatory Risks

- On May 4, 2026, SEC Chairman Paul Atkins confirmed at the Milken Institute Global Conference that the SEC, in coordination with the U.S. Treasury Department, is investigating allegations of fraud in the private credit market.
- Atkins noted that the SEC has "a special role to play, because [its] jurisdiction with respect to fraud and manipulation in the sale of securities extends to private markets[.]" Atkins warned that the SEC is "taking it seriously," while adding that the agency does not currently view private credit as a "systemic risk."

Private Credit: Regulatory Risks

- SEC examiners are moving beyond traditional compliance reviews and into the mechanics of valuation itself, probing committees, pricing methodologies, governance frameworks, and redemption processes in interval funds and other retail-facing products.
- This aligns with the agency's 2026 exam posture, which explicitly calls out complex, illiquid, and retail-distributed products—including private credit and alternative funds—as areas of heightened scrutiny.

Private Credit: Regulatory Risks

- The DOJ and the SEC is looking closely at "captive funding" models
- The DOJ and SEC are investigating structures where the same firm sits on multiple sides of a deal—the private-credit firm takes in premium money via an insurer that it controls, then directs that money into loans it originates or that flow back to its own funds and portfolio companies

Private Credit: Regulatory Risks

- In a November 2025 interview, former SDNY U.S. Attorney Jay Clayton stated that there are “definitely some areas of concern” in private markets and that “people should know that the financial regulators and the department are looking at those.” Clayton specifically cautioned against fund managers cherry-picking valuations to inflate fees and added: “I expect we will have more to do in areas of our private markets.”
- Clayton also flagged the risk of abuse when assets are transferred between portfolios, noting that an area “to watch out for is marks on assets with no trading when things are moved around from vehicle to vehicle,” and that “if someone is moving a position from Fund A to Fund B and if you can just name a price internally, the opportunity to pick a price that benefits the house over investors is pretty high.”
- At a May 2026 Managed Funds Association conference, Clayton reiterated that “if people are mismarking in order to generate fees, that’s always been a no-no.”

Private Credit: Regulatory Risks

- In early May, Treasury Secretary Scott Bessent, met with state insurance commissioners and the National Association of Insurance Commissioners (NAIC).
- Bessent framed the goal as "fit-for-purpose" regulation, encouraging innovation while managing risk, and the parties agreed to keep engaging at both staff and senior levels.
- Beyond the insurance track, Treasury has been holding one-on-one conversations with private credit leaders and asking firms for written responses about their business models and their ties to the regulated financial system.

Private Credit: Regulatory Risks

- Bessent has been signaling concern warning that the Treasury "gets involved" when assets move from private credit into regulated institutions like banks, pension funds, or captive insurers, and that the administration would not allow retirement accounts to become "a dumping ground" for distressed assets.
- Note last year's executive order on alternative assets in 401(k) plans, to make private credit available to retirement savers.

Private Credit: Potential ERISA Risks

The Employee Retirement Income Security Act (ERISA) imposes strict duties of prudence and loyalty on retirement plan fiduciaries.

Unlike traditional bonds, private credit loans are not traded on public exchanges and are manually valued by fund managers.

Fiduciaries face ERISA prudence claims if they allocate participant capital based on manager-reported Net Asset Value (NAV) that does not match actual recovery values in a downturn.

Private credit structures carry heavy performance fees, incentive benchmarks, and backend carried interest.

Parting Thoughts

- Underwriting considerations when writing private credit and portfolio companies
- Interplay between private credit and other ecosystems
- Rise in “evergreen” private credit funds

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