PGIM
GLOBAL ASSET MANAGEMENT

ALTERNATIVES

THE CONVERGENCE OF PUBLIC AND PRIVATE CREDIT

SPRING/SUMMER 2025

For institutional investors only.
All investments involve risk, including possible loss of capital.

CONTENTS

INTRODUCTION

In an ever-changing investment environment, few other asset classes capture the rapid pace of this evolution better than private credit, which from 2009 grew roughly 10-times in size by the end of 2023[1] and reached $3 trillion in AUM within the next year.[2] Yet it's the convergence of public and private credit markets that may be transforming the landscape. The blurring lines between public and private credit are reshaping capital markets, offering more choices and changing the way investors put their money to work.

While the opportunity set is expanding, the public-private convergence is also complicating regulatory oversight and risk assessment. With added complexity, investors may need to rethink the playbook for evaluating opportunities and risks in their credit portfolios.

To do this, investors could leverage solutions that extend across origination, securitized credit, and risk management. Together, these capabilities can provide investors with comprehensive credit strategies as the interplay between public and private markets deepens. Viewing credit exposure collectively will help aid investors as they seek to capture opportunities, identify overlapping correlations, and mitigate emerging risks. This will be particularly crucial as a realignment in world trade and shifts in the broader geopolitical environment give rise to unexpected challenges in navigating global markets.

Leveraging insights from investment professionals across our global businesses, PGIM examines the forces driving convergence between public and private credit, investment strategies across the credit spectrum, and portfolio implications emerging from an evolving credit landscape.

1. McKinsey & Company. (2024, Sept. 24). *The Next Era of Private Credit.* https://www.mckinsey.com/industries/private-capital/our-insights/the-next-era-of-private-credit. Accessed March 2025.
2. The Alternative Investment Management Association. (Nov. 2024). *Financing the Economy 2024.* https://www.aima.org/compass/insights/private-credit/financing-the-economy-2024.html. Accessed April 2025.

CHAPTER 1

THE PUBLIC-PRIVATE CONVERGENCE

Private credit's growth has been built on two pillars: growing demand for corporate lending and, more recently, an expanding footprint reaching a broader array of assets. In concert, these two pillars have set the stage for the convergence of public and private credit that is underway.

There are four notable forces forming the first pillar of growth:

1. The regulatory environment has pushed banks out of certain lending markets, creating a void that non-bank institutions have filled.
2. Following the Global Financial Crisis, institutions seeking stronger returns in fixed income and more diversified credit portfolios have flocked to private credit.
3. Some research suggests that private credit can offer a premium for its illiquidity and an appealing pickup in yield over other traditional fixed-income assets, even as a growing capital pool pushes down spreads.
4. Insurers in particular are a permanent source of capital well-suited for the asset class. They are increasing their allocations to private credit and structured asset strategies.

PRIVATE CREDIT'S BROADENING SCOPE

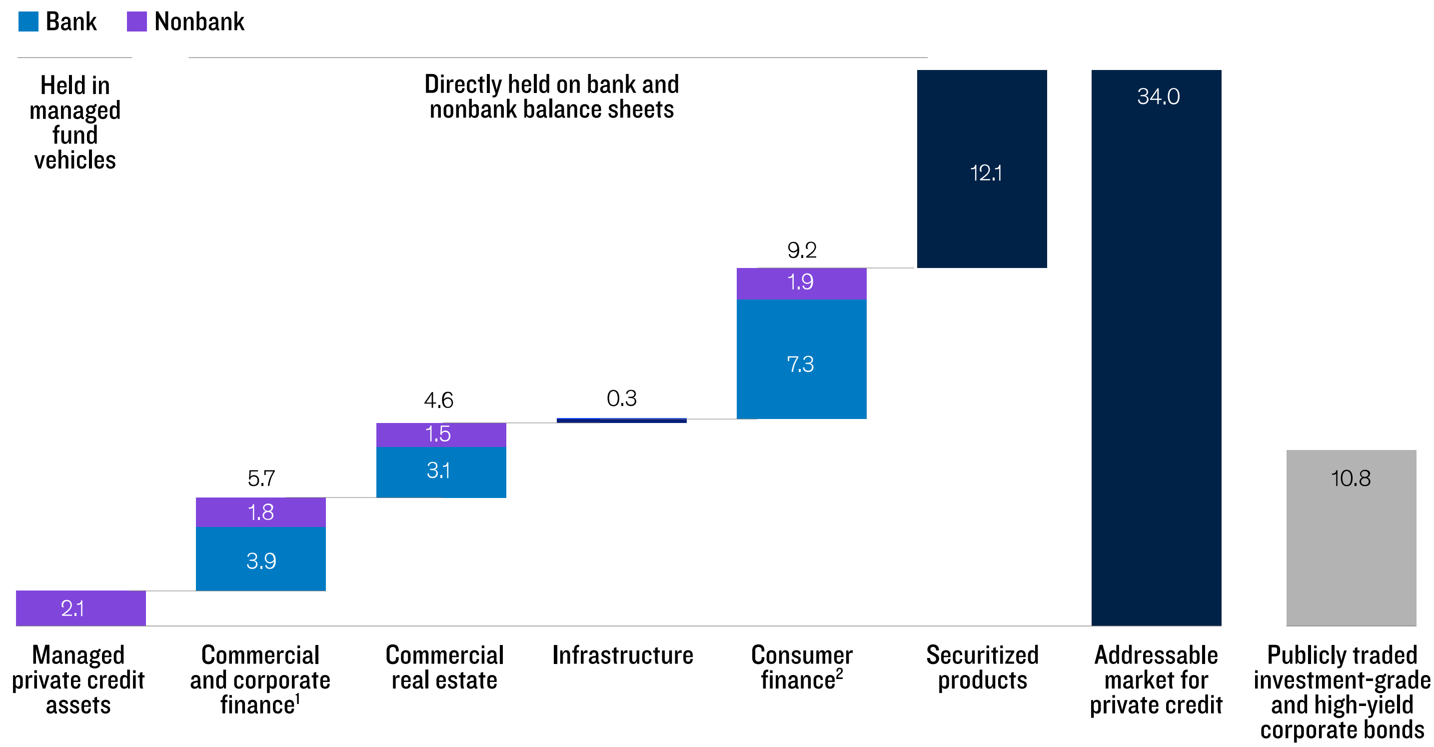
Here we will take a deeper dive into examining the second pillar: The private credit market is broadening its scope to include new areas of lending and structured finance. The public-private convergence is emerging from this next phase of credit's evolution.

Non-bank lenders are extending their reach and increasing their presence across a more diverse range of industries, including real estate, infrastructure, agriculture, energy, technology and life sciences. With private credit taking an increasingly central role in financing the economy, the universe of opportunities available to investors is expanding. This expansion is forecast to continue, with one estimate putting the size of private credit's total addressable market at $30 trillion or more in the US alone.[3]

Meanwhile, investors are capitalizing on these trends to diversify new or existing allocations. Global bond funds overall amassed record inflows in 2024 as capital flowed into fixed income in a higher-rate environment.[4] For borrowers, private markets can be a more flexible option, even if it

3. McKinsey & Company. (2024, Sept. 24). *The Next Era of Private Credit.* https://www.mckinsey.com/industries/private-capital/our-insights/the-next-era-of-private-credit. Accessed March 2025.
4. EFPR. (2025, Jan. 3). *Outside of the US, Sails Flapping at Year's End.* https://epfr.com/insights/global-navigator/outside-us-sails-flap-end-2024/. Accessed April 2025.

Private Credit's Expansion: A Diverse Spectrum of Assets
US lending balance in 2023 ($ trillion)



(1) Includes aircraft and railcar leasing, equipment leasing, receivables financing, standard corporate loans, and trade finance.
(2) Includes auto loans, credit card receivables, residential mortgages, student loans, and unsecured personal loans.
Source: McKinsey; Preqin; Securities Industry and Financial Markets Association. Data as of 2023. Provided for illustrative purposes only. Past performance is not indicative of future results.

> "Investors are seeing less and less of a distinction between public and private credit, and instead are looking for experienced credit managers who can provide access to a complete range of credit solutions and opportunities."

MATT DOUGLASS
CEO and Senior Managing Director
PGIM Private Capital

comes with a premium. As a result, a growing number of companies are tapping lenders outside of traditional financing channels.

BLURRING THE LINES BETWEEN PUBLIC AND PRIVATE

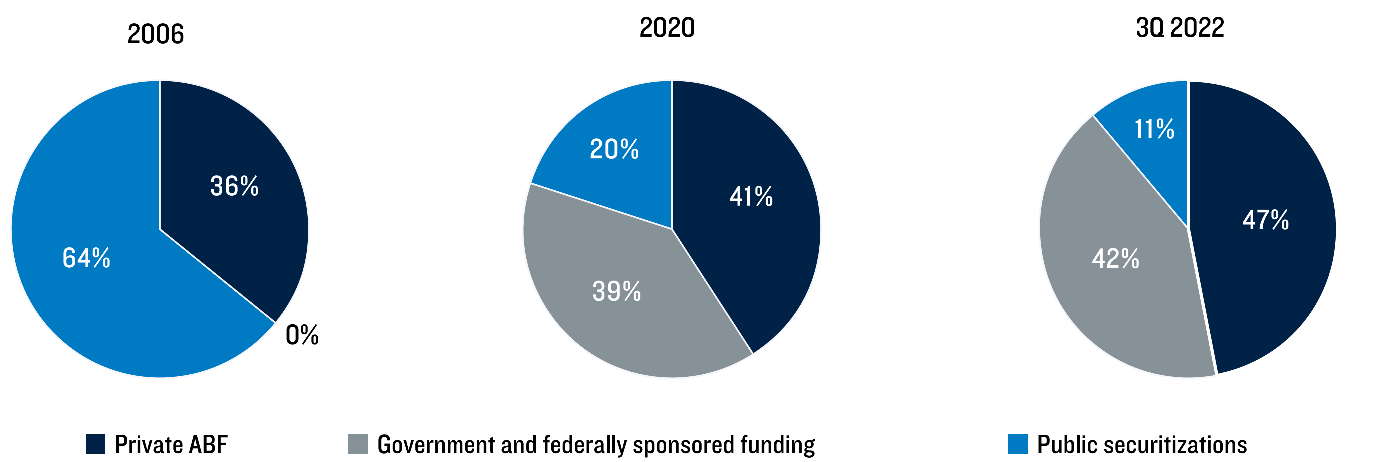
Credit markets are converging, providing new opportunities for investors to diversify returns through a comprehensive portfolio of public and private assets. Investors and asset allocators are increasingly thinking about credit markets as an expansive and all-inclusive solution, rather than creating a distinction between the public and private sides.

Private asset-based finance (ABF), a rapidly expanding market, is at the center of this convergence. The market for public asset-backed securities (ABS) shrunk in size in the aftermath of the GFC, paving the way for institutional investors to take on a larger role in asset-backed lending. Both private credit and public fixed-income managers with expertise in structured products have emerged as major players. The combination of asset-backed-lending, real estate debt and infrastructure debt accounts for 40% of all private credit AUM. Global growth is forecast to continue, as Europe and Asia-Pacific become more attractive amid greater regulatory certainty and familiarity among borrowers.[5]

Private credit is also scoring larger corporate debt deals that were previously dominated by public markets. Likewise, it is becoming more common for borrowers to tap private credit for their financing needs. In the US, business development companies (BDCs)—privately offered, publicly traded, or public non-traded—are taking on a bigger role in lending to sponsored firms. Through BDCs, public investment capital is making its way to borrowers via private credit deals. This comes amid a decline in the number of publicly traded companies over the last couple decades. Approximately nine-in-10 US companies with annual revenue of more than $100 million are now private, according to S&P Capital IQ data.

As private markets mature, understanding where they overlap with public credit will likely be crucial for investors. To help achieve true diversification across asset types, quality and liquidity, a simple strategy of making separate allocations to public and private credit will no longer suffice. Rather, investors may need to take a holistic view of credit markets and portfolios to identify opportunities and risks.

Asset-Based Finance's Expanding Market Share



Source: Integer Advisors; KKR. As of Oct. 31, 2022. Provided for illustrative purposes only. Past performance is not indicative of future results.

5. The Alternative Investment Management Association. (Nov. 2024). *Financing the Economy 2024.* https://www.aima.org/compass/insights/private-credit/financing-the-economy-2024.html. Accessed April 2025.

CHAPTER 2

OPPORTUNITIES ACROSS THE CREDIT UNIVERSE

From private lending to securitized credit strategies, the blurring lines between public and private markets are underpinning the next phase of growth throughout the credit lifecycle.

ORIGINATION

Here we highlight several areas driving private credit deeper into lending markets: middle-market direct lending, large-cap private credit, real estate debt and infrastructure debt.

Middle-Market Direct Lending

Direct lending has accounted for much of private credit's growth. Driven by insurers, pensions and other large institutional investors, direct lending comprised 44% of all private credit in North America at the end of 2023—a substantial rise from its 15% share in 2008.[6] However, the rising tide of private capital did not lift all boats in terms of financing options, as companies backed by private-equity firms benefited the most from the private credit wave.

There is potential for direct lenders that can access hard-to-reach deals in the non-sponsored market, as these businesses comprise about 90% of private US and European companies and contain a wealth of quality businesses.[7] Given the higher-touch relationships that non-sponsored companies require, it takes a broad-based geographic network of lenders to call on hundreds or even thousands of companies just to find a few dozen successful corporate loans every year. With supply-chain challenges and new trade policies injecting uncertainty into the business environment, borrowers from a variety of industries are also increasingly seeing the benefits of establishing or maintaining closer relationships with private lenders. For instance, an international company that provides communications infrastructure can tap a direct lender for senior secured notes to refinance existing debt while diversifying its funding sources.

With the right approach, adding non-sponsored deals to a direct lending portfolio can offer meaningful diversification and return benefits such as lower leverage, a yield premium, and stronger covenants. Access to the middle market can deliver better pricing, better terms, and more diversification through unique originations.

6. Preqin. (2024, March 20). *North America Is Consolidating Alternative Assets as Region Holds Almost Two-Thirds of Global AUM – Preqin Reports.* https://www.globenewswire.com/news-release/2024/03/20/2849698/0/en/North-America-is-consolidating-alternative-assets-as-region-holds-almost-two-thirds-of-global-AUM-Preqin-reports.html. Accessed April 2025.

7. PGIM. (2025, Jan. 16). *Enhancing Diversification Through Non-Sponsored Direct Lending.* https://www.pgim.com/pgim-japan/insights/2025-best-ideas/private-credit. Accessed April 2025.

Large-Cap Private Credit

The vast amount of dry powder available to direct lending platforms is sending private credit investors upmarket in search of deals, scoring bigger corporate debt transactions that were typically funded through the broadly syndicated loan market.

Private credit has generally exhibited growth and margin resilience, particularly among large-cap businesses with EBITDA exceeding $100 million. Meanwhile, larger mid-market and large-cap private credit transactions have possessed covenant resiliency as the size and scale of a business increases. In the first quarter of 2024, large-cap companies had a covenant default rate of 0.5%, compared with 15% for smaller firms with less than $10 million EBITDA over the previous 12 months, according to Lincoln International.[8] For middle-market companies in the $30-50 million EBITDA range, covenant defaults were also lower at a rate of 4.5% in the same period.

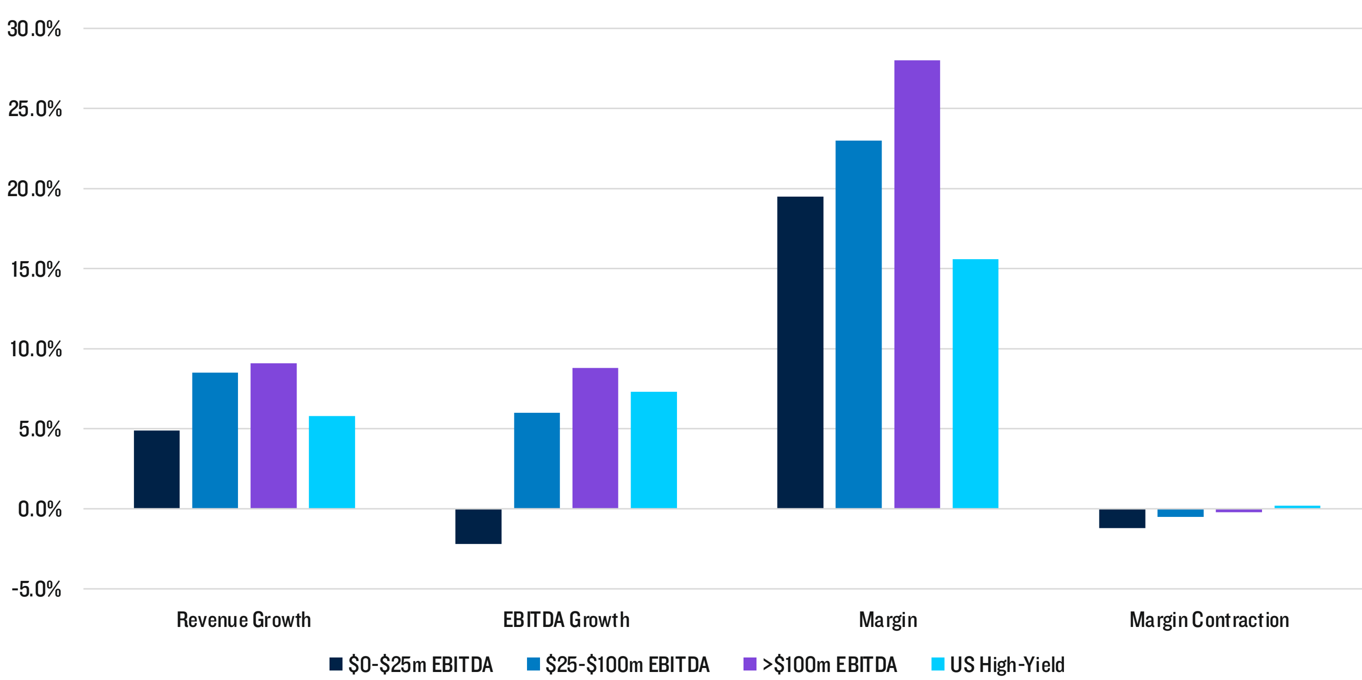
Private-credit returns have historically exceeded those of traditional fixed-income assets such as investment-grade and high-yield bonds. On a risk-return spectrum, private credit becomes noteworthy to investors seeking lower volatility and who are willing to accept a risk and illiquidity premium.

From a borrower's perspective, companies have more options today to choose which type of credit suits their financing needs: high-yield debt markets, broadly syndicated loans, or private credit. Even for companies focused on minimizing their cost of debt, private credit could be more compelling than syndicated loans due to the additional flexibility that non-bank lenders may offer. Close relationships between borrowers and lenders will likely take on greater importance as uncertainty over trade, tariffs and economic growth pervades the current business environment.

Real Estate Private Credit

Real estate is itself an expanding subset of private credit with an array of property types offering new investment opportunities. These include housing, such as multi-family housing, senior housing and co-living; and commercial real estate, such as logistics, industrial, data centers, self-storage, offices, retail and agriculture. In agriculture, private credit is providing a rising amount of financing for land ownership across farming, ranching, wineries and timber. Data centers are a growing opportunity as capital and financing needs continue to rise, with operators tapping a variety of financing structures like project finance, CMBS, and ABS. With private real estate credit forecast to reach $400

Growth and Margin Resilience in Private Credit



Source: PGIM Fixed Income; Lincoln International; JPM. Data: 2018 to Q2 2024 (CAGR for Revenue and EBITDA Growth), as of June 30, 2024. Provided for illustrative purposes only. Past performance is not indicative of future results.

8. Lincoln International data for covenant defaults delineated by companies' LTM EBITDA, as of June 30, 2024.

billion globally in the next five years,[9] a widening landscape in the sector offers diverse options for investors looking for opportunities to deploy capital as valuations near their cyclical bottom.

There are a variety of strategies available to investors, including:[10]

1. **Core commercial mortgages:** With a focus on investment-grade mortgages, core commercial mortgages can deliver stable returns with lower risk. This strategy has benefited from appealing all-in coupons amid elevated interest rates—and rates are on track to remain structurally higher in the next cycle. Investors can protect against market volatility by focusing on assets in cities and sectors that have demonstrated greater resilience. If the US economy enters a period of productivity-driven growth, markets where the local economy is fueled more by productivity and where rental rates are higher could be poised to benefit. This would include New York, Boston, San Diego and San Francisco.[11] In Europe, elevated affordability and upside risks to the outlook have been evident in second-tier markets like Manchester, Brussels and Copenhagen, faster-growing Barcelona and Madrid, and major financial hubs like London, Paris and Frankfurt.[12]
2. **High-yield credit in transitional real estate:** For investors interested in higher return potential with slightly higher risk, senior secured or subordinate loans for properties undergoing a light transition are poised to benefit from the real-estate recovery. Leverage could enhance returns amid a revival in CMBS and CRE CLO markets.
3. **High-yield credit in value-added real estate:** This strategy includes senior secured subordinate loans or preferred equity tied to properties undergoing significant transition or construction. It represents significant upside potential—particularly in senior development finance and mezzanine debt—for investors focused on total return and with a higher risk tolerance. High-yield real estate credit for both transitional and value-added real estate is an expanding opportunity set thanks to a growing need for capital used to upgrade, modify or enhance existing properties.

Uncertainty continues to challenge sentiment and activity. There are potential risks ahead, including the possibility of interest rates staying elevated for longer. This could delay the real estate market recovery and push market participants back to the sidelines, which could reduce the volume of opportunities.

> **“For investors, the value of a manager like PGIM in real estate credit is that we are able to directly originate and structure our own investments. This not only allows us to access unique deal flow, but more importantly, enables us to customize each investment to help make sure that the returns and structure match the risk.”**

JOHN JACOBS
Senior Portfolio Manager, Real Estate Private Credit
PGIM Real Estate

9. Source: Preqin. Data refers to closed-end commingled funds only.
10. PGIM Real Estate. (2024, Nov. 18). *Private Real Estate Credit: Navigating Opportunities in a Shifting Landscape.*
11. PGIM Real Estate. (2025, March 12). *United States Regional Insights.*
12. PGIM Real Estate. (2025, March 12). *Europe Regional Insights.*

Still, with careful investment selection, private real estate credit can provide a reliable income stream with built-in downside protection, positioning the asset class as a source of resilience amid market uncertainty. At $4.8 trillion, the US private CRE credit market is an asset class comparable in size to major fixed income markets, offering a foundation for diversified investment. Increased need for debt capital, driven by loan maturities, building modernization needs and selective bank appetite, creates opportunities for alternative and flexible financing solutions.[13]

Infrastructure Debt

With shifting supply chains and global trade flows contributing to rising demand for private funding, infrastructure has established itself as an important alternative asset class in institutional portfolios. Infrastructure can be attractive to institutions due in part to its long-term and diversifying nature, as well as its ability to generate steady and reliable cash flows. Global infrastructure AUM is forecast to grow from $325 billion in 2016 to $2.4 trillion by 2029, as significant capital will be needed to support transportation, energy and digital infrastructure projects.[14]

SECURITIZED CREDIT

The pooling of credit assets has opened new avenues for investors seeking credit opportunities—with the benefit of enhanced diversification and risk management. Increasingly, investors are accessing these strategies not through public markets, but direct access to originators.

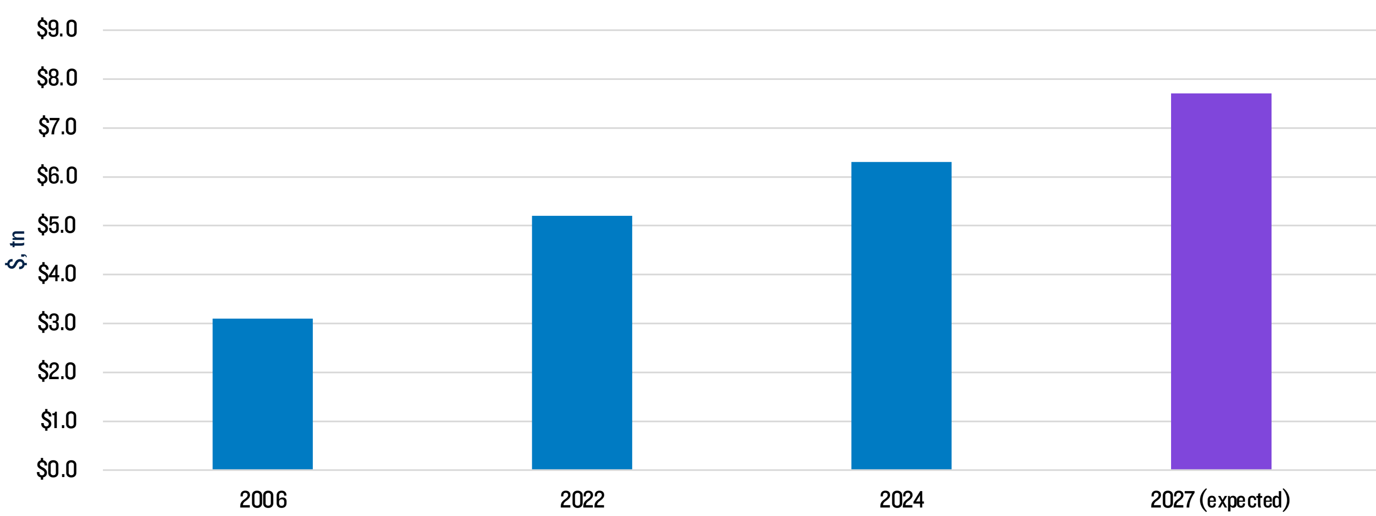
Showing how public and private investment solutions can strengthen each other, less-liquid loans are wrapped together through structures such as **mortgage-backed securities, rated-feeder funds or collateralized loan obligations** (CLOs). As managers acquire, structure and tranche an expanding array of assets, investors can achieve pricing premiums associated with more illiquid assets.

The public-private convergence is perhaps most evident in the fast-growing ABF segment, becoming an opportunity for investors seeking access to diverse and unique credit assets.

Asset-Based Finance

Music royalties and other unique assets grab headlines. But the broader ABF universe is a cornerstone of the economy, spanning car loans, credit cards, mortgages and

Private Asset-Based Finance's Rapid Growth Poised to Continue



Note: Growth expectations are not guaranteed and subject to change.
Source: Integer Advisors forecast and KKR. As of September 2024. Provided for illustrative purposes only. Past performance is not indicative of future results.

13. PGIM Real Estate. (2025, April 4). *The Expanding Opportunity for Private US Real Estate Credit.* https://www.pgim.com/pgim-japan/insights/expanding-opportunity-for-private-us-real-estate-credit. Accessed April 2025.
14. Preqin. (2024, Sept. 18). *Global Alternatives Markets on Course to Exceed $30tn by 2030 — Preqin Forecasts.* https://www.preqin.com/jp/about/press-release/global-alternatives-markets-on-courseto-to-exceed-usd30tn-by-2030-preqin-forecasts.

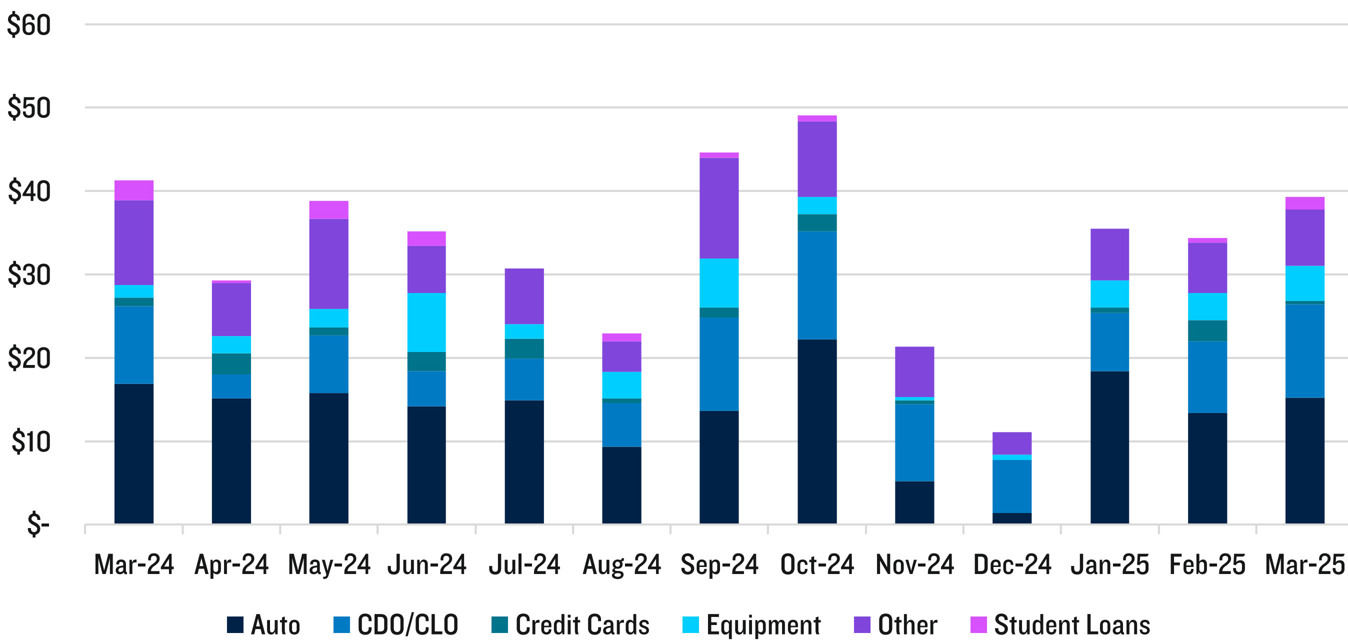
other consumer lending, as well as business lending such as jet leases and digital infrastructure. The ABF market thus captures a diverse set of investments with varied sector, quality, and risk exposure.

> **I think ABF and securitized overall will play a bigger part in portfolios, as there are clear benefits around not just relative value, but diversification."**
>
> **EDWIN WILCHES**
> Co-Head, Securitized Products
> PGIM Fixed Income

The potential addressable market for private ABF is growing. Based on Federal Reserve data, the US consumer credit market alone accounts for $5 trillion in underlying debt obligations as of January 2025, far in excess of the roughly $1.5 trillion market for corporate and high-yield debt. When considering the proliferating pool of underlying collateral in the space, the total addressable ABF market could be worth anywhere from $20 trillion to $40 trillion. And private credit investors have only scratched the surface. After accounting for debt held by banks, credit unions and the government (i.e. student loans), just an estimated 10% of the consumer debt pool is securitized, according to Bank of America research.[15]

One force behind ABF's rise is the growing size, scale and sophistication of asset managers. A single manager can possess the purchasing power and diversity of capital across its client base to execute a transaction on its own. This wasn't true of the pre-GFC period, when syndicating risk across multiple firms was the norm. Asset managers are thus going straight to the source, bypassing banks and locking up assets directly from originators.

U.S. Non-Mortgage ABS Issuance ($ Billions)



Source: Securities Industry and Financial Markets Association. Data as of March 2025.

15. S&P Global. (2024, Nov. 20). *The Opportunity of Asset-Based Finance Draws in Private Credit.* https://www.spglobal.com/ratings/en/research/articles/241120-the-opportunity-of-asset-based-finance-draws-in-private-credit-13319616. Accessed April 2025.

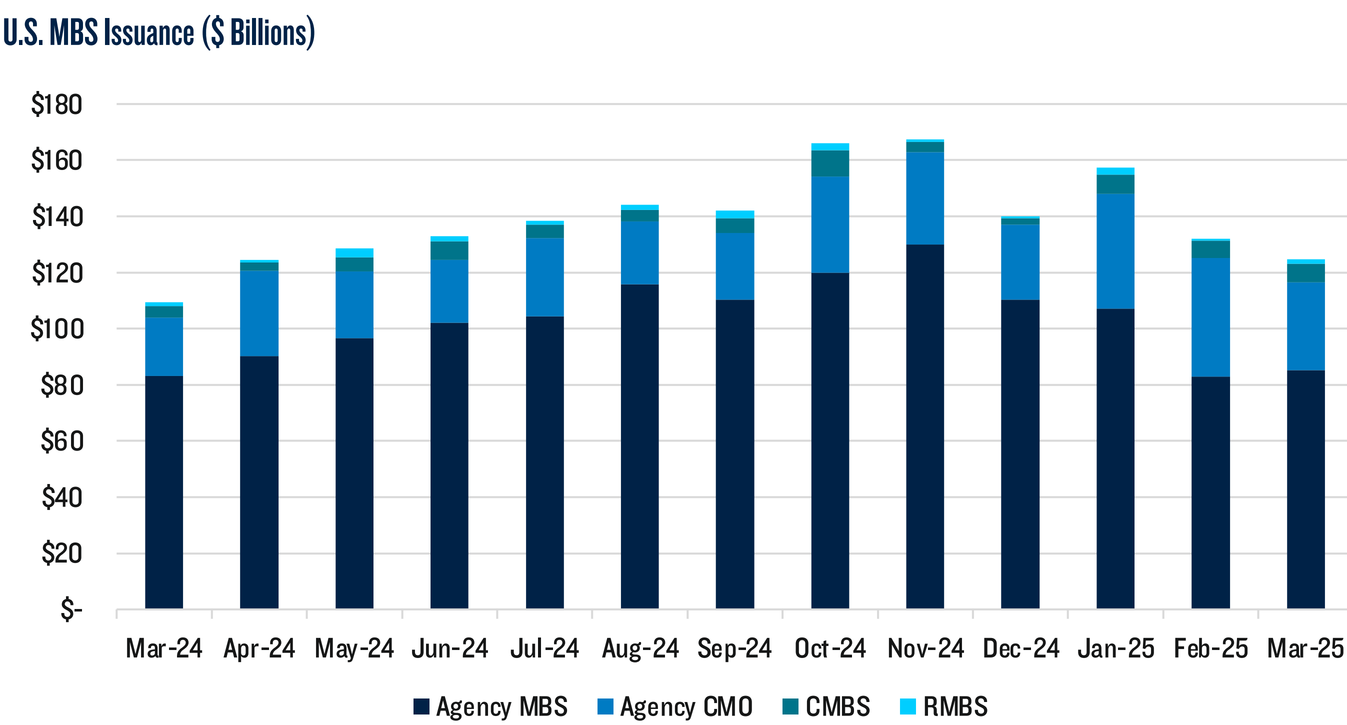
While ABF and ABS are distinct markets, it is important to examine the relationship between the two. ABS, which acts as a source of financing for ABF asset owners, registered a record-setting year for issuance in 2024. The momentum has continued. US non-mortgage ABS issuance totaled $108.9 billion in the first quarter of 2025, up 4.1% year-over-year. MBS issuance was up 33.3% at $414.3 billion over the same period. Issuance is poised to remain strong amid a steady stream of private opportunities as operators seek funding diversification. Operators are also expanding traditional ABS issuance to complement early-stage private financings and warehouses.[16]

Through private ABF, investors can find relative value and diversification:

- With yields at more noteworthy levels, fixed income is drawing capital from insurers, pensions, corporates and other institutional investors, as well as retail. Investors reallocating to fixed income are looking for greater diversification and thus are drawn to ABF and securitized assets, which can offer access to a broad array of consumer and commercial credit.
- A diverse set of underlying assets such as homes, cars and aircraft make ABF a possible hedge against inflation.
- A typical public securitized mandate, for example AAA CLOs, might provide 75 to 100 basis points above investment-grade corporates. Investors with a tolerance for less liquidity could pick up another 75 to 100 basis points through private securitizations. So, between 150-200 basis points in investment-grade ABF above IG corporates—a meaningful pickup in yield.[17]
- In addition to appealing spreads, private lenders have the flexibility to deliver stronger debt covenants, helping to provide downside protection in an uncertain macro environment. Risk-adjusted returns could be appealing when compared with other segments of the credit market.

Regulatory Landscape

Opportunities will likely continue to grow, even if a deregulatory movement paves the way for banks to reenter lending markets. In the aftermath of the GFC, regulatory reforms played a role in shifting consumer and commercial lending off banks' balance sheets and onto those of non-depository financial institutions. Potential changes to federal regulations loosening financial institutions' capital requirements could slow the pace of asset sales and large risk transfers over the near term. However, in the long run, banks will likely continue removing risk from their balance



Source: Securities Industry and Financial Markets Association. Data as of March 2025.

16. PGIM Fixed Income. (2025, March 7). *The State of Securitization from SFVegas.* https://www.pgim.com/pgim-japan/insights/state-of-securitization. Accessed April 2025.
17. PGIM Fixed Income. (2025, Feb. 19). *Credit Markets in Transition: Asset-Based Finance.*

sheets, given that fundamental regulatory frameworks created after the GFC—those that are designed to promote financial stability—are expected to remain in force.

As the 2023 regional bank crisis showed, credit is only one potential source of risk on a bank's balance sheet. Other potential risks, such as a mismatch in asset liabilities, will require banks to maintain sufficient levels of capital on hand.

Risk Management Implications

ABF is becoming a crowded space, and competition for lending opportunities across whole business securitization, equipment, aircraft and beyond is driving spread compression. In select sub-sectors of ABF, the competitive lending environment is reducing the quality of underlying assets and leading to weaker debt covenants. This is a sign that some investors are not fully pricing in risk. To help be successful in the competitive ABF market, investors could take a bottom-up view and leverage technology and big data to assess a host of risks, including credit, legal, regulatory, structural, liquidity, and operational. This approach helps to identify the most appealing opportunities as competition intensifies.

With competition across private credit markets intensifying, some lenders are willing to offer looser terms, such as covenant-lite loans, and payment-in-kind (PIK) toggles that fund dividend recapitalizations or let borrowers defer cash interest payments. In broadly syndicated loan markets, covenant-lite transactions have seen weakened security protection in terms of asset carve-outs.

The rise in covenant-lite loans underscores the importance of remaining selective and maintaining a disciplined approach to origination, rather than reaching down in credit quality to find deals during times when demand for private credit is higher than the supply. When selecting the right credit strategy, tranching offers investors flexibility based on their risk and return objectives. Investors can choose what part of the credit stack matches their risk tolerance.

Geopolitical risks may also be a consideration. The uncertain impact of changing trade policies will lead investors to identify and mitigate specific risks related to tariff exposure or supply-chain disruptions.

Reviving European Securitization

In September 2024, Mario Draghi, the former Italian Prime Minister, released a report that delivered a striking assessment of the European Union's economic health and called for a multi-pronged approach to close a widening gap with its peers, notably the US and China.[18] To achieve these objectives, the report calls for a minimum annual investment of €750-800 billion corresponding to around 5% of the bloc's GDP, reversing a multi-decade decline in funding.

These investment needs are massive and unprecedented from a historical perspective. For comparison, the additional investments provided by the Marshall Plan between 1948-51 to rebuild Europe amounted to around 1-2% of GDP annually. To unlock such large sums of investments, Europe needs to reduce its reliance on bank financing and promote a vibrant securitization market.

At a basic level, EU banks' ability to finance major investments is constrained by lower profitability, higher costs, and smaller scale than their US counterparts. There is a persistent gap in the return on equity between EU and US banks, driven largely by US banks' higher net fee and commission income. The EU banking sector also faces higher regulatory compliance costs and is more fragmented. This fragmentation means that EU banks cannot match the scale of their US counterparts. For example, the largest US bank (JPMorgan Chase) has a larger market capitalisation than the 10 biggest EU banks taken together.

However, securitization makes banks' balance sheets more flexible by allowing them to transfer some risk to investors, release capital and unlock additional lending whilst supporting the development of capital markets. This process would help to channel non-bank finance across EU financial markets. Yet, the EU market is far less developed with the region's securitization market standing at 17% of the size of the US market.[19]

Here are potential avenues for addressing these challenges:

1. Simplify Due Diligence Requirements

Duplicative due diligence obligations under the EU Securitisation Regulation (EU SR) add unnecessary operational burdens for investors, particularly smaller institutions. Isolating securitisation as a "special" asset class with its own extra layer of due diligence requirements makes Europe an outlier among peers.

18. PGIM. (2024, Oct. 3). Another 'Whatever It Takes' Moment for Europe?
19. PGIM. (2024, Dec. 16). *Reviving European Securitisation – Translating Ambition into Reality.*

- **Action:** Adopt a principles-based approach, streamlining overly prescriptive requirements, like recent UK reforms.
- **Impact:** Encourages participation, especially from smaller investors, while maintaining high fiduciary standards.

2. Reform Transparency and Reporting Standards

Granular EU SR reporting requirements create excessive issuance hurdles without adding meaningful value for investors.

- **Action:** Reduce the scope of required data fields, focusing only on key performance and risk indicators.
- **Impact:** Lowers issuer compliance costs, which can surpass €10,000–€31,000 per deal annually for CLOs, facilitating higher issuance and lowering borrowing costs for enterprises.

3. Recalibrate Insurance Capital Requirements

Current Solvency II capital charges for securitized products are disproportionately high compared to their risk profiles, deterring insurance investments. Insurance capital requirements in Europe are higher than in jurisdictions with more developed markets.

- **Action:** Lower capital charges for highly rated securitised products (e.g., AAA CLOs), reflecting their lower risk profile.
- **Impact:** Unlocks insurance sector participation and promotes liquidity while reducing spreads and borrowing costs for European corporations.

4. Revise UCITS Investment Limits

The 10% issuer limit under the UCITS framework restricts fund investment in securitisations. Furthermore, EU regulators treat securitisation investments with extreme caution in the context of UCITS supervision, only allowing limited investment in some securitisations. Supervisors could find comfort in the nearly two decades of sound performance in the most senior securitization tranches (AAA- and AA-rated).

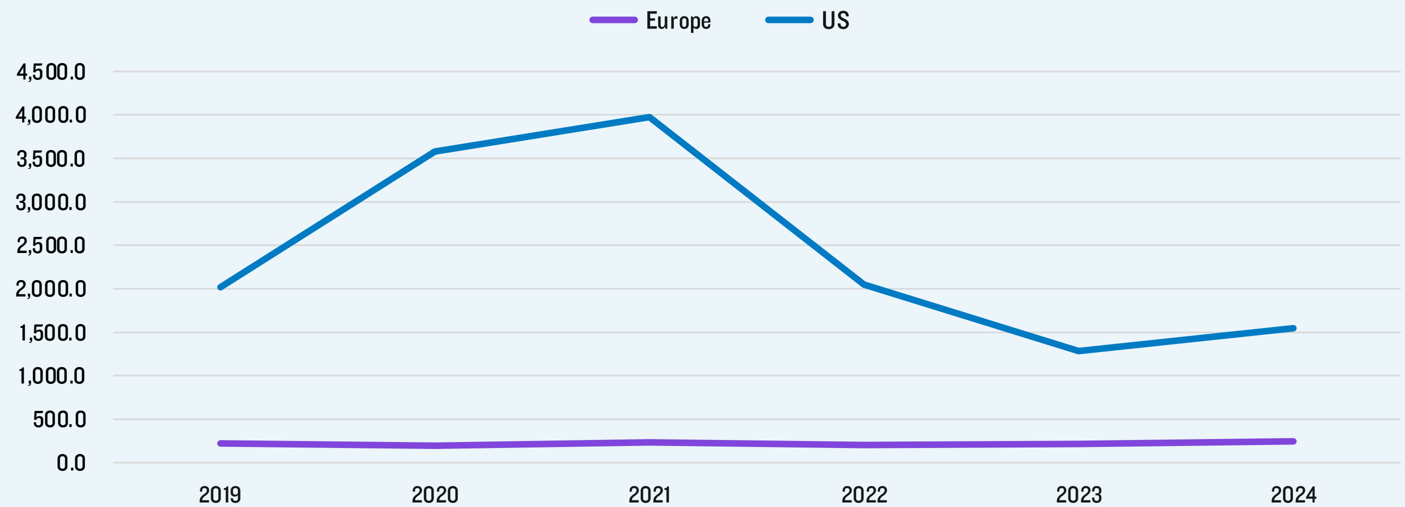
- **Action:** Exempt securitized products from this rule, recognising their inherently diversified nature. Take a risk-based approach to supervision of UCITS investment in securitisation.
- **Impact:** Expand UCITS fund allocations to securitizations, broadening the investor base and supporting market depth and liquidity. This underpins innovation of the European investment fund market.

5. Expand EU Investors' Access to Global Markets

EU regulations restrict investors to securitized assets that adhere to EU standards, leaving them locked out of 75% of the global securitization market.

- **Action:** Align EU standards with global frameworks to enable access to non-EU assets, especially U.S.-originated securities, without additional compliance costs.
- **Impact:** Broader investment opportunities for European institutions will help to boost returns and liquidity while strengthening global competitiveness.

Unequal Trajectories: U.S. and Europe Securitization Issuance
All figures in € Billions



Source: AFME. For illustrative purposes only. Past performance is not indicative of future results.

INVESTMENT VEHICLES

Amidst the public-private convergence, innovation in finance is making credit strategies available to more investors. The development of new investment vehicles is helping to meet demand and democratize access to private credit, fueling growth in retail and high-net-worth channels.

With structures like evergreen and interval funds, investors can redeem a portion of their shares on a periodic basis. In the US, BDCs are a type of closed-end fund that originates loans to small and mid-size companies, and these vehicles are becoming more active in lending directly to businesses. Private credit is beginning to enter the active ETF space as well, providing retail investors with access to publicly traded CLOs. Managers are also beginning to explore new methods of wrapping public and private assets into one ETF to give investors exposure to diverse credits in one vehicle, where liquidity is enhanced through so-called synthetic exposures. Meanwhile, for institutional and high-net-worth investors, separately managed accounts are a bespoke option tailored to meet individual investment goals, including risk exposure, return potential, and tax efficiency.

Collateralized Loan Obligation ETFs

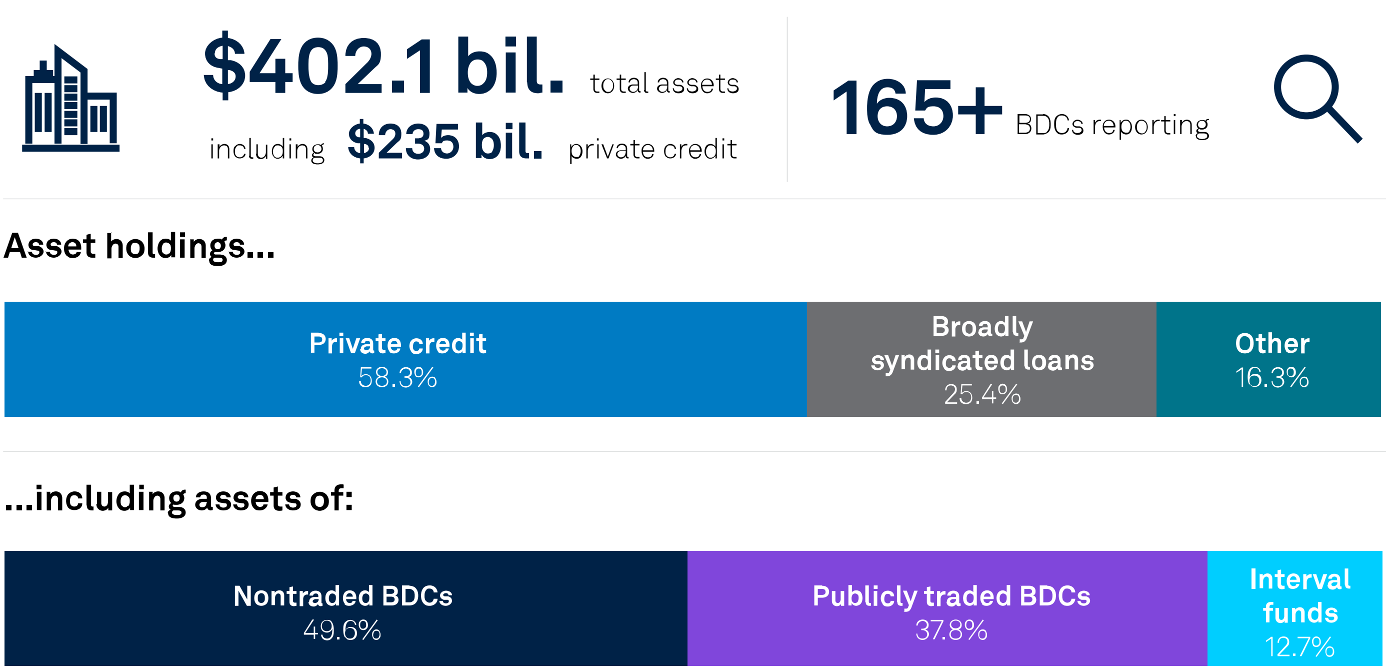
The ongoing potential of a higher-for-longer rate environment continues to drive investors' interest in floating-rate assets such as CLOs. CLO ETF assets under management have seen a nearly five-fold increase from the beginning of 2023 to October 2024, as institutional and retail investors search for high-quality yield and portfolio diversification.[20]

Unlike passive investments that mirror benchmarks, CLO ETFs are all actively managed and differ meaningfully across managers. Even at the AAA space, some managers may choose to reach further down the credit ratings spectrum in exchange for a slight pickup in yield. Others choose to limit the portfolio only to AAA-rated assets. While AAA CLO ETFs may at first appear homogeneous, the composition and credit quality of the underlying portfolios can be vastly different, with junior AAA and even AA tranches comprising a sizeable portion of some portfolios.

Business Development Companies

BDCs have underpinned private credit's growth in the US, where they account for about 20% of the private credit

Spotlight on BDCs: Asset Overview



Source: S&P Global Ratings Private Markets Analytics. Data as of Q2 2024. Provided for illustrative purposes only. Past performance is not indicative of future results.

20. PGIM Fixed Income. (2024, Nov. 7). *Not All AAA CLO ETFs Are Created Equal.*

market. They have amassed more than $400 billion in AUM by the second quarter of 2024, including the roughly 38% that are publicly traded. And as BDCs grow, they are taking a more active approach to lending. By making loans directly to private companies, these BDCs have become a conduit for public investment capital to fund originations in private credit.[21]

BDCs' growth over the last decade-plus has come amid a narrowing gap between their funding costs and those of banks. Banks lost much of their funding advantage after the GFC, while BDCs were able to lend at more competitive rates due to a decline in their relative cost of equity and an increase in leverage.[22] Growth can also be linked to the recent inflationary environment. Private credit funds such as BDCs can provide investors with inflation-hedged income, coupled with lower volatility compared with traditional fixed-income assets.

21. PGIM. (2022). *The New Dynamics of Private Markets.* https://www.pgim.com/pgim-japan/insights/pgim-megatrends-new-dynamics-of-private-market. Accessed April 2025.
22. Bank of International Settlements. (2025, March 11). *The Global Drivers of Private Credit.* https://www.bis.org/publ/qtrpdf/r_qt2503b.htm. Accessed April 2025.

CHAPTER 3

PORTFOLIO IMPLICATIONS

Private credit's maturation as an asset class is giving rise to more choices that allow investors to build a portfolio of both traditional (investment-grade and high-yield debt) and alternative (ABF, real estate, CLOs) allocations.

The public-private convergence calls for a new and improved gameplan. This could include deeper analysis of correlations between public and private assets in the portfolio, both equity and credit; regular liquidity stress testing; better collaboration between analyst teams; and considering fewer public-private boundaries in investment mandates to create more flexibility.[23] Meanwhile, with private credit becoming a key source of financing for a broad swath of industries, investors may need exposure to a blend of public and private assets to help build a portfolio that is truly diversified across sectors, liquidity profile, and region.

HOLISTIC PORTFOLIO CONSTRUCTION

The emerging prominence of private assets will likely compel investors to take a holistic approach to portfolio construction, including comprehensive risk and liquidity management.

Consider insurers as an example. Insurance liabilities are a source of long-term capital that is well-suited for private credit, but matching liabilities with the right assets can be critical. For insurance investment strategies, adhering to asset-liability management (ALM) principles will allow for the proper design, implementation, and monitoring of strategic asset allocations. Private assets including ABF are typically shorter in duration and often floating.

While private ABF can be a source of additional yield, along with spreads that can offer alpha generation potential, it could be complemented with allocations to more liquid and longer-duration assets to mitigate ALM risk. Private ABF strategies also benefit from structural protections, but robust credit monitoring capabilities could be used for early identification of potential issues.[24]

STRATEGIES FOR A NEW CREDIT REGIME

The underlying assets in ABF offer material diversification benefits compared with traditional debt portfolios. Allocations to private ABF could aid investors in building sector and geographic diversification into their portfolios,

23. PGIM. (2022). *The New Dynamics of Private Markets.* https://www.pgim.com/pgim-japan/insights/pgim-megatrends-new-dynamics-of-private-market. Accessed April 2025.
24. PGIM Multi-Asset Solutions. (2025, Jan. 16). *Navigating the Nexus: The Intersection of Insurance and Private Markets.* https://www.pgim.com/pgim-japan/insights/2025-best-ideas/multiasset-solution. Accessed April 2025.

reducing overall concentration risk. Direct lending strategies, implemented through rated feeder and CLO structures, also represent a dynamic approach to capturing noteworthy yields and, for insurers, optimizing regulatory capital requirements. Investors aiming to reduce overall volatility in the portfolio, while pursuing premium returns can find diverse credit opportunities across middle-market and large-cap companies. As managers combine their abilities to originate, underwrite and securitize credit, the emergence of CLO platforms with exposure to the private middle-market space offers a new avenue for investors to gain exposure to direct-lending assets in a capital efficient, structured manner.

An analytical portfolio model can benefit endowments, pensions and other institutional investors in properly managing liquidity and determining the right allocations to private credit. This framework could take into account factors including a public and private market asset allocation, a private asset commitment history, a forward-looking commitment strategy, and unique liquidity demands. With this approach, investors can identify potential liquidity challenges through stress testing and scenario analysis.[25] For instance, a credit strategy leveraging diverse public and private assets, including securitized products and private asset origination, could benefit a large pension plan that is looking to enhance yield but maintain sufficient liquidity to meet plan payments.

PRIVATE CREDIT POTENTIAL IN DEFINED CONTRIBUTION PLANS

Over the medium term, marrying private credit with defined contribution (DC) plans might prove to be the next evolution in retirement investing. DC plans in the US represent an enormous pool of capital that is largely invested in public assets; they held about $11.87 trillion in total assets as of the fourth quarter of 2024, according to the Federal Reserve.[26]

Private credit's ability to diversify existing fixed-income portfolios makes it a potential fit for the DC space. Plan sponsors are in the beginning stages of building solutions for retirees who could benefit from the diversification provided by private real estate and ABF. A majority (56%) of DC plans over $100 million say including private credit in target-date funds would improve long-term performance, according to PGIM DC Solutions' 2025 Defined Contribution Landscape Survey.[27] In order to make private funds accessible within DC plans, daily valuation and built-in liquidity have become common features.

CONCLUSION

As public and private credit emerge from their silos, the interplay between the two calls for investors to rethink how they build diversified portfolios that can meet their risk and return objectives. Investors of all stripes are no longer limited to choosing between public or private assets. So, as credit continues to mature as an asset class, managers and investors must have the agility to keep up with change. Those who can adapt to converging credit markets, identify emerging opportunities, and employ flexible investment and risk-management strategies can position themselves for long-term success. As competition grows, the winners and losers in the era of credit convergence may be differentiated by how well they can assess credit, legal, regulatory and operational risks—and pair this knowledge with a robust technology platform and big data.

25. PGIM. (2022). *The New Dynamics of Private Markets.* https://www.pgim.com/pgim-japan/insights/pgim-megatrends-new-dynamics-of-private-market. Accessed April 2025.
26. Board of Governors of the Federal Reserve System; FRED database. Defined Contribution Pension Funds; Total Financial Assets, Level. https://fred.stlouisfed.org/series/BOGZ1FL594090055Q. Accessed April 2025.
27. PGIM DC Solutions. (2025). *2025 Defined Contribution Landscape Survey.*

A DIVERSE CREDIT SPECTRUM

INVESTMENT IDEA	RATIONALE	CREDIT STRATEGIES
Capture yield premium with lower leverage	• There is potential for direct lenders that can access hard-to-reach deals in the non-sponsored market, which can offer meaningful diversification. • Access to the middle market can deliver better pricing, better terms, and more diversification through unique originations.	**Middle-market and non-sponsored direct lending**
Diversify portfolio of HY and BSL debt	• Private credit could offer lower volatility in exchange for a risk and illiquidity premium. • Large-cap firms, which are increasingly tapping private credit as a funding source, have exhibited growth and margin resilience.	**Large-cap private credit**
Add real estate income with downside protections	• A widening landscape in private real estate markets, featuring a diverse array of property types, gives investors options to deploy capital as valuations near their cyclical bottom. • Data centers are a growing opportunity as capital and financing needs continue to rise.	**Real estate private credit**
Seek reliable cash flows amid market uncertainty	• Shifting supply chains and global trade flows have underpinned demand for private infrastructure funding. • Infrastructure can be noteworthy to institutions due to its long-term and diversifying nature, plus its ability to generate steady and reliable cash flows.	**Infrastructure debt**
Add relative value and diversification	• Spanning credit cards, mortgages, jet leases and more, ABF captures a diverse set of investments with varied sector, quality, and risk exposure. Through ABF, investors can add value and diversification compared with other fixed-income assets. • With lending competition on the rise, investors could take a bottom-up view and leverage tech and big data to assess risks.	**Asset-based finance**

PORTFOLIO IMPLICATIONS

Holistic portfolio construction	• The credit convergence is giving rise to more choices for investors to build a portfolio that blends traditional and alternative allocations. Investors could take a holistic view of credit markets, and understand the public-private interplay, to adequately assess opportunities and risks. • With private credit becoming a key source of financing for a broad swath of industries, investors may need exposure to a blend of public and private assets to help build a truly diversified portfolio. • Deeper analysis of public-private correlations, liquidity stress testing, and fewer boundaries in investment mandates are a few considerations for CIOs in this new regime. • Insurance liabilities are a source of long-term capital that is well-suited for private credit. Adhering to ALM principles will allow for the proper design, implementation, and monitoring of strategic asset allocations.
Strategies for a new regime	• ABF's underlying assets offer material diversification benefits compared with traditional debt portfolios, reducing concentration risk. • Direct lending strategies, implemented through rated feeder and CLO structures, represent a dynamic approach to capturing noteworthy yields and, for insurers, optimizing regulatory capital requirements. • Private credit investment across middle-market and large-cap companies could reduce volatility in the portfolio and generate premium returns compared against existing fixed-income investments.
Credit potential in DC plans	• Marrying private credit with defined contribution (DC) plans might prove to be the next evolution in retirement investing. Private real estate funds are an early entrant into the DC space. • With roughly $11.9 trillion in assets in the US, DC plans represent an enormous pool of capital that is largely invested in public assets. • In order to make private funds accessible within DC plans, daily valuation and built-in liquidity have become common features.

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