MANAGER PERSPECTIVES

PGIM

HEADLINES VS. HEALTH IN PRIVATE CREDIT

Q&A

MATTHEW HARVEY
Global Head of Middle Market Direct Lending

> "Disciplined underwriting enables private credit managers to win by not losing—and that is key in times of market stress."

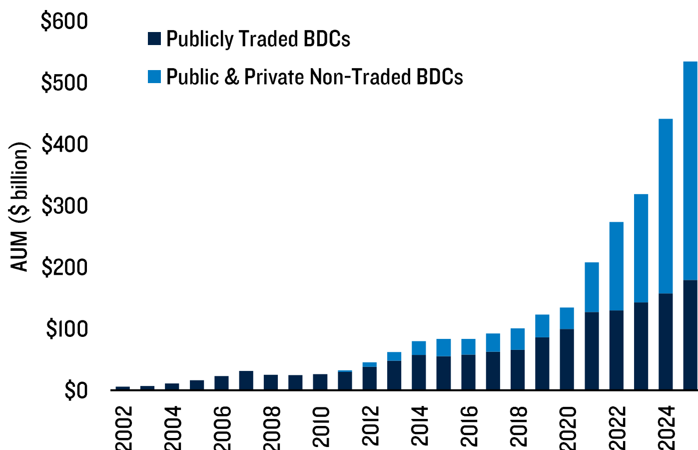
Private credit is in the spotlight, with recent volatility testing resilience and revealing risk across the asset class. Matthew Harvey discusses direct lending conditions, addresses key investor concerns, and explains how PGIM's differentiated and disciplined approach positions investors to weather uncertain environments.

THE STATE OF THE MARKET

Q: How has private credit evolved, and what role has the rise of BDCs played in shaping its growth?

A: Private credit has long been a cornerstone for institutional investors, valued for its enhanced yields and diversification. Demand for direct lending, the largest private credit segment, surged after the Global Financial Crisis as banks scaled back middle-market lending and private equity's reliance on private credit grew. This demand expanded the investor base to include retail participants via business development companies (BDCs). BDC popularity has soared since the first perpetual public non-traded BDC launched in 2021. With $500B+ in assets, BDCs now represent roughly 30% of the ~$1.8T private credit market. This growth has also increased capital availability for larger issuers, allowing direct lending to compete with traditional financing options like syndicated loans and high yield.

BDC assets under management grow to $500+ billion



Source: BDC Collateral, 3Q 2025

Q: Does recent market volatility indicate a bubble in private credit?

A: No. While recent software sector volatility has created headwinds—a trend we expect to continue as the AI transition unfolds—fears of a private credit bubble are overblown. This is not a systemic issue or the start of a macro default cycle. One point to highlight is that banks are often more highly levered (roughly 10x debt to equity) making it difficult to underwrite levered loans. Direct lending funds are generally levered 0–2x and provide a more suitable risk profile for the asset owners involved, provided illiquidity costs are clear.

Despite a potential slowdown in fundraising this year, the direct lending market has matured into a critical component of the global economy. It is well-positioned for sustained long-term growth, supporting more than 200,000 middle-market companies that employ 48 million Americans and generate one-third of U.S. private sector GDP. While the current environment presents challenges, it also creates opportunities for discerning investors.

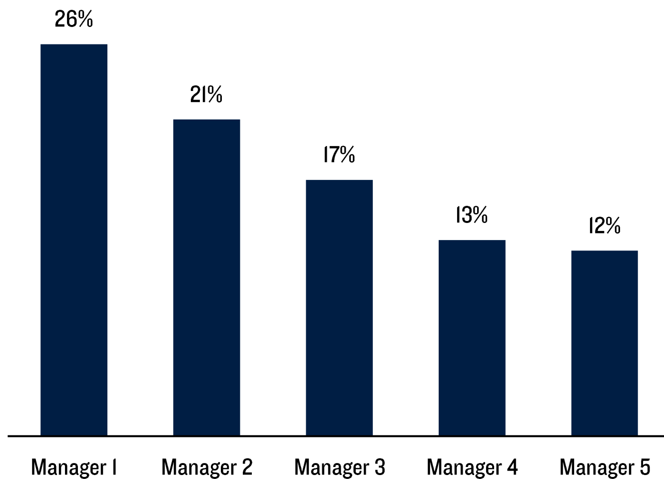
SELECTIVE NOT SYSTEMIC STRAIN

Q: How is the software slump impacting investor sentiment?

A: Concerns about a software selloff have been amplified by recent defaults in other sectors. Software, once favored for its recurring revenue and high margins, makes up over 20% of BDC assets.

Some of the largest BDCs have exposures of 10–20%+, creating potential vulnerability for loans issued at high valuations between 2018 and 2022, based on lofty recurring revenue estimates given typically low recovery rates on intangible assets.

BDCs with largest software exposure



Source: PGIM, manager websites as of 2/28/2026. Holdings subject to change.

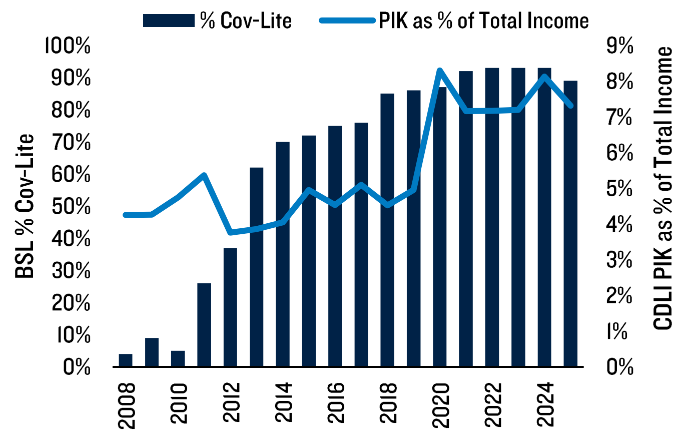
However, these concerns might be overstated. While software stocks are down significantly from recent peaks and AI disruption is looming, many software companies have definable moats. Most of these loans are structured as first-lien senior secured loans with a significant equity cushion. A 35% drawdown on equity value, while negative for the equity owner, doesn't automatically impair the senior loan, even with challenged growth prospects.

However, diversification is a core tenet of credit. Managers who avoided over-concentrating in software during the Covid-era tech supply boom should be well-positioned to navigate these challenges, even if AI disruption persists.

Q. Why are underwriting standards coming under scrutiny?

A: Current market volatility is stress-testing newer and highly levered managers. As competition intensified and higher rates strained borrowers, some managers loosened underwriting standards. They adopted covenant-lite structures, higher entry leverage, and payment-in-kind (PIK) interest, which adds to loan principal instead of being paid in cash. While these practices delivered strong returns in calmer markets, today's volatility reveals their weaknesses and highlights the importance of disciplined underwriting through all market cycles. Portfolios with covenant protections, first lien senior secured positions, and minimal PIK income indicate a higher-quality portfolio and more sustainable dividend yield.

Industry shifts to higher covenant lite and PIK loans



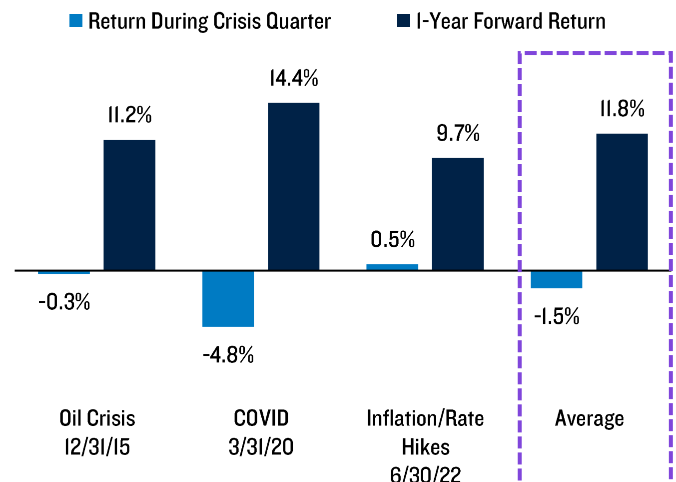
Source: Pitchbook LCD, Cliffwater Direct Lending Report, 3Q 2025. BSL refers to broadly syndicated loans and CDLI refers to the Cliffwater Direct Lending Index.

Q: Given the current dynamics, what is your outlook for private credit? Is it still a good investment?

A: Private credit remains an attractive asset class despite expected near-term volatility. The underlying fundamentals are healthy, and all-in yields still offer a compelling premium over public markets.

History shows private credit's resilience. Since 2015, it has averaged a 9.1% annual return. The year following a crisis, returns have averaged 11.8%. The asset class has had only two negative quarters: during the oil crisis in 2015 and the onset of COVID-19 in 2020. One year later, returns were 11.2% and 14.4%, respectively. After the 2022 rate hikes began, public fixed income fell 5% in the second quarter, while private credit returned 0.5% and delivered 9.7% over the following year.

Private credit resilience through macro uncertainty



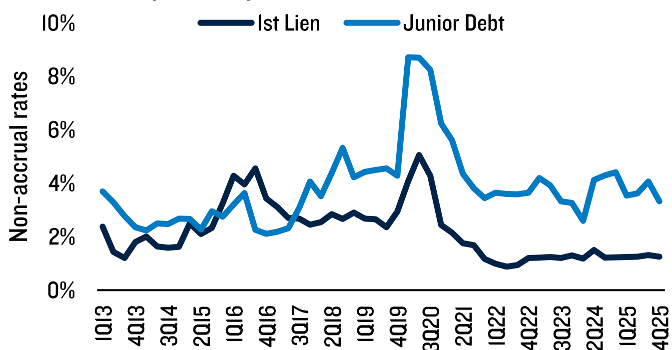
Source: Cliffwater as of 12/31/2025. Based on quarterly data for Cliffwater Direct Lending Index. **Past performance does not guarantee future results.**

Q: How healthy is the private credit market?

A: Private credit portfolio quality remains strong. Over the last decade, the market has shifted toward secured debt, with first-lien loans now comprising nearly 87% of portfolios, versus about 40% in 2008. This move toward higher-quality assets has improved market resilience, though the junior debt segment may face challenges.

While default rates have ticked higher, they remain contained. A key metric is the percentage of loans on non-accrual status (in default). As of the fourth quarter of 2025, the non-accrual rate for first-lien debt is 1.3%, well below the 12-year average of 2.2%. In contrast, the non-accrual rate for junior debt is 3.3%, near its historical average of 3.8%. This suggests first-lien debt is positioned to better weather deteriorating credit conditions than junior debt.

Fundamentally healthy market with contained default risks



Source: Cliffwater Direct Lending Report, 4Q 2025.

VEHICLE CONSIDERATIONS

Q: Why are some private credit funds limiting redemptions? Should investors be concerned?

A: Recent redemption requests are a response to broad market uncertainty, not underlying performance. Some headlines have also led investors to request larger repurchases in anticipation of being prorated. These fund structures are operating exactly as intended. For example, one major non-traded BDC received redemption requests of >11% and met its stated 5% quarterly limit. Another fund with ~8% in requests chose to fulfill its requests by injecting its own capital.

In both cases, the funds upheld their liquidity commitments without suspending distributions. The inherent illiquidity of underlying assets is a trade-off for the return premium and bespoke structure that investors enjoy. This illiquidity makes it unfeasible for forced loan sales to meet redemptions. The gating mechanism is an intentional design, allowing portfolio managers to avoid forced asset sales that could erode value for remaining long-term investors. This demonstrates the structure's resilience, not a weakness.

Q: How do BDCs manage liquidity to ensure they can meet obligations during periods of market stress?

A: BDCs maintain liquidity through diverse sources, such as investor contributions, portfolio income, principal repayments, and credit lines. They also allocate a portion of their portfolio to liquid credit, which can be sold to meet liquidity demands without affecting the value of their core private credit holdings. This multifaceted approach provides long-term stability, enabling adaptation to market changes and the delivery of consistent results.

Q: Why does the BDC structure remain compelling for investors?

A: Unlike closed-end private credit funds with 5–7+ year lock-ups, BDCs are open-ended. Traded BDCs offer daily liquidity but are highly influenced by sentiment, often trading at discounts or premiums to NAV. Non-traded BDCs, priced at NAV and marked monthly, avoid daily volatility, providing greater stability for investors seeking diversification from market sentiment.

Non-traded BDCs allow monthly subscriptions and quarterly redemptions (typically up to 5% of NAV, subject to board approval). This safeguard provides measured liquidity while preserving the illiquidity premium essential to private credit returns. By combining private credit's core strengths—senior secured floating-rate loans and attractive income—with perpetual life and managed liquidity, non-traded BDCs offer an investor-friendly structure. With features such as lower investment minimums, simplified 1099 tax reporting, and immediate access to seasoned portfolios, they remain an appealing option for private credit investors.

Comparing traded and non-traded BDC structures

Feature	Publicly Traded BDCs	Non-Traded BDCs
Liquidity	Daily Trade like a public stock on an exchange	Limited Quarterly redemptions, typically capped at 5% NAV
Pricing	Market Driven Can trade at a premium or discount to NAV	NAV-Based Price updated monthly/ quarterly based on asset value
Volatility	High Correlated with broad equity market sentiment	Low Insulated from daily market swings
Redemption Risk	None Capital is permanent	Structural May gate redemptions if requests exceed caps
Tax treatment	1099 tax reporting	1099 tax reporting
Investor Base	Retail and institutional	Primarily accredited investors

For illustrative purposes only.

OUR DIFFERENTIATED APPROACH

Q: What differentiates your approach and how can that help investors in this environment?

A: Private credit remains an attractive asset class, offering enhanced yield and diversification. As the market enters a new credit cycle, manager differentiation and portfolio diversification are crucial. Many direct lenders chased yield by focusing on large, sponsored deals in sectors like software, leading to significant portfolio overlap. Our distinct edge comes from our differentiated origination, disciplined underwriting, and a conservative credit culture deeply rooted in our insurance heritage. Our strategy is fully aligned with our investors, as we invest alongside them through our parent's general account.

- **Conservative underwriting:** We prioritize companies in stable industries with resilient cash flows and tangible assets. This has resulted in in limited software exposure (<6%) across our direct lending portfolios, shielding investors from the recent software sell-off. Sectors will come in and out of sentiment, and we ensure no single sector represents a significant portion of our exposure. Focusing on senior secured loans with low leverage and protective covenants, we lead or co-lead 90% of our deals to maintain control.
- **Lower and core middle market focus:** We specialize in the underserved lower and core middle markets to secure higher potential yields and more favorable terms.
- **Mix of sponsored and non-sponsored loans:** Our deep sourcing network uncovers opportunities in sponsored and non-sponsored markets. We target larger companies with low leverage in non-sponsored markets and smaller, higher-leverage companies in sponsored markets which helps optimize our risk-return profile and provide greater diversification.

By maintaining rigorous credit discipline, PGIM has helped investors navigate market cycles with consistent results.

Differentiated origination and underwriting

		PGIM	Industry
ORIGINATION FOCUS	Market Segment	Lower and core middle market	Larger market
	Deal Type	Sponsored and non-sponsored	Primarily sponsored
	Industries	Stable, steady growing, cashflow-generating businesses with tangible assets	More concentrated in sectors like tech and health care with greater correlation to asset prices vs. free cash flow
UNDERWRITING PROFILE	First Lien Senior Secured	100% Exclusively senior secured loans	Mix of debt types Can include senior, subordinated, and unitranche loans
	PIK at Origination	0 At origination; limited use in workouts	Commonly used As tool to win deals
	Maintenance Covenants	1–2 Covenants on all deals; quarterly-test for early signs of financial strain	~90% Cov-lite deals[1]
	Entry Leverage	3.4x Debt/EBITDA	4.9x Debt/EBITDA[1]
	Control	Lead or co-lead On ~90% of all direct lending deals	Club deals Commonly used by private equity firms

PGIM as of 12/31/2025 unless otherwise noted. [1] Source: Pitchbook LCD as of 9/30/2025. Represents broadly syndicated loans.

DISTINCT SCALE, ACCESS, AND EXPERTISE

75+	$113B	200+	15
Years of experience	Private credit AUM	Private credit investment professionals	Global offices across the U.S., Europe, and Asia

Source: PGIM as of 12/31/2025.

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