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# Market Turmoil: Proven Strategies for Managing Private Credit Portfolios Through Volatility

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As during the emergence of the COVID-19 pandemic in March 2020, private credit lenders today face the challenge of adapting to rapidly shifting circumstances driven by a volatile macroeconomic landscape. If past is at all prologue, lenders should prepare for borrowers to request flexibility to manage unanticipated cash demands, and to assume control in certain cases where sponsors determine to walk away. In anticipation of increased defaults and restructurings, private credit lenders can bolster their resilience through proactive measures and strategic considerations.

**Communication and Monitoring**. Market instability demands swift responses to emerging challenges, making early, often and open communication with borrowers and sponsors crucial. Loan documents generally contain reporting obligations regarding matters relating to litigation and certain other material events and developments, as well as inspection rights and general information rights. If borrowers fall short in voluntary transparency, these provisions can be instrumental in achieving these objectives. Internally, lenders should refine procedures for monitoring credit quality across their portfolios by implementing robust rating systems, watch lists, and other grading mechanisms to stay ahead of potential risks.

**Enhanced Due Diligence.** Proactive diligence is essential before defaults arise. Private credit lenders should take extra precautions to identify vulnerabilities and incorporate protective terms into documentation. Areas and actions that warrant careful consideration include:

- **Financials & Projections.** Stress-test financials and projections for sustained macroeconomic volatility, including evaluating cash flow projections and the ability of the borrower to manage through multiple quarters of disruptions.
- **Supply Chains.** Assess the robustness of supply chains, factoring in slowdowns and tariff-related delays and impacts.

- **Material Contracts.** Review contract obligations, including performance risks, termination and cure provisions, change of control triggers, and potential litigation exposure.
- **Employment and Key Persons.** Analyze material employment contracts, consider key persons, and evaluate flexibility to adapt the workforce in response to economic pressures.

**Lock-Down Drill / Documentary Tightening.** In addition to enhancing their visibility into each business and its current challenges, lenders should ensure they have full view of the terms of relevant loan documentation. Over the past few years, private credit lenders have underwritten various documentary flexibilities that will now become relevant to some of their credits, so it is crucial that they refresh their understanding of their documents in view of present and anticipated circumstances with a “red flag review” or similar process. For example, if liquidity tightens, lenders should know the company’s ability to incur pari passu or priming debt, and to sell (and lease-back) material assets. Investment committees should ensure portfolio managers thoroughly understand key terms so that they are well positioned to address loose ends when negotiating amendments, forbearances or other modifications.

**Payment Defaults.** Private credit lenders should expect borrowers to take any and all steps to preserve liquidity, including stretching trade payables, deferring rent payments, and, in some cases, requesting to defer interest and/or principal payments to lenders through credit agreement amendments or forbearance agreements. The more information a lender brings to any such discussion, the more successful it will be in responding to it.

**Bringdown of Representations & Warranties**. A borrower is typically required to bring down representations and warranties to access its revolving line of credit, or to incur an incremental financing or delayed draw term loan. Borrowers may be challenged to make certain of these representations, and lenders will be well-served to have a view before receiving the relevant request.

**Refinancing and Debt Buybacks**. The disruption in the syndicated market caused by the effects of macroeconomic volatility and the potential response of the Federal Reserve to reduce interest rates also may present opportunities for borrowers to refinance their existing debt at lower rates or buy back debt at below par. Creditors should refresh on the refinancing and debt buyback provisions, including affiliated lender restrictions. Private credit lenders may be sources of liquidity to facilitate these refinancings or debt buybacks.

**Business Interruption Insurance**. Lenders may want to review the adequacy and scope of borrower's insurance policies, including whether the borrower maintains appropriate business interruption insurance.

**Defaults, Cures, Amendments and Waivers**. The economic impact of sweeping trade policy is rapidly changing every day. As highlighted above, best practices include increased communication among borrowers, sponsors and lenders, general industry monitoring, and stress testing portfolio loans to anticipate issues, including the impact on revenue and the adequacy of liquidity runway. Borrowers may look for ways to avoid a breach by seeking covenant holiday, waivers or other amendments. They also may use equity cures, make prepayments, or even obtain additional equity infusions to help avoid or fix an issue before it becomes a default. While these capital infusions may evidence sponsor confidence and support for the business, they may also change the timing and tenor of restructuring negotiations. In particularly distressed credits, lenders may need to quickly prepare to be tossed the keys in a downside scenario.

**Private Credit Restructuring.** In the current market, borrowers will continue to focus on maximizing and stretching liquidity and managing their creditors to best position themselves to survive the economic fallout caused by recent market volatility. No one can predict how long the storm will last. Companies that entered this cycle in a weakened state are particularly vulnerable. Private credit lenders should expect tough and potentially prolonged negotiations among lenders, sponsors, and borrowers in the months ahead, and likely an uptick in private credit restructurings for those companies with acute exposure to tariffs and supply chain disruption. Even against this uncertain macroeconomic backdrop, the best and most value-maximizing solution for most companies will be out-of-court, consensual restructurings. Direct lenders with available "dry powder" and operational resources will emerge as major stakeholders at the table and may provide rescue or special situations financing as the market regains its footing.

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