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Three Risks to Monitor in Private Credit

The Capital Commitment on **May 20, 2025**

Private credit has become an essential source of financing globally, with fund sponsors enjoying strong demand from borrowers, market participants, and investors. However, as the industry's "golden age" continues, regulatory scrutiny is growing. Media coverage and legislative inquiries have pressured agencies — particularly the SEC — to take action.

For example, the SEC Division of Examinations' 2025 priorities highlight increased focus on private credit firm disclosures. In 2024, the SEC brought a number of first-ever enforcement actions against distressed debt managers for failing to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of MNPI. With regulators emphasizing compliance and oversight, managers must proactively address emerging risks, especially as managers begin marketing to individual investors who, regardless of their wealth, will be viewed by the SEC as "retail."

This post outlines three areas that could become areas of regulatory focus on in coming years: (1) conflicts in bank partnerships, (2) investing across multiple capital structure layers, and (3) valuation challenges. By managing these risks effectively, firms can meet regulatory expectations and protect the interests of the firm and their clients.

Conflicts – Deal Sourcing Arrangements

As private credit institutionalizes, banks and capital providers increasingly form partnerships that leverage their respective strengths. Banks often originate and service loans, while private credit firms provide funding — benefiting from favorable regulatory treatment and long-term capital. While these partnerships offer strategic advantages, they also pose potential regulatory challenges.

Private credit firms must ensure their fund disclosures consider these arrangements and carefully draft agreements in line with fiduciary obligations. Many partnerships provide credit firms with preferred access to bank-originated loans. While this is often framed as a “first look” rather than a commitment to fund every deal, consistently approving nearly all presented opportunities could raise concerns about underwriting rigor and disclosure accuracy.

Conflicts may also arise when banks extend favorable credit terms to longstanding clients, particularly those engaged across multiple business lines. Unlike banks, private credit firms may not benefit from these broader relationships. If a credit firm agrees to terms not based on an independent borrower assessment but rather to maintain its bank partnership, regulators could perceive a conflict between securing future deal flow and ensuring risk-adjusted returns for investors.

To mitigate risks, firms should evaluate whether their investment decision-making process and disclosures accurately reflect the realities of these partnerships.

Capital Structure – Managing Multi-Strategy Conflicts

Historically, private fund managers specialized in either credit or equity, simplifying conflict management. However, when a buyout firm launches a credit strategy — or a credit firm expands into equities — conflicts become more complex.

Investing across a company’s capital structure can create misalignment between funds. A firm managing both debt and equity stakes may encounter scenarios where the credit fund prioritizes downside protection while the equity fund seeks maximum upside. These risks intensify in distressed situations, where firms controlling restructurings must balance competing fund interests.

Even when firms do not invest across multiple capital levels, conflicts may arise. For example, if a company seeking debt financing is also a potential buyout target, questions may emerge over which fund should receive investment priority.

To mitigate these risks, firms should ensure clear compliance policies, conflict management frameworks, and independent oversight mechanisms. Disclosures should transparently outline how funds allocate opportunities and manage competing interests, particularly in times of distress.

Calculating Values – Heightened Scrutiny on Valuation Policies

Private fund sponsors are well-versed in the valuation of illiquid assets, but structural aspects of the credit markets have intensified regulatory scrutiny. Unlike traditional buyout funds — where portfolio company valuations are complex but typically controlled by a few owners — certain credit assets are widely held, including by BDCs and other investors subject to public reporting. Yet, despite broader ownership and increasing reliance on third-party valuation firms, these assets can be just as difficult to value as private equity investments. Firms may assign different values to the same credit investment based on their own policies, internal models and subjective evaluation of available data. While valuation discrepancies among firms are not itself problematic (and to be expected), this has sparked media scrutiny and regulatory attention. To reduce risk, firms should ensure their valuation policies are well-documented and effectively applied—particularly in scenarios not initially anticipated. Buyout firms expanding into credit may need to refine their valuation processes to align with the asset class. Regularly reviewing valuation practices can help maintain credibility with investors and regulators alike.

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