

Private Credit's Quiet Move Into Corporate America

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TL;DR

A structural stress test is unfolding across the private credit landscape as direct lenders orchestrate an abrupt retreat from software sector concentration in response to generative artificial intelligence threats. While a steady rise in payment-in-kind (PIK) amendments is helping stressed borrowers defer cash interest payments and mask the true extent of credit distress, institutional allocators remain undeterred, projecting the industry to expand to \$3.4 trillion by 2030. Consequently, the ultimate default risk is shifting away from traditional banks and concentrating heavily within the balance sheets of yield-hungry insurers and pension funds.

The AI-Driven Software Underwriting Retreat

Direct lenders are aggressively scaling back their exposure to the technology sector as generative artificial intelligence threatens the cash flows of their core software borrowers.

"There is increasing risk that AI labs like OpenAI and Anthropic expand downstream into enterprise applications such as Salesforce Inc." — AI and SaaS Concentration Risk

"The proportion of software issuers among credit-estimated companies fell to 11.2% in April 2026, down sharply from 16.7% in March 2026." — AI and SaaS Concentration Risk

As analyzed by CNBC, the rapid advancement of generative models is eroding the pricing power of customer-facing software applications, which historically served as a stable cash cow for direct lenders AI and SaaS Concentration Risk. This sudden structural shift is forcing managers to actively rein in software underwriting to prevent severe portfolio concentration shocks AI and SaaS Concentration Risk.

What to watch: Whether this rapid tech pullback leaves highly leveraged software rollups unable to secure refinancing.

The Soft-Default Surge and the PIK Trap

Borrowers are increasingly relying on payment-in-kind arrangements to delay formal defaults, creating a growing gap between reported credit performance and actual cash generation.

"...the percentage of borrowers securing PIK toggles through amendments to existing credit agreements has risen steadily every month in 2026: January 2026: 3.38%... April 2026: 6.63%" — Record 6.0% Private Credit Default Rate

"Our updated perspective points to a meaningful increase in private credit defaults, rising from roughly 4.4% to 9–10%, driven in part by the implications of the AI cycle..." — Record 6.0% Private Credit Default Rate

According to data published by S&P Global Ratings, the steady monthly rise in PIK amendments reflects intense cash-flow pressures on middle-market companies Record 6.0% Private Credit Default Rate. While these "soft" restructurings temporarily keep formal bankruptcies at bay, strategists warning on CNBC suggest defaults are poised to double as the cash squeeze intensifies Record 6.0% Private Credit Default Rate.

What to watch: How retail interval funds handle expected withdrawal requests in June as these cash-dry, PIK-heavy portfolios face liquidity pressures.

The Contagion Web Linking Insurers and Pension Funds

The systemic risk of private credit is shifting away from traditional banks and concentrating heavily inside the balance sheets of life insurance companies and pension funds.

"Banks' direct losses were 'contained,' not exceeding 1.3% of total equity... Insurers faced the largest absolute losses due to their larger, less senior exposures and equity holdings." — The \$322 Billion Hidden Leverage Chain

"...private credit assets held by U.S. life insurers grew more than 20% in 2025, reaching approximately 10% of total assets, and exceeding 15% for private equity-affiliated insurers..." — The \$322 Billion Hidden Leverage Chain

A simulated market shock published by the European Central Bank on Reuters confirms that traditional banks have insulated themselves via senior-secured subscription lines, leaving yield-hungry insurers and pension funds to absorb the bulk of direct credit write-downs The \$322 Billion Hidden Leverage Chain. This concentration is equally pronounced in the United States, where Barclays analyzed that life insurers have rapidly expanded their direct lending books The \$322 Billion Hidden Leverage Chain.

What to watch: Whether the U.S. Treasury Department's newly assembled team proposes stricter capital rules for PE-affiliated insurers.

Resilient Institutional Capital Defies the Headwinds

Despite escalating default rates and regulatory warnings, institutional allocators are doubling down on private credit and driving the market toward a projected multi-trillion-dollar expansion.

"...the industry is projected to grow from its current \$2 trillion in assets under management (AuM) to \$3.4 trillion globally by 2030." — Institutional Investors Continue Allocations

"More than half of surveyed credit portfolio managers are 'not concerned at all' or 'only slightly concerned' about an increase in defaults over the next one to two years." — Institutional Investors Continue Allocations

As outlined in WealthBriefing's summary of PwC's Global Private Credit Fund Survey 2026, the structural drivers of direct lending are so robust that the vast majority of credit portfolio managers expect increased allocations over the next year Institutional Investors Continue Allocations. Direct lenders view defaults as a

localized, manageable cost of doing business, meaning that intense competition for high-quality deals remains their primary threat Institutional Investors Continue Allocations.

What to watch: Whether the flood of new capital further compresses yields and forces managers to accept weaker covenant terms to win deals.

What surprised us

- **The Velocity of the Software Pullback:** While the software sector has been under scrutiny for months, the sheer speed of the underwriting retreat is startling. According to S&P Global Ratings, the proportion of software issuers among credit-estimated companies plunged from 16.7% to 11.2% in a single month [ai-saas-concentration-private-credit-underwriting-maturity-wall]. This proves lenders are actively executing an emergency exit from SaaS concentration rather than slowly phasing it out.
- **Banks Excel at Risk Transference:** Traditional commercial banks have successfully insulated themselves from direct private credit risk. The European Central Bank's simulated market shock revealed that banks' direct losses would be capped at a minor 1.3% of total equity, whereas insurers and pension funds would bear the absolute brunt of direct asset write-downs and secondary pricing hits [bank-insurer-private-credit-exposure-fsb-ecb-2026].
- **The Cognitive Dissonance of Portfolio Managers:** Despite Fitch clocking a record 6.0% default rate [private-credit-default-rates-software-systemic-risk-2026], more than half of surveyed portfolio managers claim they are "not concerned at all" or "only slightly concerned" about default levels [institutional-investors-private-credit-allocations-evergreen-2026]. They are far more worried about losing deals to competitors than they are about their existing borrowers going bust.

Appendix: Findings

AI and SaaS Concentration Risk in Private Credit — Underwriting Deterioration and Maturity Wall

The intersection of private credit and artificial intelligence disruption is producing a structural stress test concentrated in software and Software-as-a-Service (SaaS) lending. While software investments were long considered a highly stable cash cow for direct lenders, the rapid rise of generative AI is disrupting traditional business models, slowing growth, and driving a notable retreat by private credit managers from new software credit estimates.

The AI Threat to Software Collateral

For years, private credit funds aggressively backed software rollups and SaaS companies, attracted by recurring subscription revenues. Today, software represents a massive concentration of collateral, accounting for **19% of total assets** for private credit collateralized loan obligations (middle-market CLOs), according to S&P Global Ratings.

However, the rapid advancement of artificial intelligence models is eroding the pricing power of customer-facing software applications. Bank of America analyst Tal Liani highlighted this threat, noting:

"There is increasing risk that AI labs like OpenAI and Anthropic expand downstream into enterprise applications such as Salesforce Inc."

This structural shift is leading to slowing growth, contract cancellations, and margin compression across the software sector. UBS strategist Matthew Mish warned on May 28, 2026, that this AI-driven deterioration will be a primary catalyst for a spike in private credit defaults:

"Our updated perspective points to a meaningful increase in private credit defaults, rising from roughly 4.4% to 9–10%, driven in part by the implications of the AI cycle... Risk is expected to evolve over the next year, intensifying toward year-end and into early/mid-2027 as software businesses experience slowing growth, waning pricing power, margin compression, and contract cancellations."

S&P Data: Managers Retreat from New Software Underwriting

In response to these mounting concentration and AI risks, private credit managers are actively reining in their exposure to new software lending. S&P Global Ratings' SF Credit Brief, published on May 27, 2026, revealed a dramatic pullback in software underwriting:

- **The proportion of software issuers among credit-estimated companies fell to 11.2% in April 2026**, down sharply from **16.7% in March 2026**.

This pullback reflects growing caution among managers who are looking to diversify their portfolios away from software concentration. S&P also noted that software and healthcare issuers reviewed in March and April 2026 had significantly smaller EBITDA sizes compared with previous months, indicating that larger software deals are drying up or returning to traditional syndicated bank markets.

Bank Exposure to Software Debt

The software concentration risk extends directly into the traditional banking sector, which has provided substantial leverage to these funds. Wells Fargo, for example, disclosed in May 2026 that **17% of its \$36 billion corporate debt portfolio** carries software sector exposure.

As software businesses face slowing growth and contract cancellations, both banks and private credit funds are bracing for a wave of downgrades and restructurings. In its May 26, 2026 financial stability review, the European Central Bank (ECB) simulated a severe shock to the private credit market and specifically warned that "loans to software firms in correlated leveraged debt markets" would be a major transmission channel for contagion, leading to material second-round revaluation losses for insurers and pension funds.

Sources

- AI is boosting the stock market. But it's a threat to private credit
- SF Credit Brief: U.S. Private Credit CLO Insights 2026: Another Month Of Stable Performance; Software Declines As A Proportion Of New Credit Estimates
- Rising Private Credit Defaults Are Testing Banks And Insurers
- Private Credit Losses May Hit Insurers More Than Banks, ECB Says

Fitch Reports Record 6.0% Private Credit Default Rate in April 2026 as Distressed Restructurings and "Bad PIK" Squeeze Portfolios

The U.S. private credit default rate hit a record high of 6.0% in April 2026, driven by a wave of distressed restructurings, maturity extensions, and payment-in-kind (PIK) toggles. While the industry has historically relied on "amend-and-extend" maneuvers to defer pain, credit strategists are warning that a major default cliff is approaching as macroeconomic pressures, particularly from the artificial intelligence cycle and elevated interest rates, weigh heavily on borrowers.

Record Defaults and Distressed Restructurings

Fitch Ratings registered a record-high 6.0% annual default rate in April 2026, clocking 99 defaults over the 12 months ended in April. These defaults include interest payment deferrals, maturity extensions under duress, and payment-in-kind (PIK) toggles, rather than just conventional bankruptcies. Proskauer's Private Credit Default Index, which tracks 697 loans totaling \$189.2 billion, similarly reported a sharp rise in defaults, reaching 2.73% in Q1 2026, up from 1.84% just two quarters prior.

UBS strategist Matthew Mish warned on May 28, 2026, that default rates are poised to double from their current baseline:

"Our updated perspective points to a meaningful increase in private credit defaults, rising from roughly 4.4% to 9–10%, driven in part by the implications of the AI cycle... Risk is expected to evolve over the next year, intensifying toward year-end and into early/mid-2027 as software businesses experience slowing growth, waning pricing power, margin compression, and contract cancellations."

The Rise of PIK Amendments

To avoid formal defaults, a growing number of private credit borrowers are relying on payment-in-kind (PIK) toggle features, which allow them to pay interest with additional debt rather than cash. According to S&P Global Ratings' SF Credit Brief published on May 27, 2026, while the proportion of *new* loan agreements with PIK toggles at issuance has declined, the percentage of borrowers securing PIK toggles through *amendments* to existing credit agreements has risen steadily every month in 2026:

- **January 2026:** 3.38% of reviewed credit-estimated issuers had PIK toggle amendments
- **February 2026:** 5.01%
- **March 2026:** 5.76%
- **April 2026:** 6.63%

This steady monthly rise in PIK amendments indicates that existing borrowers are increasingly facing cash flow pressure and are negotiating with private credit managers to defer cash interest payments.

Institutional and Retail Stress

The rising default pressure is beginning to affect middle-market collateralized loan obligations (MM CLOs). As of May 26, 2026, S&P Global Ratings placed 11 ratings from four MM CLO transactions on CreditWatch negative. S&P noted that six MM CLO transactions are now failing one or more junior coverage tests, and several transactions have had overcollateralization (O/C) ratio numerator haircuts due to defaults or deferring assets.

Meanwhile, retail interval funds are facing a looming liquidity test. DoubleLine Capital CEO Jeffrey Gundlach noted:

"Beware the ides of June... You're going to get humongous withdrawal requests from these interval funds in June, and I think that's going to be a catalyst for more angst."

Sources

- AI is boosting the stock market. But it's a threat to private credit
- Rising Private Credit Defaults Are Testing Banks And Insurers
- SF Credit Brief: U.S. Private Credit CLO Insights 2026: Another Month Of Stable Performance; Software Declines As A Proportion Of New Credit Estimates

The \$322 Billion Hidden Leverage Chain: FSB and ECB Warn of Bank and Insurer Interconnections in Private Credit

As the global private credit market expands to \$2 trillion, international financial regulators are sounding alarms over the complex, opaque web of leverage and interconnections linking private funds, insurance companies, pension funds, and traditional banks. In late May 2026, the European Central Bank (ECB) published a detailed stress test simulation revealing that European insurers and pension funds would bear the brunt of a "severe" shock to the private credit market, while banks' direct losses would remain contained but highly concentrated.

The ECB's Simulated Severe Shock

On May 26, 2026, the ECB published an "illustrative exercise" simulating a severe shock to the private credit market. The simulation tracked three cascading stages of contagion:

1. **Direct private credit losses:** Capital write-downs on direct loans.
2. **Software sector spillovers:** Hits to loans extended to software firms in correlated leveraged debt markets.
3. **Second-round market revaluations:** Broader market revaluations affecting equity and debt holdings.

The simulation's findings highlighted a stark divergence between banks and non-bank financial institutions:

- **Banks' losses contained:** Banks' direct losses were "contained," not exceeding 1.3% of total equity, thanks to the seniority of their loans to private credit funds (e.g., subscription credit lines and warehouse facilities) and the relatively small size of their direct positions.
- **Insurers and Pension Funds hit hardest:** Insurers faced the largest absolute losses due to their larger, less senior exposures and equity holdings. Pension funds suffered the most severe damage relative to total assets when factoring in all three stages of the shock.

According to the ECB, euro area exposures are highly concentrated within a small number of large institutions, totaling:

- **Insurers:** €211 billion (2.3% of total assets)
- **Pension Funds:** €52 billion (1.4% of total assets)
- **Banks:** €62.5 billion (0.2% of total assets)

U.S. Insurer and Bank Vulnerabilities

The interconnections are equally pronounced in the United States, where life insurers have aggressively grown their private credit exposure. A Barclays analysis found that private credit assets held by U.S. life insurers grew more than 20% in 2025, reaching approximately 10% of total assets, and exceeding 15% for private equity-affiliated insurers (such as Apollo-backed Athene and KKR-backed Global Atlantic).

This rapid expansion has drawn the attention of the U.S. Treasury Department, which has assembled a dedicated team to assess insurer exposure and plans to hold meetings with state insurance regulators on these emerging risks.

Traditional banks are also heavily interconnected as behind-the-scenes lenders. By late 2025, Moody's estimated that U.S. banks had extended nearly \$300 billion in credit to private credit funds, Business Development Companies (BDCs), and middle-market CLOs.

Several global banks have disclosed massive exposures:

- **Deutsche Bank:** Disclosed \$30 billion in private credit exposure in March 2026, warning of "potential indirect credit risks through interconnected portfolios and counterparties" — a disclosure that triggered a sharp decline in its stock price.
- **JPMorgan Chase:** Disclosed \$22.2 billion in direct exposure by mid-2025 and has begun selectively marking down private credit loans.
- **Citigroup:** Reported a \$22 billion corporate private credit book under active monitoring.
- **Wells Fargo:** Disclosed that 17% of its \$36 billion corporate debt portfolio carries software sector exposure.

JPMorgan CEO Jamie Dimon warned in his 2026 shareholder letter that:

"Private credit losses will be 'higher than expected' and criticized the industry's lack of 'rigorous valuation marks.'"

The Federal Reserve has since formally queried major banks about their private credit exposure to map out potential systemic contagion channels.

Sources

- Private Credit Losses May Hit Insurers More Than Banks, ECB Says
- Euro zone may face pockets of stress from private credit, not systemic risk: ECB
- Rising Private Credit Defaults Are Testing Banks And Insurers

Institutional Investors Continue Allocations Despite Private Credit Headlines

Despite a surge in defaults, regulatory scrutiny, and high-profile restructuring headlines, institutional investors remain highly committed to private credit. The structural drivers of the asset class — including bank regulatory capital requirements and corporate borrower demand for bespoke financing — continue to fuel long-term growth projections. According to PwC's Global Private Credit Fund Survey 2026, released in late May 2026, the industry is projected to grow from its current \$2 trillion in assets under management (AuM) to \$3.4 trillion globally by 2030.

Strong Allocation Intentions

The PwC survey, which captured insights from over 120 credit portfolio managers across the U.S., UK, Europe, Middle East, Asia, and Australia, highlights robust institutional investor appetite:

- **81% of managers** expect to receive increased allocations over the next 12 months.
- **44% of managers** expect those allocations to increase by more than 20%.

This resilient fundraising outlook stands in sharp contrast to the negative headlines. Many giant state pension funds — including those in California, Arizona, Kentucky, Virginia, and other states — maintain significant private credit exposure and appear committed to maintaining or expanding their allocations.

Portfolio Managers' Outlook on Defaults

While regulators sound alarms, private credit portfolio managers themselves express a high degree of confidence about their underwriting. The PwC survey revealed that:

- **More than half** of surveyed credit portfolio managers are "not concerned at all" or "only slightly concerned" about an increase in defaults over the next one to two years.
- **Less than 20%** of managers expressed serious concern about rising defaults.

Instead of a broad systemic collapse, managers view rising defaults as a localized and manageable trend. They expect stress to be concentrated in specific sectors over the next 12 to 24 months:

- **Consumer and retail:** 56% of managers expect acute stress here.
- **Automotive:** 42%
- **Hospitality and leisure:** 27%
- **Technology:** 24%

Competition Overriding Default Concerns

For most managers, the primary threat to performance is not credit defaults, but rather the intense competition for high-quality deals. Two-thirds (67%) of respondents cited greater competition as the primary driver impacting fund performance in 2026, followed by credit defaults and losses (64%).

This intense competition is driving margin compression and forcing managers to put a greater emphasis on investment selection, downside protection, and operational efficiency, including the

adoption of technology in underwriting.

Sources

- Private Credit Funds Industry Projected To Grow Significantly – PwC Report
- AI is boosting the stock market. But it's a threat to private credit