Private Credit Insights: Juvenile Delinquency

Despite recent bankruptcy headlines causing jitters in private credit markets, most corporate balance sheets remain healthy. But we need to talk about some of this messy lending.

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Key takeaways

- Defaults by First Brands, Tricolor, and Renovo seem indicative of some private high yield and broadly syndicated loan managers relaxing lending discipline to win deals in a market where lender supply outweighs borrower demand.
- **The good news:** Most corporate balance sheets remain healthy, and investment grade private credit underwriting standards—including here at Voya—haven't budged.
- **The bad news:** Hidden trouble can lurk in private credit portfolios that regularly compromise on structure and documentation. We show you where to find the skeletons in the closet.
- **The bottom line**: Private credit returns are increasingly likely to bifurcate between managers with experienced teams who maintain tight covenants and rigorous underwriting, and managers who are compromising on pricing, credit, and/or structure.

Investment grade private credit defaults have been negligible over the past year.

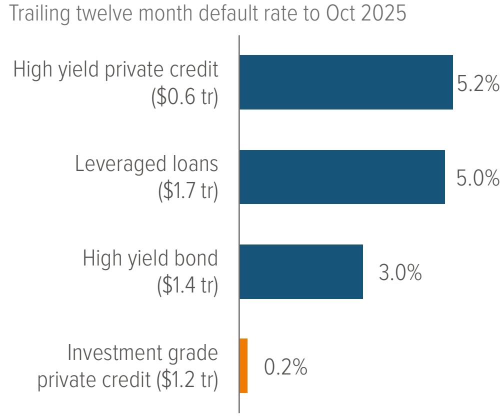
Hog wild

A thing I think about a lot these days is the old saw, "Bulls go to the bank, bears go to the bank, and hogs go to slaughter." We all know in our hearts that 2025 was a toppy year in the markets. It started with managers being pressured to stretch traditional underwriting discipline in the private market, driven by thin corporate bond spreads, copious dry powder, and deal competition from banks. Not every manager acted on it, but the temptation was sure there.

It's not surprising that this toppiness is now flowing into losses in some portfolios.

Exhibit 1: Reports of private credit's demise have been greatly exaggerated

Trailing twelve month default rate to Oct 2025



As of 11/21/25. Source: Fitch Ratings, Voya IM estimates. Numbers in parentheses represent estimated total market sizes. Default measurement includes interest deferrals and stressed extensions.

So far, the bankruptcies that have made headlines have involved primarily the leveraged loan and high yield private credit markets, but journalists have labeled it all "private credit."

What makes it trickier is that some of these loans were included in public CLOs, and Tricolor also had publicly traded subprime auto ABS securitizations. Due to waterfall payment structures, those securitizations all had senior, investment grade tranches—even though none of these borrowers were ever investment grade themselves.

Believe me, I understand why this gets confusing for non-specialists. But even so, there are two important points to keep in mind about private credit right now.

Nobody ever talks about investment grade private credit

The first is that the majority ($1.2 trillion) of private credit is investment grade, and it has a negligible default rate (Exhibit 1).

Investment grade private credit doesn't make headlines because most journalists don't even know it exists. That's because it's usually held in SMAs on insurance company balance sheets or in comingled trusts for pension funds. This differs significantly from the high yield private credit market, which tends to exist as closed-end direct lending funds or as business development companies (BDCs).

You also don't hear about investment grade private credit because it doesn't tend to do newsworthy things. All of it is NAIC rated, and 2/3 of it carries an NRSRO rating at the issuer or placement level. Its underwriting practices tend to be the most rigorous in all of lending.

So if you wouldn't sell out of investment grade corporate bonds because a junk bond defaulted, don't avoid investment grade private placements because a couple high yield managers cut corners.

High yield private credit is still mostly fine

Even in the $600 bn high yield private credit market, default rates are not yet at concerning levels. Dig further into October's default rate of 5.2% and it breaks down into a 10.9% trailing default rate for borrowers with EBITDA under $25 mn and then a much lower default for larger companies (2.9% for borrowers with $25-50 mn EBITDA)[1].

The optimist would take from this that high yield private credit remains quite healthy. The pessimist would say that the big trouble hasn't hit yet.

The truth, as always, is somewhere in the middle.

The de-risking trade

Why some insurers are raising investment grade private credit allocations

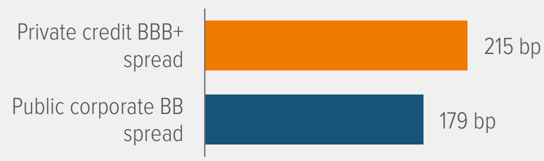
With corporate bond spreads historically tight, risk is skewed asymmetrically to the downside should the economic outlook worsen and credit curves decompress.

A compelling way to rotate up in credit quality right now is to shift some allocations out of high yield bonds and into investment grade private credit.

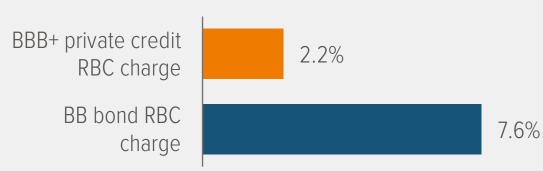
The trade is simple: BBB+ private placements currently have higher spreads than BB public bonds, while also offering potentially lower credit losses.

The trade is especially attractive for insurers looking to optimize portfolio efficiency, due to investment grade private credit's much lower risk-based capital charge.

Moving from high yield bonds to investment grade private credit can increase spread ...



... While reducing capital charges for insurers



As of 12/12/25. Source: FRED, Voya IM.

[1] As of 11/21/25. Source: Fitch Ratings.

Inside our due diligence process

Voya's investment grade and high yield private credit teams use a number of legal protections to mitigate risk. These include contractual constraints on the borrower to prohibit an honest actor from taking actions that would unduly increase credit risk.

We also work to prevent fraudulent action and other potential malfeasance via the use of conditions, reporting, verifications, certifications and other measures under available statutory and regulatory regimes, as well as third-party authentication and advisory expertise. Here's a sampling of our risk mitigation steps:

Lien verification and representations

- Counsel conducts lien searches to detect preexisting liens filed by third parties.
- UCC financing statements are filed to perfect security interests and to provide public notice to alert other potential lenders.
- Lenders perfect liens on accounts by taking control, including through deposit account control agreements.
- Counsel issues legal opinions re: enforceability, legality, and perfection of security interests, shifting some of the legal risk if there are undisclosed liens.
- Closing conditions include, among others, borrower representation and warranties (no liens other than those scheduled, then-current status and ranking of debt with all other obligations, government approvals, disclosure of leases and purchase obligations, schedules of affiliates, schedules of material litigation, schedules of material indebtedness, compliance with tax filings, employee benefit matters, sanctions, etc.), payoff arrangements of existing liens, title searches and lien searches, proper UCC filings, mortgages, and other security instruments, as well as conditions tailored to each project, borrower, fund, or deal.
- In the event of a default, acceleration and enforcement is permitted where issuer or borrower breaches obligations (such as those listed above), makes material misstatements, etc.

Collateral verification

- Appraisals for real estate, material equipment and other project components, coupled with minimum loan-to-value thresholds, are required.
- Issuer or borrower certifies the perfection of collateral at closing.
- Collateral agent acts on behalf of noteholders or secured lenders to ensure collateral is continuously perfected and maintained.
- Access to records and ability of lenders to conduct inspections is ensured.

NRSRO and NAIC ratings

- Ratings from third-party rating agencies that conduct independent due diligence are obtained and maintained.

Intercreditor agreements

- Intercreditor agreements establish priorities and procedures among creditors for taking enforcement action, bringing claims, monetizing collateral, and sharing distributions, among other things.
- Cross-default clauses to other material credit facilities or project documents help ensure overall borrower discipline.

Covenants

- Negative covenants limit indebtedness, liens, related party transactions, investments, speculative transactions and derivatives risk, asset sales, change of control, changes to corporate structure and business undertakings, accounting changes, document amendments, and impairment of security, among many others.
- Anti-Cookson clauses prevent securing any permitted additional material credit facilities without equally and ratably securing our debt.
- Financial covenants constrain debt service coverage ratios, leverage ratios, debt-to-equity ratios, loan-to-value ratios, liquidity ratios, and/or asset coverage ratios, and we monitor financial performance so that headwinds are identified and addressed proactively.
- Affirmative covenants require quarterly and annual financial reporting with quarterly compliance certificate deliverables, annual audited financials, disclosure of material adverse events, and other obligations of the issuer or borrower to maintain status quo and ongoing delivery of certifications, subsidiary guarantees, default reports, compliance with applicable laws (including anti-money-laundering and sanctions), and a host of other deal-specific terms.

Additional guarantees and support

- Various forms of credit support (subsidiary and parent guarantees, sponsor guarantees, minimum equity contributions, equity pledges, default cash sweeps, debt service reserves, hedges, performance bonds, etc.) are required.
- Upstream distributions and other payments are restricted unless certain metrics are satisfied, including absence of default, project completion, DSCR test, etc.

"You're not paid to do due diligence in this market"

Some high yield managers are sacrificing documentation and covenant quality to deploy capital.

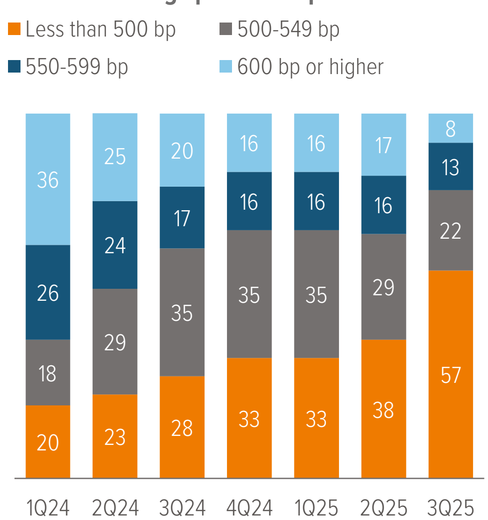
While our high yield private credit team, like the entire Voya private credit team, has weathered multiple credit cycles and uses that experience to be extremely rigorous on collateral, pricing, and structure, we are seeing declining documentation and covenant quality—and even subordination—from some high yield lenders.

This is happening for two reasons. The first is strong capital deployment pressure stemming from the half a trillion dollars in dry powder in high yield private credit funds.[2]

The second is aggressive competition from banks on both pricing and structure. Broadly syndicated loan pricing has tightened by over 200 basis points (bp) over the past two years to around 285 bp, along with the addition of private-credit-like options such as delayed draws. This undercutting has helped push down high yield private credit's median spread below 500 bp in 3Q25, from 650 bp in 1Q23 (Exhibit 3).[3]

Performance dispersion is likely to increase across private credit managers.

Exhibit 3: Fierce competition for direct lending deals is causing spread compression



As of 11/30/25. Source: Configure Partners.

Some lessons in lending you only learn the hard way, and school is now in session.

The fundamental issue here is that some managers across private credit and leveraged loan markets will consistently underwrite better than others. This hasn't been as noticeable while both the economy and the corporate credit cycle have been in an upswing. However, as the credit cycle starts to turn while PE exits (and thus loan repayments) remain sluggish,[4] that performance disparity will become more obvious.

Private credit's comparatively recent broadening in popularity as an asset class also means that there are a lot of managers who haven't lived through multiple credit cycles. That matters—there are lessons in lending you only learn the hard way. I fear that in 2026, school may be in session for some newer managers.

High yield private credit, investment grade private credit, and leveraged loans all still have their place in institutional and insurance portfolios. But careful manager vetting will be increasingly critical for sustaining the elevated returns these markets can provide—and for avoiding lenders who pass off a credit loss by saying, "You're not paid to do due diligence in this market."[5]

How to hide a body in private credit

It's important to understand where safeguards are being degraded by some high yield private credit managers, how that affects the risk around the underlying loan—and why those managers might then still carry the loan at full value. If nothing else, it will help you ask tough questions at quarterly reviews.

Imagine for a moment you're that manager with a $10 billion upper middle market direct lending fund. You're pretty

[2] Configure Partners, as of 11/30/25.
[3] Spread figures from Private Debt News #79, 12/06/25.
[4] Partners Capital reports that PE distributions of portfolios they're invested in are running about 1/3 below the norm, in part because heavy debt burdens are gumming up M&A and IPOs are slow.
[5] Well, there's your problem! A First Brands lender quoted in Matt Taibbi's newsletter, Racket News, 11/17/25.

Cov-lite loans fare significantly worse in times of financial stress or crisis.

"Cov-loose" lending maintains the illusion of covenants but not their utility.

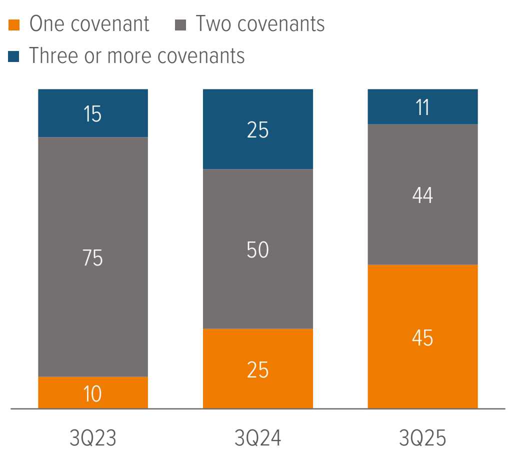
experienced—you've been in the markets for over a decade (all boom years, but who's counting)—but you're under a lot of pressure to put capital to work. What are easy things you can do to attract borrowers?

First, you could loosen your standards

Around 90-95% of new, broadly syndicated first-lien loans this year were cov-lite, and somewhere around 30% of private credit loans followed suit (Exhibit 4).[6]

This is absolutely late-cycle behavior by managers, rationalized by the fact that the leveraged loan market is doing it, and that cov-lite loans generally don't have higher default rates during good markets. The problem is, they do have significantly higher defaults during times of financial stress or crisis.[7]

Exhibit 4: The number of covenants in middle market lending has declined

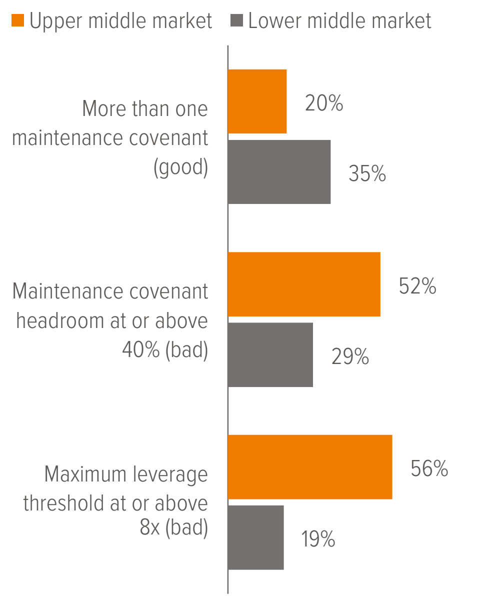


As of 11/30/25. Source: Configure Partners.

Now, some investors (rightly) don't like their managers to indulge in cov-lite lending. That's why there's now something called "cov-loose" lending—my favorite financial neologism since "investment-grade-like ABF." Cov-loose is when you have only one maintenance covenant and/or your maximum leverage threshold is something like 8x, or there's 40% headroom on all the covenants (Exhibit 5).

You can look your investors in the eye and say, "Yes, of course we have maintenance covenants, they're very important," but your covenants are also so rubbery that they're functionally useless at their most critical purpose: bringing the borrower to the table when they're just starting to get into trouble.

Exhibit 5: Covenants are also getting looser, especially in the upper middle market



As of 04/23/25. Source: S&P Global. Upper middle market is defined here as borrowers with EBITDA over $50 million; lower middle market is borrowers with EBITDA under $30 million.

In upper middle market lending, over 50% of loans are estimated to have maximum leverage thresholds over 8x.[8] Eight times! Look, you can't get a residential mortgage over 5x leverage, and that comes with a lien on your house.

Cov-lite often also goes hand in hand with diligence-lite, in which lenders dangle the carrot of fast execution in front of borrowers. Unfortunately, a quick close is often accomplished by abandoning tedious but critical legal processes like lien searches, and various recent headlines can tell you why that's a bad idea.

[6] Covenant Review from Fitch Solutions, as of 09/30/25.
[7] Consequences of Cov-Lite Loans, by P. Demerjian, E. Horne, and K. Moon, 03/01/25.
[8] S&P Global, "Leveraged Finance: Loose Maintenance Covenants Permeate Private Credit," 04/25/25.

PIK toggles mean a borrower can switch to accrued interest without breaching covenants.

Second, turn to payments in kind

The next step after loosening standards is baking measures into your loan agreement that allow your borrower to not pay you during periods of negative cash flow: the payment-in-kind (PIK) toggle.

PIK is a form of deferred interest, and it has traditionally been employed in two ways. Planned PIK is used in infrastructure placements to cover the project's build phase. A power generation project, for example, will raise construction finance on the back of signed power purchase agreements that give it highly predictable, steady cash flow once it reaches operation. However, it doesn't make economic sense for the project to pay cash interest before it reaches operation, so interest payments are deferred during its construction phase.

Unplanned PIK is primarily a distress/restructuring technique. Your borrower is facing a cash crunch, so you amend your covenants to allow PIK and the borrower switches to higher-rate accrued interest until things get better or they go bankrupt. That still exists, it's known as "bad PIK," and it tends to be a strong predictor of future credit deterioration, delinquency, and bankruptcy.[9]

But more and more lenders are now including PIK toggles in their loan structure for corporate loans to asset-light borrowers with volatile and unpredictable cash flows, such as tech companies. Importantly, a PIK toggle gives the borrower the ability to switch from cash interest to accrued interest without getting approval from the lender—and, crucially, without triggering either a covenant breach or a default.

This is occurring a lot: 22% of new middle market loans in 3Q had PIK interest toggles baked into their structure, up from 14.8% in 2Q.[10] It's also more concentrated in the larger end of the market, with 44% of deals in the over-$1 billion range including PIK toggles but less than 3% in the under-$350 million range.[11]

Bad loans don't fix themselves; extensions should involve a larger liability management exercise.

Third, delay and pray

The next tool that's being used willy-nilly is the "amend and extend," which is exactly what it sounds like: Amend terms to extend the loan's maturity, often along with an increase in coupon. This is a workout technique; when it is used well, it is part of a larger liability management exercise to get a borrower back on their feet. However, the high yield private credit market is increasingly using extensions with troubled loans that are already deferring interest via PIK toggles as a way of avoiding the reputational headache and loss crystallization that proper restructuring entails.

The hope is that the sponsor will find an exit before the borrower falls apart. The catch for investors in funds that do this is that, because the definition of default can be flexible with unrated debt, a high yield private credit manager can choose not to classify a maturity extension—even one without offsetting compensation to keep the loan economics at least level—as a full default. It can instead be noted as a "selective default." Whether you *report* it to investors as a default (and mark the loan down) is between you and your conscience.

Is this happening? Yes. Looking at BDCs, in 2Q24 there was $13.7 billion of debt maturing at the end of this year, and as of end 2Q25 there's only $4.6 billion due.[12]

Finally, enter your equity era

Let's say the extension doesn't fix things. Your next step is a debt-for-equity swap, and the sponsor may or may not also pump more equity in. It's the tenth debt-for-equity swap in your portfolio, but hey, if only one or two of them IPOs, then you've got an equity kicker and can easily make up the loss.

[9] Rintamäki, Paul and Steffen, Sascha, PIK Now and Pay Later - How Deferred Interest Reshapes Private Credit, 06/07/25.
[10] As of 11/30/25. Source: Configure Partners.
[11] As of 11/30/25. Source: S&P; Morgan Stanley Research.
[12] As of 11/05/25. Source: S&P Global.

The art of the covenant

At Voya, we use an array of covenants to monitor borrower health and serve as an early warning system.

Covenant types	Private credit covenants	Protects	Examples	Likelihood in a deal
Capital structure protection	**Liens**	Restricts future borrowing with assets and preserves location in the capital structure.	Permitted liens defined.	Frequent–nearly always present but dependent upon industry
	Priority debt	This limits all types of claims that can rank ahead of the private credit holders. These types of claims generally include liens and debt at subsidiaries.	Basket = 5% total assets	Frequent–nearly always present but dependent upon industry
	Sale of assets	This type of covenants limits the ability of the company to sell revenue-generating assets. Generally, there is a level of asset sales permitted, after which, the company must use proceeds for replacement assets or to pay down debt.	Basket = net book value of dispositions <15% total assets	Frequent–nearly always present but dependent upon industry
	Most favored lender	This type of covenant assures that if the company's main bank facility gets a different or more favorable covenant, the private credit lenders will receive the benefit of that as well.	MFL	Semi-frequent–present depending upon the industry
Financial	**Leverage or DSCR test**	Ensures repayment of debt relative to cash flows of the Company.	Debt/EBITDA < 3.5x Debt service coverage ratio (DSCR) > 1.5x	Frequent–nearly always present but dependent upon industry
	Interest/ fixed coverage	Ensures limitation of interest relative to cash flows of the Company.	EBITDA/Net finance charges ≥ 4x	Frequent–nearly always present but dependent upon industry
	Net worth	Ensures repayment of debt relative to value of the Company	Net worth > $1 billion	Semi-frequent–present depending upon the industry
Event risk	**Merger**	This type of covenant limits the types of mergers and restructuring transactions that the company may undertake.	Certain restrictions on company, parent guarantor and subsidiary guarantor mergers.	Frequent—nearly always present but dependent upon industry
	Restrictions on distributions	This type of covenant will limit the distributions the company may make to its shareholders.	Distributions limited if DSCR < 1.3x or upon an event of default	Less frequent–present typically in tighter credit markets
	Change of control	This type of covenant generally states that if a third party purchases a majority of the equity of the issuer, the lenders will be able to exit the transaction.	Offer to prepay at par upon change of control	Frequent–nearly always present but dependent upon industry
	Non-payment cross default or acceleration	This provision provides that if the company does not pay another source of debt or is in default with another source of debt, our facility will also be in default.	Cross-default for non-payment defaults	Frequent–nearly always present but dependent upon industry

As of 03/31/25. Source: Voya IM.

There has been a wave of high-profile debt-for-equity swaps in 2025.

You mark the loan down to 80. You're much more diligent than your co-investor, who still has it on their books at 100.[13] Everything will be fine.

It's not systemic, but it's not great either

None of the techniques I've described above are inherently bad—they're all perfectly valid tools in any lender's structuring (and restructuring) kit. But they are potential red flags when taken out of their original context and combined with flimsy due diligence, aggressive lending to companies with volatile cash flow, and a lack of appropriately strict covenants to act as early warning systems.

The lack of thorough underwriting and creditor protections (along with the sheer number of loans in some of these portfolios) mean that if borrower trouble occurs, it's likely to come as a surprise to the manager. Add to that the onrushing maturity wall of five- and seven-year loans extended during 2020-2021's historically low rates and an economy showing patches of strain, and it's likely we'll see more messy bankruptcies.

We are likely to see more messy bankruptcies.

Is any of it systemic? No, I don't think the next global financial crisis will be kicked off by the $600 bn high yield private credit market. But looking at portfolio overlap figures in BDCs, there is more linkage between larger lenders than I'd like to see at the upper end of the market (Exhibit 7).

Add to this the often high (and in some cases near complete) overlap between portfolios with the same parent company, and things could get unpleasant for a few managers and their investors if a couple larger high-yield names go down and/or there's a significant shakeout among AI companies. (There has been some questionable AI lending.)

It doesn't have to be like this.

I find this situation frustrating, because it's so avoidable. In both investment grade and high yield, Voya's private credit team has always worked to make good investments, monitor them carefully, and value them honestly.

Exhibit 7: BDC portfolio overlap is not high ... except at the upper end

BDC size (portfolio fair value)	Number of BDCs	Average portfolio overlap against same-size BDCs
over $5bn	21	9.20%
$2-5bn	24	3.90%
$1-2bn	35	2.30%
under $1bn	82	1.40%

As of 06/30/25. Source: SEC filings, SOLVE, LFI. Overlap calculations exclude BDCs with the same ultimate parent, some of which have up to 95% overlaps.

We measure potential investments on three core criteria: credit, structure, and price. Think of it as a three-legged stool—if you weaken one leg (for example, compromising on structure to get attractive credit and pricing), the stool falls over. All three legs have to be solid for us to proceed with a transaction, and this is why, in 2025, we went forward with less than one in ten deals we were shown.

When the market is frothy, that can get us dismissed as boring—for example, we've never really been big on corporate loans to low-collateral businesses like tech (high obsolescence risk), health care (high policy risk), or service roll-ups (high integration risk), even though these are currently the high yield private credit market's most popular sectors.[14]

But in an asset class where the best that can happen is you get all your money back plus some interest, we take our clients' capital preservation very seriously. (And yet, thanks to our preference for and skill in the more structured end of the market, the spreads we achieve for our clients consistently beat the average.)

We are, in fact, paid to do due diligence in this market.

[13] "Justin, would someone really keep a loan on their books at par after doing a debt-for-equity swap and deferring interest payments via PIK?" Ahahaha.

[14] As of 11/30/25. Source: Configure Partners.

A note about risk

All investing involves risks of fluctuating prices and uncertainties of rates of return and yield. All security transactions involve substantial risk of loss.

Private credit: Foreign investing does pose special risks, including currency fluctuation, economic, and political risks not found in investments that are solely domestic. As interest rates rise, bond prices may fall, reducing the value of the share price. Debt securities with longer durations tend to be more sensitive to interest rate changes. High yield securities, or “junk bonds,” are rated lower than investment grade bonds because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities. Other risks of private credit include, but are not limited to: credit risks, other investment companies risks, price volatility risks, inability to sell securities risks, and securities lending risks.

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