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Iñaki Aldasoro, Sebastian Doerr and Karamfil Todorov

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Iñaki Aldasoro
Iñaki.Aldasoro@bis.org

Sebastian Doerr
Sebastian.Doerr@bis.org

Karamfil Todorov
Karamfil.Todorov@bis.org

Retail investors in private credit

Key takeaways

- *Private credit is poised for wider participation from retail investors through the rapid growth of business development companies and, more recently, private credit exchange-traded funds (ETFs).*
- *ETFs may introduce price signals that make the opaque private credit market more transparent, especially during downturns when discounts to net asset value could be large and persistent.*
- *The rise of retail investment vehicles may also give impetus to the creation of secondary markets for currently illiquid private loans, which could erode the benefits of private credit as an asset class.*

Private credit has become an important source of funding for mid-sized firms, increasingly replacing bank credit. The industry manages more than $2.2 trillion in assets globally, up from just $100 billion in 2010. In many jurisdictions, private credit volumes already rival those in the leveraged loan and high-yield bond markets. The migration of lending from well regulated and supervised banks to the opaque private credit sector raises important questions for investors and about the future of private markets.[1]

A striking recent development is the increasing participation of retail investors. Historically, private credit funds were the remit of institutional investors, but the share of assets under management (AUM) accounted for by retail investors climbed from virtually zero to 13%, or $280 billion, in the past decade. The rise has been driven by the growth of business development companies (BDCs), with exchange-traded funds (ETFs) entering the space more recently. BDCs, a type of closed-end private credit fund that is often publicly traded, already represent 20% of the private credit market in the United States. Private credit ETFs seek to capitalise on the popularity of both ETFs and private credit. They promise retail investors higher returns from exposure to illiquid long-term private loans while providing liquid shares that trade daily.

An unresolved question is to what extent private credit's greater openness to retail money introduces risks for investors and financial stability. Private credit ETFs marry shares traded in a liquid market to illiquid underlying private assets that barely trade. This mismatch could lead to the emergence of steep and persistent discounts between the ETF price and the value of its underlying assets in periods of stress. While discounts may serve as a safety valve against fire sales of illiquid assets, they can raise doubts about the quality and accurate valuation of the underlying assets and lead to losses for investors. BDCs avoid liquidity mismatches but their debt-to-equity ratio, increasingly supported by bank credit lines, has tripled over the past 15 years and is highly procyclical. This raises concerns about their credit supply during downturns and spillovers from non-bank financial intermediaries (NBFIs) to banks.

While risks from rising leverage require careful monitoring, addressing the issues in ETFs linked to private markets may present a conundrum. The risk of persistent discounts could be moderated by creating a secondary market for private loans, ie by increasing their liquidity and raising transparency by introducing a market price. However, an open question is whether this would dilute private credit's very advantages. First, trading in secondary markets requires standardisation of loan terms, but borrowers are willing to pay a premium for private lenders' relationship-focused approach and tailored loan terms. Second, higher yields compensate investors for private credit's illiquidity. And third, introducing price

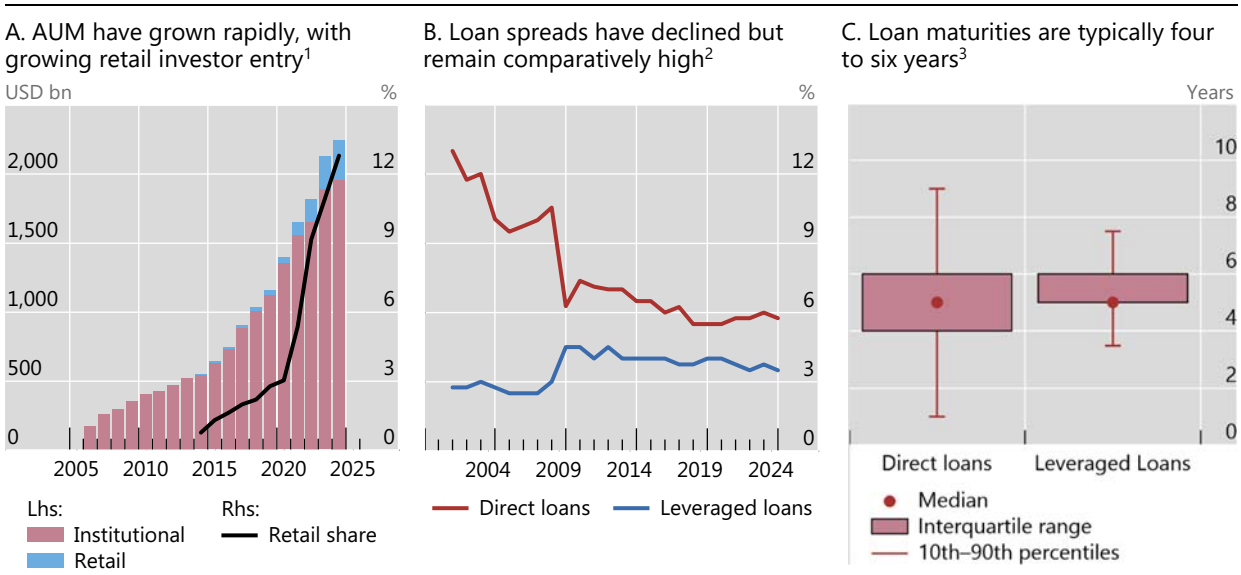
[1] Avalos et al (2025), Aldasoro and Doerr (2025) and IMF (2024) provide detailed descriptions of private credit and direct lending.

discovery in private markets would likely bring about demands on asset managers and their investors to mark their loan portfolios to market, rather than rely on a through-the-cycle approach.

The rise of private credit

Private credit refers to non-bank credit extended by specialised investment vehicles ("funds") to small or medium-sized non-financial firms. The AUM of such funds have grown substantially in recent years (Graph 1.A). Direct lending, which refers to covenant-heavy floating rate loans, has been the dominant strategy. Outstanding loan volumes increased from around $100 billion in 2010 to over $1.2 trillion today.

The rise of private credit — Graph 1



[1] Total assets under management (AUM) held by institutional and retail investor-oriented funds (retail investor-oriented funds include BDCs, interval funds and tender offer funds, as classified by Pitchbook). Data on retail investments are available from 2014 onwards. [2] Loan spread (annual rate over Libor or SOFR) on direct loans and leveraged loans. [3] Distribution of loan maturities for direct loans and leveraged loans.

Sources: Pitchbook, *Global Private Debt Report 2024*; PitchBook Data Inc; authors' calculations.

Private credit loans give borrowers valuable flexibility, but bespoke loan terms imply that lenders tend to hold loans to maturity – making illiquidity and flexibility two sides of the same coin. Deals are directly negotiated between lenders and borrowers, and lenders hold the loan on their balance sheets until maturity. Bespoke covenant structures, greater certainty and speed of execution, and more flexible renegotiation (Block et al (2024)) compare favourably with eg broadly syndicated loans. The latter involve multiple lenders and trade on an active secondary market but feature slower execution and more standardised loan terms. For example, loan origination or renegotiation can happen in a few days with direct lenders but can take weeks for syndicated loans. Borrowers, in turn, value such non-price loan terms and are hence willing to pay higher rates for direct loans (Abuzov et al (2024)).

Greater flexibility could also explain why direct loans have higher interest rates compared with other debt instruments. The loan spread averaged about 10 percentage points on direct loans (Graph 1.B, red line) before the Great Financial Crisis, exceeding that on leveraged loans, ie syndicated loans to non-investment grade firms (blue line). The difference narrowed as private credit expanded,[2] but it has hovered at 2–3% since 2015, which could partly reflect the value of flexible loan terms to borrowers.

[2] The decline in the spread partly reflects that, as AUM swelled, private credit funds increasingly catered to larger and less risky borrowers, requiring a lower compensation for credit risk.

Traditionally, private credit funds operated mostly as closed-end structures that lock in institutional capital for their entire life cycle, which typically ranges from four to eight years. Closed-end funds do not trade on exchanges and are not easily available to retail investors due to high minimum investments, which makes them illiquid and subject to lighter regulation. The life cycle of funds usually matches the average maturity of their loan portfolios (around five years, Graph 1.C), mitigating liquidity and maturity transformation risks. The main source of capital is institutional investors with long-term investment horizons and low liquidity needs, such as public and private pension funds or insurance companies.

More recently, retail investors play an increasingly important role in private credit. Their share has grown from less than 1% of total AUM in 2010 to almost 13% today, with a sharp rise in the past four years (Graph 1.A, blue bars and black line). Retail entry has happened mainly through BDCs. An alternative and very recent development are private credit ETFs. We discuss these structures in what follows.

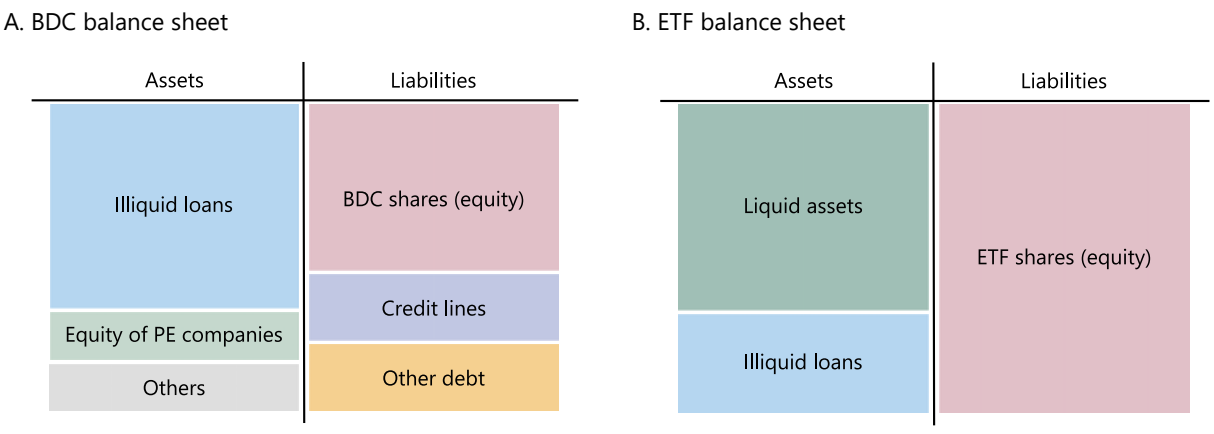
Private credit goes retail: BDCs and ETFs

BDCs are closed-end investment vehicles that typically list their shares on stock exchanges and, with over $300 billion in AUM, account for about one quarter of all direct lending in the United States.[3] On the asset side, BDCs largely hold direct loans as well as some shares, mostly in private equity companies (Graph 2.A, left-hand side). Common or preferred shares in other portfolio companies account for less than 10% of assets. BDC assets are thus mostly illiquid private loans with a typical maturity of four to six years.

BDCs' liability side combines equity funding with debt instruments, in particular bank lines of credit and unsecured notes. Fund managers usually raise equity first and then draw on committed, floating rate bank lines of credit to finance day-to-day operations and loan originations. Over time, BDCs issue other debt instruments such as unsecured notes. For the average BDC, drawn bank lines of credit represent about 40% of its debt, while unsecured notes account for another 50%, with the remainder being mostly secured bonds (Chernenko et al (2025)). Regulation currently requires BDCs to keep their debt-to-equity ratio below two, and most BDCs operate well below that limit.

ETFs differ markedly from BDCs. The first private credit ETF was launched in early 2025, enabling retail investors to access illiquid private credit markets within a liquid ETF framework. The stylised balance sheet

ETFs and BDCs hold illiquid loans, with BDCs featuring leverage — Graph 2



BDC = business development company; ETF = exchange-traded fund; PE = private equity.

Source: Authors' elaboration.

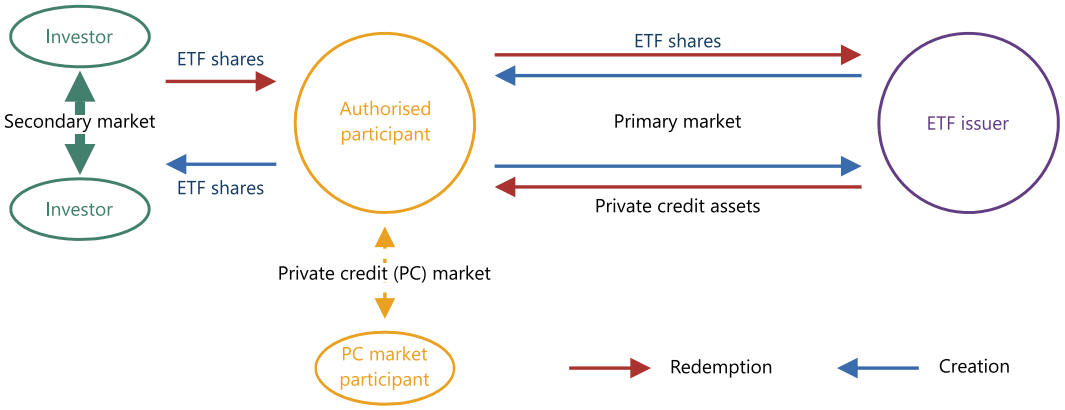
[3] BDCs come in three organisational forms: exchange-listed BDCs, non-traded public BDCs and privately offered BDCs (Davydiuk et al (2025); Chernenko et al (2025)). The different types are comparable in the composition of their assets and liabilities. Our analysis mostly applies to exchange-listed BDCs, in which retail investor participation is greatest.

of the ETF looks as follows (Graph 2.B, right-hand side). The ETF allocates 10–35% of its portfolio to illiquid private credit, such as senior secured loans, with the remainder in liquid public credit (eg corporate bonds). This stands in stark contrast to most ETFs, which hold marketable securities. On the liability side, the ETF issues shares that are sold to investors, who trade them in the secondary market (Graph 3, in green). Private credit ETFs report gross expense ratios of about 0.7%, comparable with those of actively managed ETFs but substantially higher than those of passively managed ETFs (Chau et al (2025)).

Like other ETFs, private credit ETFs operate through the interaction of primary and secondary markets. In the secondary market, investors trade ETF shares like those of individual companies (Graph 3). Residual buying or selling demand is settled in the primary market, where a set of specialised investors called authorised participants (APs) creates or redeems ETF shares by exchanging the assets or cash with the ETF issuer (typically a large asset manager). APs are typically large broker-dealers trading in the assets underlying the ETF, but the list of APs for private credit ETFs was not publicly available as of June 2025.

A key role of APs is to ensure that the ETF market price (determined in the secondary market) is aligned with the net asset value (NAV) of ETF holdings (based on the prices of the underlying assets). APs engage in creation-redemption activity to eliminate deviations between ETF share prices and the NAV, as they present an arbitrage opportunity that generates profits. When ETF prices are above NAV (the ETF is at a premium), APs have incentives to create new ETF shares (Graph 3, blue lines). When ETF prices are below NAV (the ETF is at a discount), APs redeem existing ETF shares for the underlying assets (red lines). Typically, this creation and redemption takes place in kind by exchanging underlying assets for ETF shares.

ETF mechanics and the multiple roles of APs — Graph 3



Source: Authors' elaboration.

Emerging risks and implications for private markets

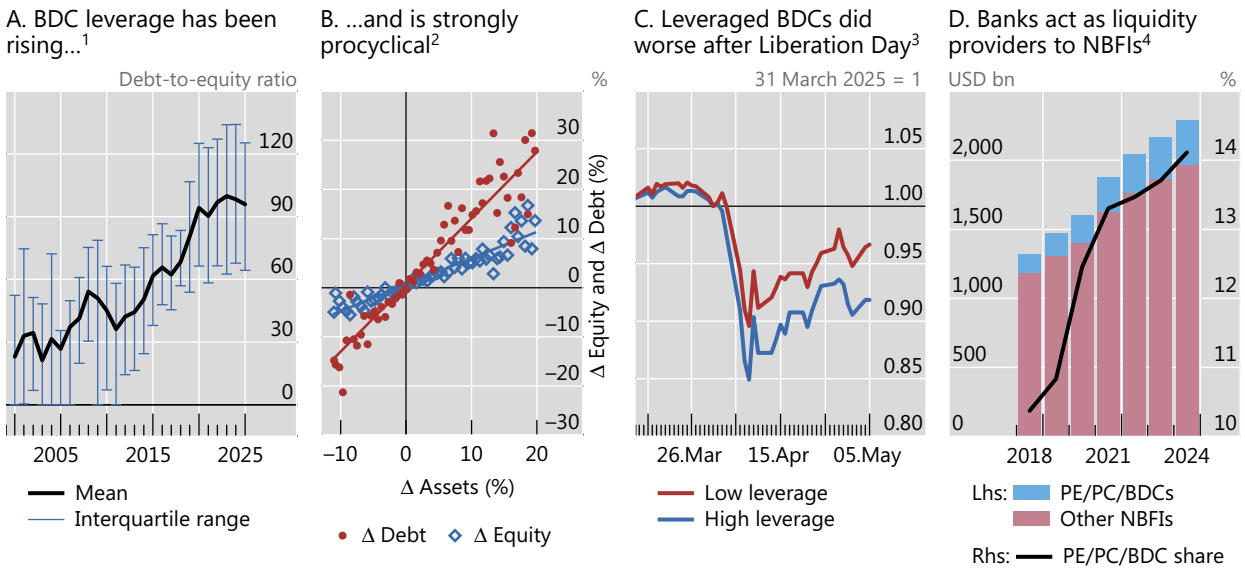
BDCs have seen rising leverage. The debt-to-equity ratio of the average BDC has tripled over the past 15 years, from 30% to over 90% (Graph 4.A). This leverage is highly procyclical: there is a substantially stronger relationship between the quarterly changes in debt and total assets than between equity and total assets (Graph 4.B). The change in assets in any given quarter is hence mostly accounted for by the change in debt, while equity is sticky. Such procyclical leverage could lead to steeper reductions in credit supply during downturns and further propagate stress (Adrian and Shin (2014)). Higher leverage also implies that large share price declines could erode equity, risking insolvency or forcing sales to meet debt obligations. The April 2025 "Liberation Day" episode underscored this fact, with high-leverage BDCs facing larger share price drops compared with low-leverage BDCs (Graph 4.C).

While the leverage of private debt funds remains substantially below that of banks, interconnections between private markets and banks have been growing. NBFIs' reliance on bank contingent liquidity

provision has risen rapidly and currently stands at $2.3 trillion (Graph 4.D). Private markets represent a growing share of the total (black line). Private credit funds' reliance on bank credit lines could transmit stress in private markets to bank balance sheets through simultaneous credit line drawdowns (Berrospide et al (2025)). It is paramount to monitor these developments, but the lack of harmonised data on eg fund holdings, valuation methods or debt structures makes assessing risks difficult. Better disclosure and reporting requirements might thus be warranted, and recent initiatives by the Financial Stability Board (2024) already take a step in this direction.

Rising and procyclical BDC leverage is largely funded by banks

Graph 4



BDC = business development company; NBFI = non-bank financial institution; PC = private credit; PE = private equity.

[1] Average debt-to-equity ratio among BDCs (black line) with interquartile range (blue bars). [2] Correlation between total debt growth or total equity growth vs total asset growth among BDCs. Binned scatter plot of BDC-quarter observations. [3] Stock price of BDCs in the top and bottom tercile of the debt-to-equity distribution around "Liberation Day" (2 April 2025). [4] Bank credit commitments to NBFIs in the US.

Sources: Board of Governors of the Federal Reserve System, *Financial Stability Report*, April 2025; Bloomberg; PitchBook Data Inc; authors' calculations.

Questions remain about whether private credit ETFs can attract retail investors at scale and what they may imply for private markets. During a downturn, investors may rush to sell their liquid ETF shares. Since the underlying loans hardly trade (ie they have no up-to-date market price), APs' ability to arbitrage the gap between the ETF price and its NAV may be limited, as they cannot offload the loans in a thin and illiquid market. And without a market price, the NAV may adjust only slowly. Private credit ETFs may hence feature deep and persistent discounts during stress episodes similar to less liquid corporate bond ETFs (Aramonte and Avalos (2020)). If APs are also major holders of private credit assets and actively trade those (Graph 3, in orange), their incentives might be to manage their own balance sheets rather than eliminate ETF discounts, making them more persistent. To be sure, such discounts may serve as a "safety valve" that prevents fire sales of illiquid assets (Shim and Todorov (2020)). But they may also lead to losses for retail investors and generate price signals that provide some transparency in the opaque private credit market. Greater transparency may paradoxically lead investors to doubt the accurate valuation of the underlying assets as well as stated NAV marks across affiliated private credit or private equity funds. This could constrain new fundraising or credit originations that are secured against inflated portfolio valuations.

How could ETF issuers mitigate the drawbacks of persistent discounts? For one, some private credit ETF structures advertise agreements with large private credit asset managers, who are not official APs but in principle stand ready to buy certain pre-agreed amounts of the ETFs' private loans at book value (eg up

to 25% of the loans per day). These asset managers thus could serve as an implicit backstop during periods of large redemptions, with the promise to act as liquidity providers. However, their role as major originators and holders of direct loans raises concerns about their ability or willingness to step in during times of stress in private markets.[4] An alternative option is to make the underlying loans more liquid by introducing marketplaces. Akin to the secondary market for broadly syndicated loans, private credit loans would then have a market price, allowing NAVs to adjust faster and facilitating arbitrage by APs.

Whether private credit can keep its purported benefits as loans become more liquid is far from clear, as the introduction of ETFs and secondary markets may erode the very advantages that make private credit an attractive asset class. A secondary market would require more standardised loan terms, implying that lenders could offer less flexibility – and hence less value to borrowers. For investors, loan trading is likely to reduce the illiquidity premium that drew them to the private credit market in the first place. Finally, asset managers often argue that private credit's illiquidity allows them to see through the cycle even when public markets gyrate, so that investors need not constantly mark their portfolios to market. The existence of greater transparency and price discovery through ETFs and secondary markets could lead to greater demands for asset managers to more frequently mark their holdings to market. All in all, "democratising" access to private credit may undermine the very features that have sustained its growth.

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[4] Further, concerns about the quality of the loans that are bought vs those that remain on the ETF's balance sheet loom large.