

Regulators Are Coming for Private Credit: Key Takeaways for Financial Institutions

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KEY POINTS

- The FSB's May 2025 report identifies four core vulnerabilities in the \$1.5 trillion to \$2 trillion private credit market: circular funding links, weak borrower credit quality masked by high leverage, heavy sector concentration, and persistent data gaps.
- Approximately 75% of private credit borrowers have EBITDA below \$100 million, and warning signs of credit stress — including selective defaults, distressed exchanges, and payment-in-kind reliance — are already emerging.
- Private credit funds are the second-largest source of funding for AI-related capital expenditure, meaning a sector-specific shock could transmit stress to banks and the broader financial system through circular ownership and funding structures.
- The FSB intends to continue developing work on mapping interconnections, defining the private credit ecosystem, facilitating supervisory discussions, and addressing data gaps — areas that historically precede formal regulatory action by 12 to 24 months.
- Financial institutions should act now by increasing valuation frequency and independence, enhancing exposure monitoring, and tracking signals from the SEC, Fed, OCC, and FDIC ahead of anticipated rulemaking.

On May 6, the Financial Stability Board (FSB) released its first dedicated [report](#) on the private credit market's vulnerabilities, and the findings land squarely on banks and fund managers. With private credit now at \$1.5 trillion to \$2 trillion globally, the FSB warns that circular funding structures, opaque borrower credit quality, and deepening interconnectedness between banks and funds could transmit stress across the financial system.

FSB'S KEY FINDINGS

The FSB identifies four core vulnerabilities:

- Circular funding links between banks, insurers, private equity, and private credit funds.
- Weak borrower credit quality masked by high leverage and limited disclosure.
- Heavy sector concentration exposing funds to correlated shocks.
- Persistent data gaps preventing effective regulatory monitoring.

FINANCIAL SYSTEM INTERCONNECTEDNESS

Private credit is increasingly intertwined with banks, insurers, pension funds, and private equity firms. The FSB's primary concern is the emergence of circular ownership structures: private equity firms acquiring control of

insurance companies that invest in private credit funds managed by those same firms, raising systemic risk and conflict-of-interest concerns. Banks are also exposed through subscription credit lines, loans to private-credit backed borrowers, and strategic partnerships with private credit managers. While bank exposures are currently estimated at less than 0.5% of total bank assets, the FSB is focused on the trajectory of this risk.

BORROWER CREDIT QUALITY

The private credit market's borrowers carry meaningful credit risk. Approximately 75% of borrowers have earnings before interest, taxes, depreciation, and amortization (EBITDA) below \$100 million, meaning most of the market consists of smaller, higher-risk companies. Limited transparency compounds this concern: private credit ratings are not publicly disclosed, and high leverage and EBITDA adjustments can obscure true indebtedness. Warning signs of credit stress are already emerging: selective defaults, distressed exchanges, and increasing reliance on payment-in-kind arrangements.

SECTOR-SPECIFIC CONCENTRATION

Private credit lending is heavily concentrated in a small number of sectors, with technology and AI among them. The FSB views this concentration as a pattern to watch closely rather than an imminent threat, but the underlying risk is real. Private credit funds are the second-largest source of funding for AI-related capital expenditure, meaning a sector-specific shock could hit private credit performance hard. Given the circular funding structures and bank linkages described above, that stress would impact the entire financial system.

DATA AND MONITORING

Underlying all these vulnerabilities is a shared problem: the private credit market lacks transparency and reliable data. Private credit valuations are typically only updated quarterly, which is workable in a normal market, but inadequate when conditions deteriorate. Those valuations are also increasingly outsourced to third-party firms whose conclusions are subjective and shaped by the manager's own judgment. That same data problem affects regulators. Without granular loan-level and fund-level data, they have limited visibility into private credit risk exposures and how borrower credit quality is trending. This blind spot makes it difficult to identify trouble early and respond before conditions worsen.

WHAT THIS MEANS FOR CLIENTS

PRIVATE CREDIT FUND MANAGERS

Bolster borrower quality monitoring, strengthen concentration risk controls, and diversify away from sector-concentrated exposures, particularly in technology and AI.

PRIVATE EQUITY SPONSORS AND PORTFOLIO COMPANIES

Audit conflict-of-interest policies around circular ownership structures, prepare to defend them to regulators, and stress-test portfolio companies' ability to withstand a sector-specific shock.

BANK LENDERS TO PRIVATE CREDIT FUNDS

Enhance monitoring of direct and indirect private credit exposures, embed stronger reporting requirements in

subscription line conditions, and reduce sector-specific concentration risk.

NEXT STEPS

While the FSB did not prescribe a regulatory timeline, it identified four areas it intends to continue developing, signaling where regulation may be headed:

- Mapping interconnections between private credit and other nonbank financial entities;
- Developing clearer definitions of the private credit ecosystem;
- Facilitating supervisory discussions regarding risk oversight; and
- Addressing data gaps to improve market monitoring.

FSB reports of this nature have historically preceded formal regulatory action by 12 to 24 months. The vulnerabilities identified here are not hypothetical; they describe the market right now. Market participants who act before rulemaking begins will be best positioned to manage cost and disruption.

All market participants should take four steps now:

- **Valuation:** Increase the frequency, independence, and rigor of your valuation processes.
- **Transparency:** Give investors, lenders, and counterparties visibility into credit quality and exposure before they demand it.
- **Portfolio:** Scrutinize borrower leverage, sector concentration, and AI/technology exposure, and adjust where necessary.
- **Regulatory horizon:** Track FSB follow-on work and domestic signals from the Securities and Exchange Commission, Federal Reserve, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation; formal action could come within 12 to 24 months.

CONCLUSION

The regulatory direction is clear: more transparency, better data, and closer oversight of private credit are coming. Financial institution clients should act now: strengthen valuation governance, enhance exposure monitoring, and close internal data gaps, rather than wait for formal rulemaking to force the issue.

Troutman Pepper Locke is monitoring these developments and is available to help clients prepare. Please contact us with any questions.

Kennedy Reardon, a 2026 summer associate with Troutman Pepper Locke who is not admitted to practice law in any jurisdiction, also contributed to this article.

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