

Private Credit in the News

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For individual investors, there are generally two different spheres of *private credit* opportunities:

- **Those from large firms focused on AUM and currently garnering negative headlines**
- **Others from smaller niche sponsors that put performance first**

By now, most investors have probably noticed the recent news headlines regarding problems and unrest in the private credit market. Unfavorable news coverage of this sort has surfaced from time to time over the past few years and became greatly intensified in late 2025 and early 2026. Notably, these headlines concern some of the largest institutions in the private credit space—even some of the biggest in the entire financial sector.

And that's the key point. Firms in this rarified echelon are distinctly different from the many smaller niche sponsors specializing in the private credit space—the type of sponsors that TRO pursues for its fund portfolios, including in its most recent offering, TRO Specialty Private Credit Fund, LLC. So, to get a better idea of why the headlines don't relate to these niche credit sponsors, let's take a step back and look at the recent problems facing the large private credit lenders, as well as the causes behind them.

Large Private Credit Firms: Liquidity Challenges

The firms mentioned in the recent headlines each hold anywhere from about \$25 billion to \$200 billion of assets on their private credit platforms, primarily direct corporate loans and, to a lesser extent, BDC (Business Development Company) structures. The most visible problem facing these large lenders concerns liquidity issues, as investors are increasingly lining up to seek redemptions from their private credit funds.

These credit funds may be called “private,” but as they grow ever larger, they unfortunately experience some of the disadvantages associated with public-market securities. Once primarily institutional offerings, these funds have attracted a growing audience of individual investors, many of whom lack financial sophistication and long-term patience. When volatility and other issues arise, they tend to follow a herd mentality and try to cash out. The resulting capital outflows have caused some of these large funds to place restrictions on withdrawals, which leads to even greater investor concerns.

Large PC Firms: Credit Risk Issues

The root cause of the investor unrest—as well as the resulting capital outflows and share-price declines—is primarily the public’s perception of the firms’ credit risks. What’s more, this issue of credit risk can also be traced to the huge size of these firms’ private credit funds.

Simply put, these large firms suffer from diseconomies of scale. Due to their enormous AUM (assets under management), it is only practical for them to make loans to businesses seeking vast amounts of finance capital—i.e., very large, typically high-profile companies and, in many cases, huge private-equity-backed buyouts. These very large borrowers are also well-known to all the other prominent lenders. This creates an “auction” atmosphere with substantial competition among lenders, making it considerably more difficult for them to attain favorable loan terms. In addition, the sheer magnitude of their AUM, coupled with shareholder expectations, can create constant pressure to put the money to work very quickly.

As a result, these large private credit firms must often perform their underwriting in haste and settle for covenant-lite loans with less-than-ideal interest rates—relying on leverage to make their loans more profitable. This combination of rushed underwriting, weak covenants and significant leverage can be a toxic brew if and when a loan becomes stressed.

On the other hand...

Smaller Niche Sponsors: The Advantages of the “Middle Market”

Niche credit sponsors typically lend capital in the middle tier of the private credit market, where the annual revenue of borrowers ranges from \$10 million to \$1 billion. The middle market is immense: It is comprised of more than 200,000 companies that together generate approximately one-third of all U.S. private sector GDP and it employs 48 million people, roughly one-third of all private sector employment.

Given the middle market's extensive number of companies—often relatively low-profile businesses—lenders here generally face significantly less competition than those lending to the nation's largest businesses. As a result, they enjoy a greater advantage in negotiating loan interest and terms and can generally attain:

- A substantial yield premium on their loans, leading to higher Net IRRs.
- Often, equity stakes with relatively low entry valuations (in addition to interest payments).
- And, perhaps even more crucially, tighter underwriting, higher-quality collateral and stronger covenants.

Sector Specialization

Smaller sponsors often focus on specific market sectors where they can use their specialized industry expertise to better evaluate a prospective borrower's underlying business in the underwriting process. During the loan term, they can use their industry acumen to adeptly monitor the borrower's ongoing business operations and help them successfully navigate any potential rough patches in order to avoid issues with their loan.

Stronger Alignment of Interests with Investors

Whereas large lenders generally depend on their massive AUM and sizeable management fees to enhance their profit margins, sponsors in the middle market can focus on attaining higher interest rates and, often, equity participation, which can result in stronger returns for investors. Accordingly, they tend to emphasize their incentive fee in their business plan, which promotes a stronger alignment of interests with their investors.

It should also be noted that many niche credit sponsors often have large numbers of investors lining up to subscribe. But they refrain from accepting additional investors until new loan opportunities come to fruition—further demonstrating their priority of enhancing yield to existing investors rather than prioritizing AUM.

Niche Credit's Place in Your Portfolio

Some industry experts portray the large private credit funds (the ones with the negative headlines) as a way for investors to gain exposure to the broad private credit market. And, they cite smaller sponsors as the means to access the niche opportunities at the inefficient, less well-publicized edges of the market.

So, if you're already invested with one or more of the large private credit firms, you might consider niche sponsors and the opportunities they offer as a complement to your current private credit holdings. If you're not yet invested in the private credit space, you may want to pursue the enhanced opportunities offered by niche private credit sponsors.

KEY TAKE-AWAYS

The negative headlines in the news about private credit do not relate to niche private credit sponsors...but rather, to the very large private credit firms, whose very size is the root cause of their liquidity and credit risk issues.

Niche private credit sponsors generally lend to borrowers in the nation's huge middle market, where they face less competition than do large firms, whose size dictates that they lend to the nation's largest companies.

This gives the niche sponsors an advantage in negotiating loan interest and terms, and generally allows them to attain:

- A substantial yield premium on their loans, leading to higher Net IRRs.
- Often, equity stakes with relatively low entry valuations (in addition to interest payments).
- And, perhaps even more crucially, tighter underwriting, higher-quality collateral and stronger covenants.

Niche private credit sponsors often focus on specific market sectors where their specialized industry expertise can enhance their underwriting process, as well enable them to help their borrowers successfully navigate any potential rough patches.

Niche sponsors have the flexibility to focus on attaining higher loan interest payments and investor returns rather than on gathering greater AUM. This promotes a stronger alignment of interests with investors.

Author's Viewpoint:

Taking a Strategic Approach to the Niche Private Credit Markets

At TRO Investment Group, we've been investing in private credit assets for all our funds since 2011 and in our newest fund, TRO Specialty Private Credit Fund, the portfolio is invested exclusively in private credit and closely related assets. I want to share with you some of the ways we pursue maximizing our private credit performance.

Niche Sponsors Only

TRO Specialty Private Credit Fund invests solely with niche credit sponsors due to all the advantages highlighted in the body of the article. We should candidly note that there are some disadvantages generally associated with smaller sponsors, such as idiosyncratic risk and high dispersion of returns. Our investors circumvent these generalities by relying on TRO Investment Group's 15 years of experience vetting private credit sponsors and selecting very successful sponsors in each particular area of specialization.

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Author's Viewpoint

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Specialty Finance

We not only invest with sponsors who are direct lenders, but also with those who provide credit in the closely related sub-asset class of specialty finance. Whereas, direct corporate loans are often extended over lengthy terms, specialty finance debt is typically of short duration. This short-duration structure means that the liquidity of the debt aligns well with the potential liquidity obligations of the sponsors. Also, specialty finance debt is typically secured by pools of income-generating receivables with well-delineated cash flow and, in some cases, physical assets with well-defined values.

Also, the Secondary Market

Some of our opportunistic sponsors even benefit from the dislocation and liquidity issues in the broad market by buying limited partner stakes sold off from the large funds at sizeable discounts in the secondary market. These discounts translate into significant capital appreciation on day-one and provide a substantial margin of safety.

Investing Alongside Institutional Investors

TRO focuses on private credit investments with fairly high investment minimums, where our fellow investors tend to be institutions and large family offices—sophisticated investors who won't be inclined to overreact with herd mentality to the day's headlines. This gives us further insulation from the liquidity and credit risk issues being heralded in the news.

Furthermore, investors in TRO Specialty Private Credit Fund can access a diversified portfolio of niche-sponsor offerings with a single convenient capital commitment.

If you'd like to find out more or have any questions, please get in touch...

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