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What's Missing In Private Credit? Integrating Asset-Backed Finance

Better Together: Integrating asset-backed finance with direct lending can enhance diversification and broaden the opportunity set of a private credit allocation.

The Next Evolution of Private Credit is Here... How We Arrived at this Moment

As private credit takes on a larger and more important role in powering economic growth, integrating asset-backed finance (ABF) with direct lending enables strategic asset allocations to evolve alongside this broader market evolution.

1 Bank Disintermediation

Regional bank consolidation and increased bank regulatory pressure have reduced balance-sheet lending appetite **creating white space across both corporate and specialty-finance borrowers.**

2 Borrower Demand & Flexibility

Sponsors, corporates and specialty finance companies seek financing that matches their assets or cash flows, with diversification away from traditional lenders.

3 Investor Demand

Private credit's yield, structure, and seniority characteristics have broadened its role in portfolios—**asset-backed finance and direct lending address different parts of that demand set.**

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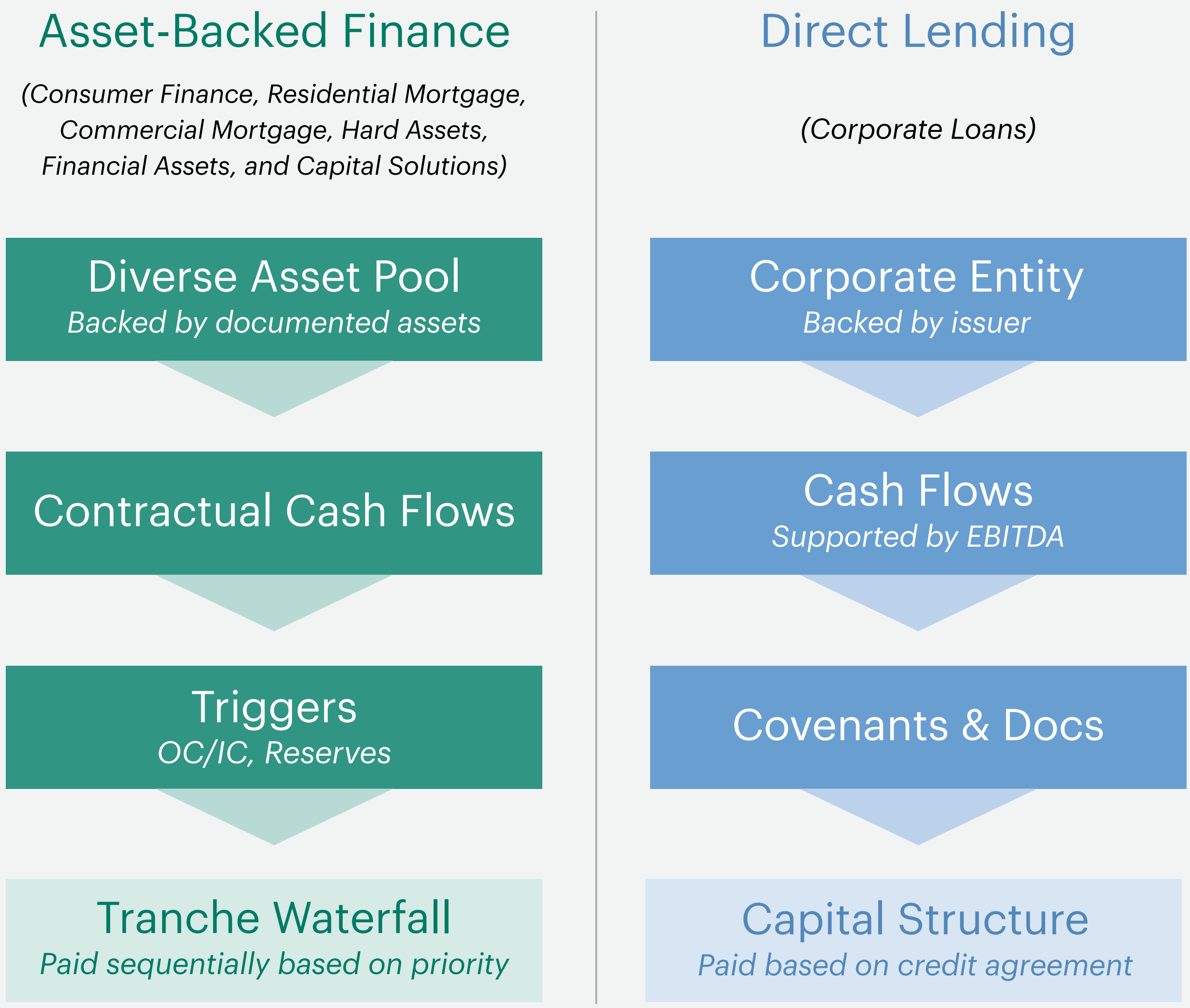
Distinct Sources of Repayment, Shared Spread Premium

While asset-backed finance and direct lending are anchored to different sources of repayment, both can deliver an attractive spread and downside protection (through different mechanisms).

Pairing them together can expand the opportunity set, providing complementary exposure.

Two Distinct Protection Mechanisms, Same Outcome: Downside Protection



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Key Benefits

Asset-backed finance and direct lending can deliver a differentiated set of potential investment benefits.

Benefits by Asset Class

Asset-Backed Finance

Ring-Fenced Collateral
Bankruptcy-remote SPVs (true sale) isolate asset cash flows from originator’s creditworthiness.

Cash-flow profile
Amortizing, contractual payments; excess spread and reserves can build protection over time.

Diversification
Large, granular pools (often thousands of individual loans) reduce single-name concentration.

Layered Protection
Credit enhancement, overcollateralization and cash flow triggers add protection beyond borrower equity.

Direct Lending

Seniority in capital stack
1st Lien, 2nd Lien or Unitranche with senior security and covenant packages.

Economic alignment
Floating-rate coupons, call protection, original issue discounts; negotiated terms and control rights with sponsors/borrowers.

Relationship & monitoring
Direct access to management/sponsors; information, covenants, and remedies support active oversight.

Key Risks to Evaluate

Asset-backed finance and direct lending also have a differentiated set of investment characteristics that require different considerations when evaluating risk.

What to Underwrite in Each Asset Class

Asset-Backed Finance

Tranche selection & structure

ABF can span a variety of rating profiles including investment grade, sub-investment grade and residual. Each respective ratings bucket maintains a different risk / return profile.

Asset-class sectors

A manager's breadth across sectors, deep asset-level insight, and scale to access niche markets.

Platform depth

Sourcing capabilities, data and analytics, economic alignment and risk management.

Diligence process

Underwriting process and risk management framework.

Direct Lending

Capital-structure focus

1st Lien vs. 2nd Lien vs. Unitranche; leverage

Documentation quality

Covenants (or covenant-lite context), private equity sponsor, number of lenders, EBITDA definition, covenant headroom, restricted payments and layering.

Loan profile

EBITDA target, industry focus, ICR, PIK usage, leverage, and LTV.

Manager breadth

Sourcing, sector specialization, sponsor diversification; governance and workout experience.

The Bottom Line: Different Structures That Can Both Provide Spread Premium and Downside Protection

Both asset-backed finance and direct lending aim to protect principal and deliver resilient income—asset-backed finance via the underlying collateral pool and credit enhancement, and direct lending via enterprise-level seniority, covenants, and controls. Pairing them together can diversify risk drivers, deployment profiles, and market cycle sensitivities.

Complementarity Grid *(illustrative)*

	ABF	DIRECT LENDING	WHAT IT MEANS	PORTFOLIO EFFECT
Source of repayment	Asset pool cash flows	Corporate cash flows, refinancing, asset sale	Different drivers underpin returns	Diversifies risk sources
Downside mitigation	Underlying collateral pool and credit enhancement	Conservative underwriting and seniority in capital structure	Distinct protection mechanisms	Reduces tail risk
Cash-flow profile	Contractual, self amortizing, fixed and floating rate	Floating rate, negotiated	Self-liquidation vs. matched-term funding	Smoother cycle performance
Risk drivers	Asset pool performance vs. underwritten assumptions	Corporate entity performance	Increased mitigants against risk factors	Broader opportunity set

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