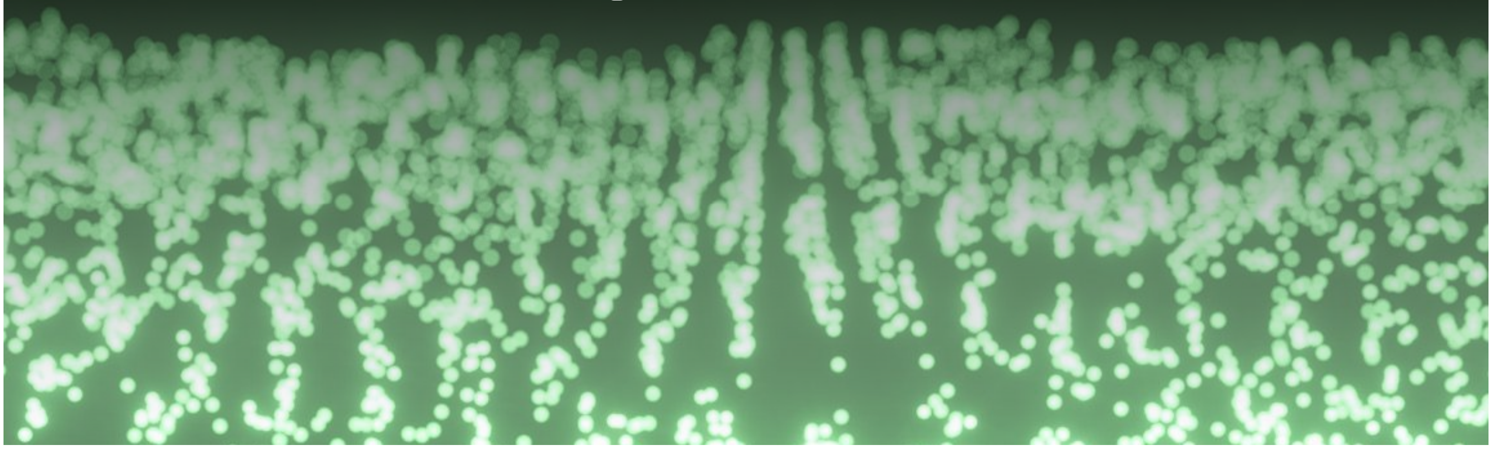
WINSTON & STRAWN LLP

CLIENT ALERT

Private Credit Is Booming; Banks Want Back In



MAY 20, 2025

Once satisfied with their dominant position in commercial lending from the middle market through the large cap, public syndicated market, banks have suffered significant erosion of market share at the hands of private credit (i.e., "direct lending") competitors. With a wide range of firms leading the "golden age" of private credit, banks increasingly want back in and are employing a variety of strategies to get there. With the addressable U.S. market for private credit nearing $2.0 trillion (still a fraction of the public market), banks are ever more eager to participate in private credit's one-stop lending solution that is one of the fastest growing businesses on Wall Street. Over the past several years, high-profile partnerships and other collaborations among banks and private credit firms have been announced at a brisk pace. Such activity is likely to continue.

In this client alert, we explain the rise of the modern private credit market generally and briefly review the different kinds of partnerships and initiatives banks employ to participate in the ever-growing private lending landscape.

While private credit—bi-lateral loans extended to corporate borrowers that do not trade publicly on any exchange or on any "over-the-counter" platform—has long been a significant part of the corporate lending landscape, it was not until the global financial crisis of 2008 that private credit matured into its current, prominent form. Policy reforms enacted in the wake of the crisis, including Basel III regulatory, supervisory, and risk management practices (including risk-based capital requirements) made it harder for banks to hold highly leveraged loans on their balance sheets. Consequently, banks retreated from significant portions of their traditional balance sheet lending businesses and focused on less-levered lending as well as "traditional" investment banking activities—arranging, underwriting, and syndicating loans to the public market. Amid this retreat from risk, the door was open for non-bank financial institutions to lend directly to companies and hold the loans themselves. From 2008 to present day, private credit came of age and grew from a once-niche asset class to what is now a major source of financing for corporate and sponsor-backed borrowers alike. In addition to filling the void left by retrenched banks, private credit firms offer flexible loan structures, customized terms, efficient execution, and leverage for a wide range of specialized assets. Private credit firms, often structured as groupings of funds, also offer investors a wide array of opportunities to gain exposure to higher-yield corporate credit in tailored funds, business development companies (BDCs), collateralized loan obligations (CLOs) and other private credit fund strategies.

Banks have taken notice of the potential for higher fees and higher-return deal flow generated by private credit firms and have re-entered the space in a myriad of ways. In some instances, a bank cooperates (or partners) with one or more private credit firms, which can take the form of sourcing arrangements, co-lending arrangements and even investments in BDCs sponsored by private credit firms. Within a partnership arrangement, the bank may provide a portion of a corporate loan solution (e.g., a senior or revolving piece), while the private credit partner provides the remainder (e.g., a junior or term piece). In such a relationship, the private credit firm benefits from the institutional corporate relationships of the bank to access a new (or underserved) portion of the market as well as a limited and risk-balanced portion of the bank's balance sheet, while the bank benefits by mitigating regulatory capital risk while using the private credit firm's know-how, lending expertise and capital. In other instances, a bank may compete directly with private credit: utilizing its own wealth management division, a bank builds its own private credit fund to offer one-stop lending to borrowers. Joint ventures are also increasingly common, with banks and private credit firms entering into relationships to source, fund and manage portfolios of loans that satisfy the joint-venture partners' predetermined lending strategies.

In many instances, banks seeking greater exposure to private credit are employing a mix of the above strategies. We expect these strategies to continue to gain footing in the private credit market and to evolve to meet customers' needs.

With decades of experience in the private credit market, Winston's global finance practice is extremely well positioned to continue to advise clients of all types of private credit financings. From our expertise in leveraged finance to representation on behalf of private equity sponsors and sponsor-backed companies, to fund finance, Winston provides best-in-class services to clients participating in every corner of this significant lending landscape. Deep technical credit skills, expertise in financial regulatory matters, constant exposure to innovative structuring and client-first attitude differentiate Winston as the first (and only) call for bank and private credit market participants.

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