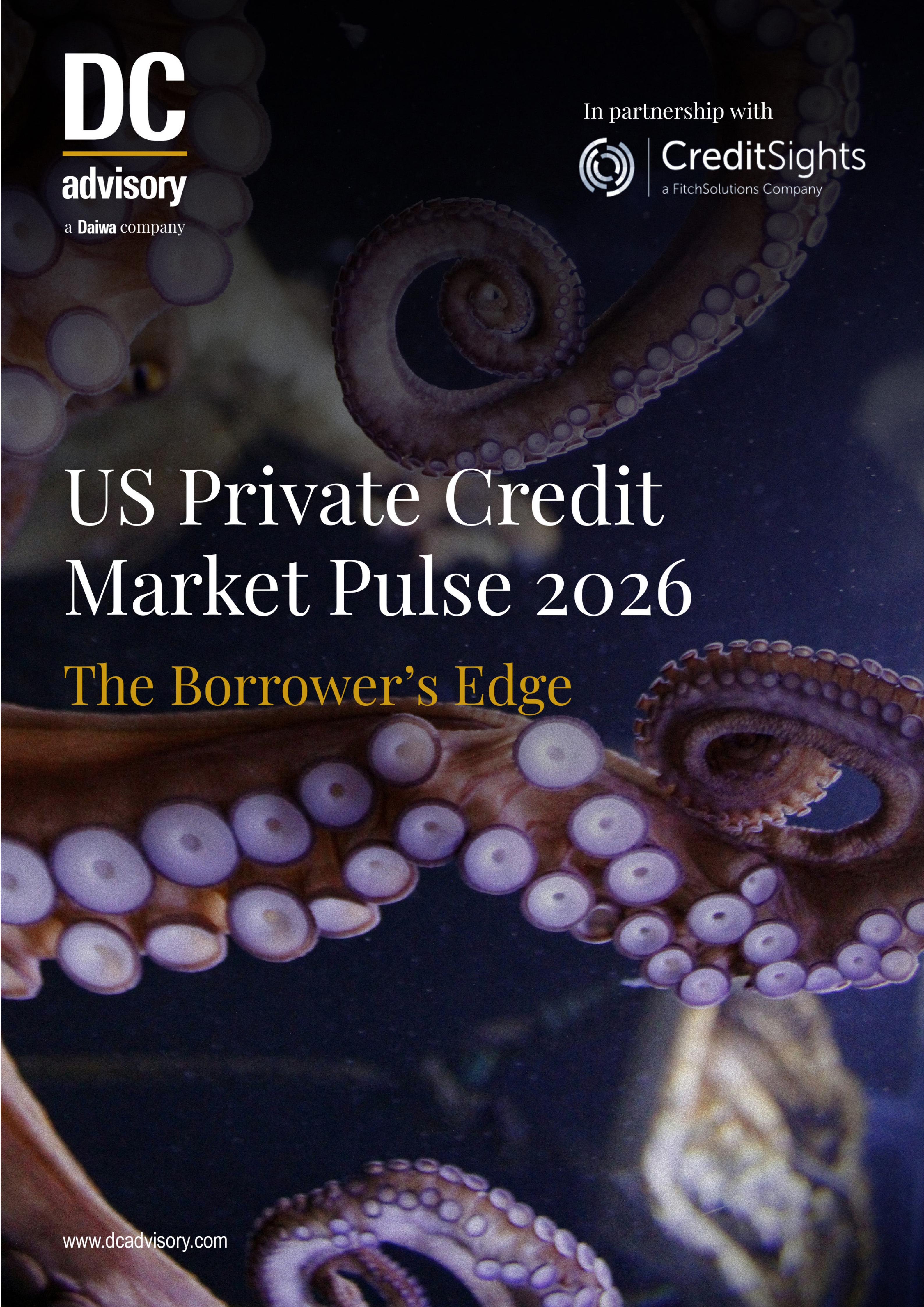

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US Private Credit Market Pulse 2026

The Borrower's Edge

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The Borrower's Edge

As we flip the calendar to 2026, it is worth reflecting on the resilience of the private credit market throughout a year of volatility. Despite macro headwinds - including labor market concerns, consumer softness, and credit quality consternation - strong technicals have kept the private credit market moving.

DC Advisory's US Private Capital Markets team and LevFin Insights discuss the drivers that sustained the momentum of the private credit market in 2025, and what's on the horizon for 2026.

Topics include:

- **Why documentation scores hit historic lows** and how "auto-cure" provisions are altering the default landscape
- **How direct lenders are navigating a falling base rate environment** to protect institutional returns
- **Implications of the FDIC and OCC's withdrawal of leveraged lending guidelines** on bank-led competition
- **2026 outlook**

The common refrain of "too much capital chasing too few deals" has certainly benefitted issuers and supported returns, but it has also resulted in intense competition among lenders. Market participants have regularly groused that muted LBO activity is leaving lenders with fewer deals to select from, handing sponsors much of the negotiating leverage.

With this, deals increasingly clear the market with fewer lender protections, including an uptick in:

- cov-lite transactions and bullet repayments
- Payment-in-Kind (PIK) at the onset
- inclusion of "auto cures" for default events

Notably, "auto-cure" provisions eliminate the need for a borrower to seek a waiver if it fails to take an action or deliver standard reporting - such as a notice, report or document under its credit agreement - effectively allowing a breach to be cured at any time, rather than by a specific deadline.

According to CreditSights' *Covenant Review*, the average documentation score for private credit loans eroded to 3.14 in Q3 2025, the least protective reading since the data started being tracked (on a scale of 1 – most protective – to 5*).

Technicals are likely to remain favorable for sponsors and borrowers in 2026

Private equity firms and direct lenders are optimistic that 2026 will usher in the return of M&A, though, in our experience, this has been the refrain for much of the last three years. Market participants are buoyed by the strong dealflow shown in the second half of 2025, as evidenced by the robust Q3 2025 BDC origination numbers*.

Still, we expect this strong technical environment will likely continue into 2026. While there are plenty of private equity assets primed to trade due to extended hold periods, large amounts of private credit dry powder has resulted in significant market slack*. Whether the anticipated pickup will be enough to absorb this demand remains an open question. Any acceleration in deals could shift the technicals back in favor of lenders, but as long as the dealflow backlog persists, the technicals will still likely remain in favor of the sponsors and borrowers.

Interest rate cuts may push spreads higher

Lenders may soon find more leverage as they seek to defend all-in yields. The Federal Reserve's 2026 path for policy rates[i] may provide more negotiating leverage to private credit firms too. With the softening labor market and lower-than-expected inflation[ii], CreditSights forecasts three Fed rate cuts in 2026, which would bring the policy range to 2.75%-3.0% from the 3.5% to 3.75% following the December 2025 meeting*.

Direct lenders must balance two competing factors as the base rate decreases. Private credit firms must offer pricing that can compete with the cheaper Broadly Syndicated Loan (BSL) market, but they also need to meet the returns promised to institutional investors (such as pension plans, insurers and other yield-focused institutional investors).

Those returns are generally high single-digit targets. The going market spread for competitive credit remains approximately S+450*. However, if multiple rate cuts occur in 2026, an S+450 pricing becomes a harder bargain for those lenders.

While Original Issue Discounts (OIDs) and fees will push returns beyond just the effective interest rate, yields would be much lower if spreads remain at their current levels.

FDIC, OCC withdrawal of leveraged lending guidelines adds an 'X' factor to 2026

The Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency's (OCC) withdrawal of leveraged lending guidelines[iii], which were post-global financial crisis regulatory statutes governing leveraged finance, adds an 'X factor' to the mix for 2026 - especially since the Fed is yet to follow suit.

This move will likely make it easier for banks to underwrite and invest in more aggressively structured deals, including those with leverage surpassing 6x, the threshold which regulators broadly used as the ceiling under the guidelines.

While bank financings may now be more competitive against private credit packages, private credit has other edges over the syndicated market, including:

- certainty of terms and pricing
- availability of PIK interest
- the possibility for larger Delayed-Draw term loans (DDTLs)
- customized financing packages

Before this, higher leverage levels were largely understood to be an edge for private lenders, but the withdrawal of the guidance alters the calculation somewhat.

While these guidelines were largely deprioritized in 2018 - following the OCC's Head announcing banks need not comply with the now-withdrawn rules[iv] – banks can now underwrite highly levered deals without worrying about regulators.

Defaults, tariffs present uncertainty

While defaults are always on lenders' minds, credit quality has become a key concern among market participants and observers in the wake of high-profile failures like Tricolor and First Brands[v].

A choppy labor market and possible economic softness also raises questions of fundamental health. The November 2025 payrolls report included a surprising upside to the unemployment rate at 4.6%, marking the highest level in four years, before falling back to 4.4% with the December data.[vi].

An uncertain economic outlook leads to questions about defaults, which have already posted a notable increase in recent years*.

For November 2025, the private credit default rate was 5.7% over the Trailing Twelve Months (TTM), which is the highest since February 2025[vi]. Over the TTM period, 91 default events were recorded with 59% stemming from interest payment deferrals and the introduction of PIK in lieu of cash interest*.

Large middle-market default rates have now eclipsed 5% for the past three years, a notable uptick from 2007-2022 average of 1.9% and above even the peak default rate during the GFC of 4.6%*. Finally, the ongoing saga around US tariffs continues to present uncertainty, particularly with the Supreme Court still expected to render its opinion on the legality of some tariffs in early 2026[vii].

The specific levies at issue were decided under a law called the International Emergency Economic Powers Act (IEEPA)[viii], and if the Supreme Court rules against the Trump administration, questions will arise about what comes next for trade policy, tariff rebates and the US fiscal deficit.

While those tariffs could be invalidated, the White House maintains that it has other avenues to impose tariffs (such as Sections 301[ix] or 232[x]), meaning a loss at the Supreme Court for the president could open a new chapter in the tussle over trade policies[xi].

Key contacts

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What lies ahead for the European Market?

European credit markets delivered another strong quarter with Broadly Syndicated Loan market volumes totalling €62 bn in Q3 2025. This brought year-to-date volumes to €211 billion, already surpassing full-year 2024 totals, the previous high.

DC Advisory's European Debt Market Monitor: 'Turning the Tide', provides an optimistic outlook for debt markets across Europe for 2026, citing stable financing conditions, improved market sentiment, and a strong M&A pipeline.

Access the full report >

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***All deal references and quantitative data has been sourced from LevFin Insights, a CreditSights company**

Unless otherwise indicated, all data referenced in this article is from LevFin Insights and Covenant Review. Covenant Review is a sister publication of LevFin Insights, and tracks the strength of protective covenants in private credit agreements. All deal references and quantitative data have been sourced from the LevFin Insights database.

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