# How can banks adapt to the growth of private credit?

*As alternative lending goes mainstream, banks may need to revamp strategies to meet corporate borrower needs*

**Deloitte Center for Financial Services**

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# Banks face a new lending reality

Deloitte's research found many banks are not embracing new opportunities, even when private credit poses a serious risk to their current lending business.

The dramatic growth of private credit in the United States has highlighted the expanding role nonbank financial institutions are playing in corporate lending. This phenomenon is part of a broader secular trend that began in 2002, when nonbanks lent more to corporate borrowers than banks did (see "What is private credit?").

### WHAT IS PRIVATE CREDIT?

Sometimes called private debt or alternative lending, private credit refers to lending by nonbanks to corporates. These loans are not publicly traded and include strategies, such as distressed and direct lending strategies.

Until recently, private credit managers often focused on riskier lending strategies, such as distressed debt. But now, their strategy has evolved to include more creditworthy borrowers, as this report will discuss. One of the main reasons borrowers have used private credit is the efficiency and flexibility in the lending process. Private credit firms can typically offer more tailored solutions that match borrower's needs.

How are banks responding to the growth of private credit? This Deloitte report examines a range of strategies currently being adopted by banks. Based on information from publicly available sources, such as regulatory filings and public statements, Deloitte studied the initiatives the 50 largest banks based on assets in the United States, including foreign banking organizations and intermediate holding companies, are taking to respond to the increased competition for corporate lending revenue (see "Methodology" for more on our research approach).

So far, banks appear to be following a variety of strategies. Many US-based global systemically important banks (GSIBs) are developing their own funds; however, given current fundraising, there is a wide disparity in the competitiveness of these funds.

From advising on and structuring deals to providing distribution access through their wealth management platforms, banks have an opportunity to work alongside the private credit ecosystem in myriad ways. Some banks are choosing to compete directly by building their own funds to complement existing investment banking services and wealth management products. But there are also opportunities for banks to cooperate with private credit firms. The decision to either compete or cooperate may depend on the strategic position of a bank, its size, and its product offerings.

Deloitte's research found many banks are not embracing new opportunities, even when private credit poses a serious risk to their current lending business. This analysis shows that this is especially true for regional banks: Some have yet to respond with a clear strategy.

# How private credit grew from niche strategies to prominence in direct lending

Nowhere does banks' displacement look more pronounced than the rise of private credit. When banks stepped back from lending in part due to market volatility in 2023, private credit managers stepped in.

Since 2002, corporate borrowing from nonbanks has been greater than borrowing from banks. But this diverged over the past few years. Deloitte's analysis of Federal Reserve data shows bank lending fell from 44% of all corporate borrowing in 2020 to 35% in 2023, while nonbank lending grew tremendously (figure 1).[1]

Nowhere does banks' displacement look more pronounced than the rise of private credit. When banks stepped back from lending in part due to market volatility in 2023, private credit managers stepped in to provide borrowers with stable funding and efficient lending processes. This appears to have had a profound impact on the diverging lending trajectories of banks and private credit firms.

Private credit managers used to focus on boutique strategies, such as distressed debt.[2] But now, direct lending is the dominant strategy; according to Preqin data, it has reached ~US$800 billion in AUM, or about half of all private credit investments.[3] The significant growth in direct lending and its mainstream adoption by corporate borrowers helps set it apart from other nonbank lenders.

There are some differences between loans offered through private credit and traditional bank loans. For instance, the average private credit loan is much larger than the average bank loan. Research from the Federal Reserve Bank of New York found that the average size of loans from private credit has increased in recent years and exceeded US$80 million since 2022, which is "much larger than the standard loan size in bank-dependent borrowers."[4]

Overall, the private credit market has grown exponentially, reaching US$1.6 trillion globally in assets under management in 2023, while the US leveraged loan market is ~US$1.4 trillion and the US high-yield market is ~US$1.3 trillion.[5] According to BlackRock, the private credit market is expected to grow to US$3.5 trillion globally by 2028, which would exceed the combined value of today's US leveraged loan and high-yield markets.

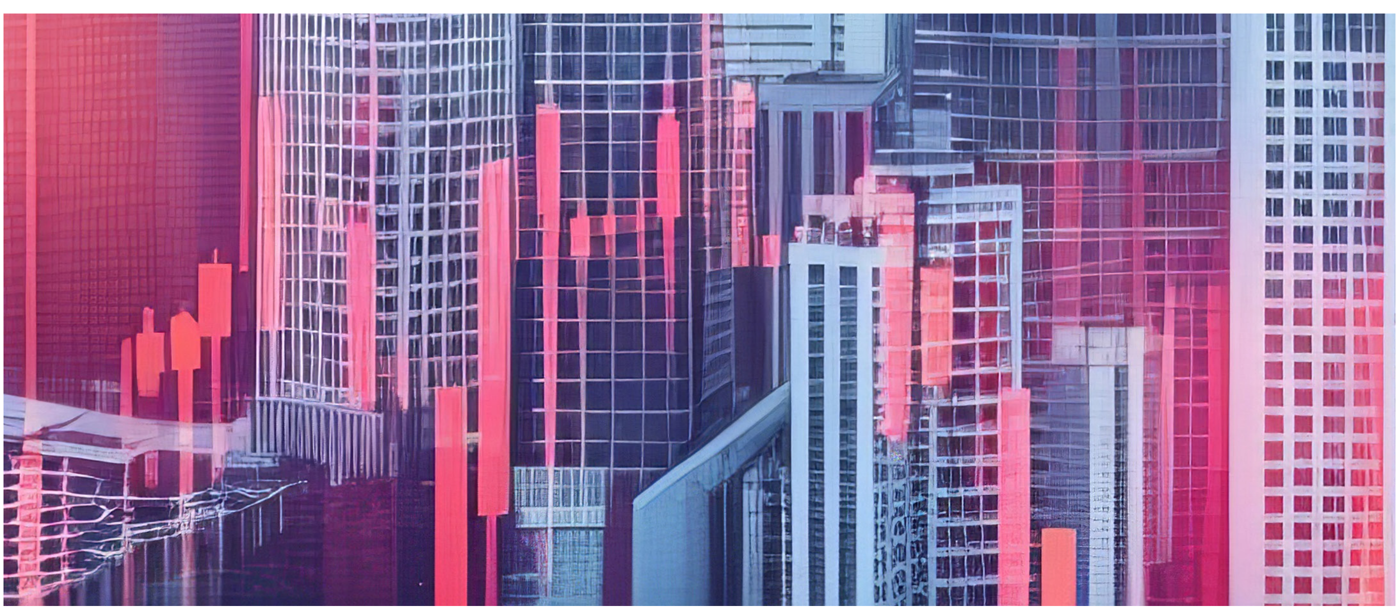
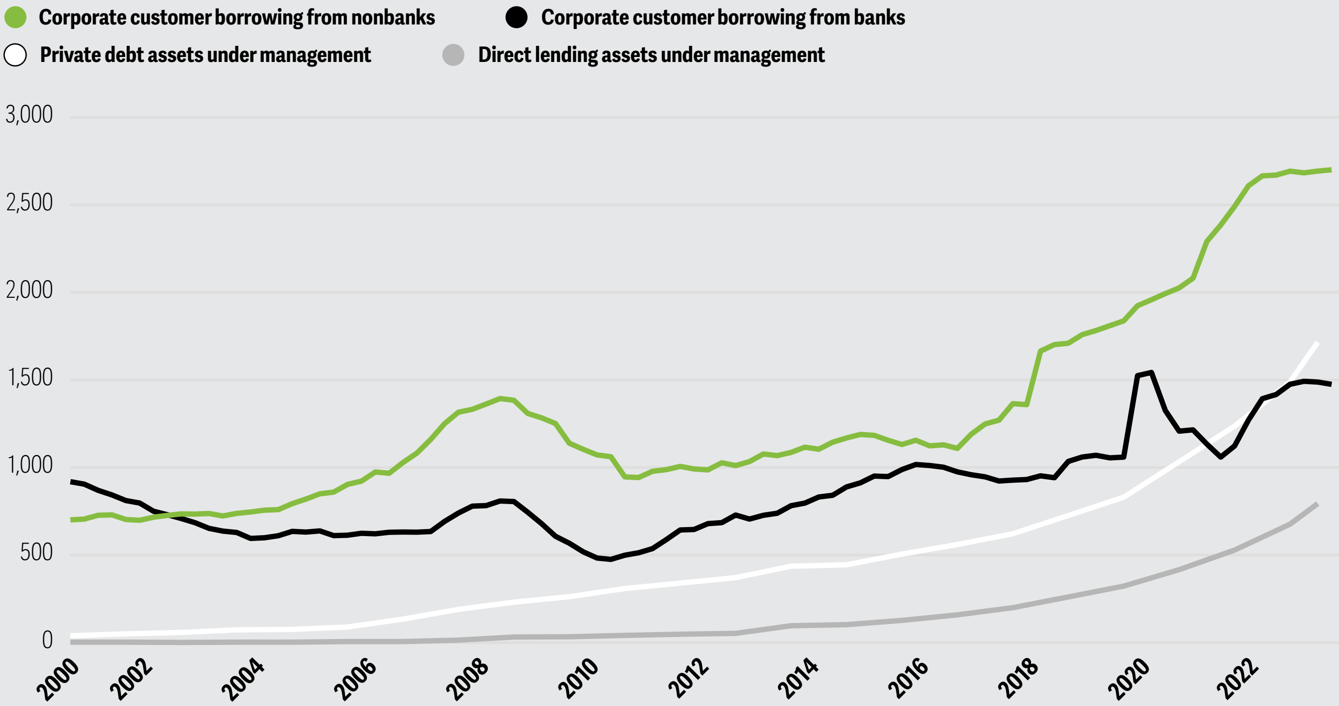


*Figure 1*

## Corporate borrowing from nonbanks continues its steady growth, eclipsing bank borrowing

*Borrowing from banks and nonbanks, 2000 to 2023 (US$ billion)*




Source: Deloitte Center for Financial Services analysis of data from the Board of Governors of the Federal Reserve System, The Federal Reserve Bank of New York, and Preqin Ltd.

### Case study: Impact of private credit on the leveraged buyout market

The impact of private credit is greatly impacting the lending market as evidenced with how it is displacing banks in leveraged buyouts. Since 2020, private credit has financed more leveraged buyouts than the syndicated loan market has, according to PitchBook LCD data.[6]

The leveraged lending market has been a multibillion-dollar revenue stream for the largest banks. On average, banks collect a 1% fee each time they syndicate debt, so by displacing this market, private credit funds are taking billions of dollars of potential revenue away from banks.[7]

Historically, a third of investment banking fees have come from underwriting and syndication.[8] The private credit market has outpaced the syndicated market in recent years, in terms of number of deals (figure 2).

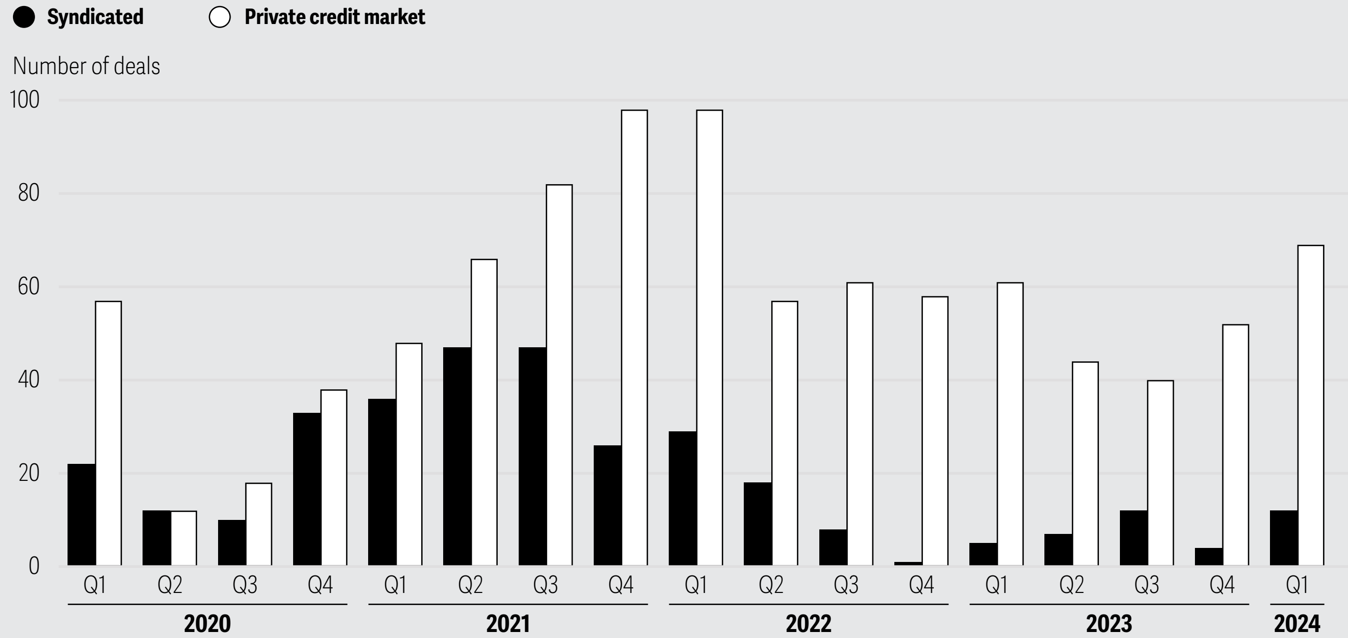
Among those deals, single lenders are the most common form of financing. And, as private credit firms work together, there will likely be more and more opportunities for them to finance ever larger deals, such as Thoma Bravo's 2021 US$6.6 billion takeover of Stamps.com backed by Ares Management Corporation, Blackstone, and PSP Investments.[9] Figure 3 shows the difference between single lender and three or more lenders since the third quarter of 2020.[10]

Private credit's dominance in one area of the lending market may be a harbinger of the future of private credit as banks lose revenue across a loan's life cycle. And while there are some signs that banks are taking market share from private credit firms in 2024, the numbers remain low, and banks may not recover to their previous peaks in syndicated loan market deals.[11]

*Figure 2*

## Since 2020, the leveraged buyout market has skewed toward private credit

*LBO financing, syndicated versus private credit, 2020 to 2024*

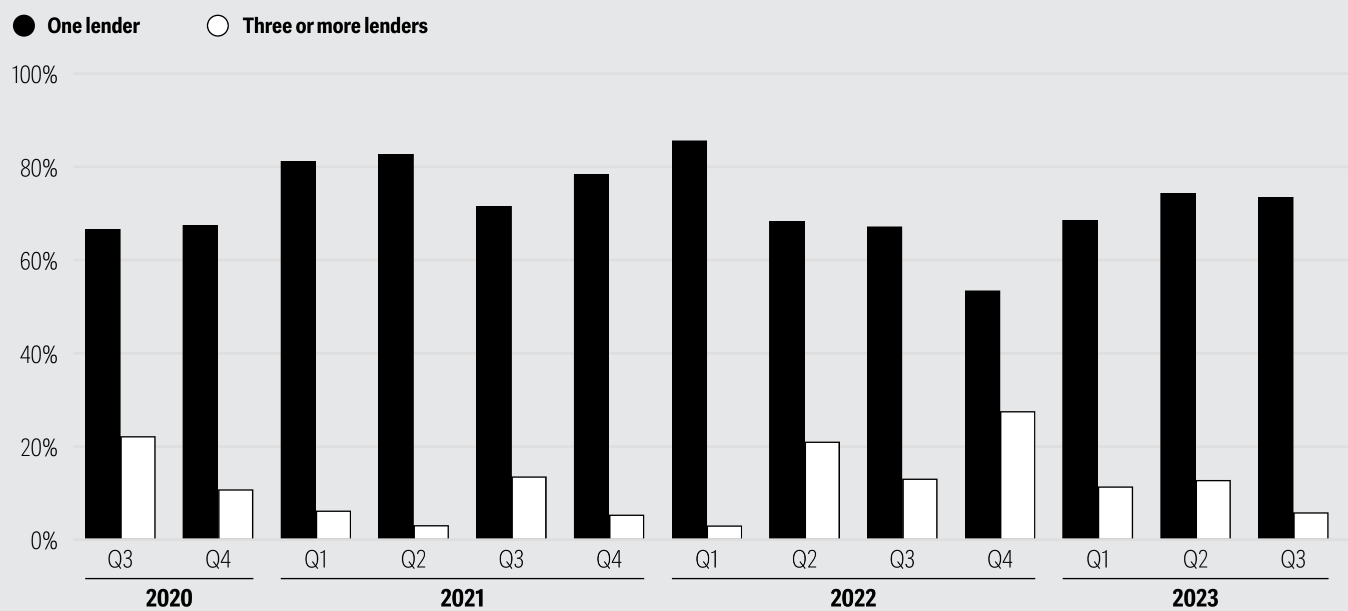



Source: PitchBook LCD.

*Figure 3*

## How leveraged buyouts are financed in the private credit market

*One lender, or three or more lenders, Q3 2020 to Q3 2023*




Source: PitchBook LCD.

# How banks could cooperate or compete in the private credit space

Banks' corporate clients may benefit from faster and more flexible lending terms while private credit firms benefit from the bank's relationships.

Private credit firms can help banks maintain their client relationships in the corporate lending market. For example, banks can play the role of facilitator by creating connections between their corporate clients and private credit firms. Corporate clients may benefit from faster and more flexible lending terms while private credit firms benefit from the bank's relationships.

For banks, one advantage of working with private credit firms is retaining less credit risk. With the expected adoption of Basel III endgame capital requirements, banks may be limited in their ability to lend to riskier clients. But since private credit firms are nonbanks, they often face fewer regulations. Working in partnership may help banks provide better service to their corporate borrowers.

By adopting this strategy, banks could relinquish their traditional lender role and become middlemen, which could reduce overall revenue. However, some banks are leaning into it by developing units to lend directly to credit funds, aligning the success of a private credit fund with the bank.

Below are examples of cooperative initiatives banks are undertaking (figure 4):

*Figure 4*

### Examples of cooperation within the private credit space

| | |
|---|---|
| **Partnerships** | PNC and TCW have partnered to create a lending platform for middle market companies.[a] |
| **Fund lending** | Citizens Financial Group has built out a unit focused on lending to private credit funds.[b] |
| **Fund services** | Deutsche Bank has focused on servicing funds, given its low-risk nature and reduced requirements to hold capital.[c] |
| **Wealth management** | Morgan Stanley, Merrill Lynch, and UBS are some of the main distribution partners for Blackstone's private credit products.[d] |
| **Investment advisory** | HSBC is advising on the deals it helps originate for private credit.[e] |
| **Risk transfer** | U.S. Bank has issued credit-linked notes tied to a pool of auto loans to optimize its balance sheet.[f] |

Sources: a. PNC Financial Services Group Inc., "PNC, TCW partner to expand capabilities, create private credit platform," press release, May 6, 2024; b. Carleton English, "Wells Fargo and other big banks aren't fighting private credit—they're enabling it," Barron's, December 30, 2023; c. Patricia Kowsmann, "The man who tamed the world's most troubled bank," The Wall Street Journal, February 18, 2024; d. Jonathan Kandell, "As private credit surges, banks and alternative asset managers turn frenemies rather than foes," Institutional Investor, December 4, 2023; e. Silas Brown and Kat Hidalgo, "HSBC makes global push to broker deals in private credit market," Bloomberg, October 12, 2023; f. Scott Carpenter, "US Bank plans to issue $2.5 billion of auto credit-linked notes," Bloomberg, December 5, 2023.

Some banks are responding to the rise of private credit by building their own private credit capabilities to compete directly with nonbanks.

Some banks are responding to the rise of private credit by building their own private credit capabilities to compete directly with nonbanks. Large banks can combine their balance sheet, wealth management, and investment banking groups to help build their own funds. They can raise money from wealth management clients and find deals through their leveraged lending and advisory teams.

Bank advisory and wealth management divisions can work cooperatively or competitively with private credit (figure 5). Below are examples of how banks are competing:

*Figure 5*

## How banks compete with private credit firms

| | |
|---|---|
| **Private credit fund creation** | Morgan Stanley is launching its own funds for opportunities in private credit.[a] |
| **Wealth management** | Goldman Sachs Asset Management continues to build its private credit unit.[b] |
| **Investment advisory** | JP Morgan is leveraging its investment bank to support the funds created by JPM Asset Management for private credit deals. These deal advisory teams can be dedicated to JPM fund deals, maintaining revenue for the group.[c] |

Sources: a. Gillian Tan, "Morgan Stanley mulls private credit fund bet with balance sheet," Bloomberg, December 21, 2023; b. Saeed Azhar, "Goldman Sachs seeks to expand private credit portfolio to $300 billion in five years," Reuters, March 12, 2024; c. Joshua Franklin, "JPMorgan takes on direct lenders with leveraged loans unit," *Financial Times*, July 20, 2022.

# Strategic initiatives leading banks are taking

As private credit plays a more prominent role in the lending market due to its growth, there is a large dispersion in how banks are responding. Banks have announced a range of strategic initiatives to compete and/or cooperate with private credit firms (figure 6).

*Figure 6*

**Categorization of banks' cooperative and competitive strategies with private credit**

| Cooperative or competitive | Strategic initiatives | Intersection with private credit | Implication |
|---|---|---|---|
| Cooperative | Fund services | Fund services provide operational support to private credit funds, such as treasury services, foreign exchange, and custody. | Fund services offer additional service income that can be offered throughout the life cycle of a deal. These low-risk services also don't require banks to hold a lot of capital. The services are then available to portfolio companies that need services private lenders do not provide. |
| | Fund financing | Banks provide debt to private credit funds to support their fundraising. | Banks continue earning interest income by providing loans to credit firms that lend to portfolio companies. This can help banks remain relevant to borrower needs even when they are not the primary lender. |
| | Origination partnerships | Banks work with private credit funds as an intermediary to make connections with current clients. | Banks leverage private credit partnerships to offer clients seamless and streamlined lending opportunities. This helps banks remain at the center of the relationship with clients, which benefits private credit firms and borrowers. |
| | Risk transfer | Banks transfer assets off their balance sheets to private credit funds. These may include originate-to-distribute processes and credit risk transfers (CRTs). | The transactions reduce banks' credit risk and decrease their capital requirements. For example, CRTs are being used discretely by both large and small banks to transfer assets and help strengthen their balanc sheets. |
| Both | Wealth management | Banks use their wealth management divisions to offer private credit investments to clients. | Wealth management divisions act as distribution partners to promote funds among wealthy clients. As private markets become more mainstream, these clients are likely to expect access to private credit investments. |
| | Investment advisory | Banks' investment banking divisions support private credit transactions by working with private credit funds or borrowers. | Investment banking divisions may find more of their revenue coming from private credit transactions. The largest banks will likely want to launch private credit funds: It will enable their investment banking division to be part of the deal flow. |
| Competitive | Build private credit fund | Banks raise money to build funds and make private credit investments. | This strategy is common among large banks that have the capacity on their balance sheets. Additionally, the funds use complementary services in wealth management to raise funds from clients and investment advisory groups help generate deals. |

Source: Deloitte Center for Financial Services analysis.

# Bank size is playing a big role in strategic approaches

Deloitte's Center for Financial Services analysis shows US globally systemic important banks (GSIBs) are pursuing multiple strategies (figure 7; see "Methodology" for more details). Our research found great dispersion in initial success when looking at individual GSIBs. Fundraising for bank-owned private credit funds, for example, has not been equally successful.

**METHODOLOGY**

Drawing from publicly accessible data, such as regulatory filings, annual reports, public statements, and media articles, Deloitte analyzed the actions of the 50 largest banks (including foreign banks) in the United States in the private credit space.

Deloitte compiled around 100 data points to identify and group bank activities into seven key strategies: fund services, fund financing, origination partnerships, risk transfer, wealth management, investment advisory, and fund development. This analysis was up to date as of May 31, 2024.

*Figure 7*

**How banks are responding to the growth of private credit**

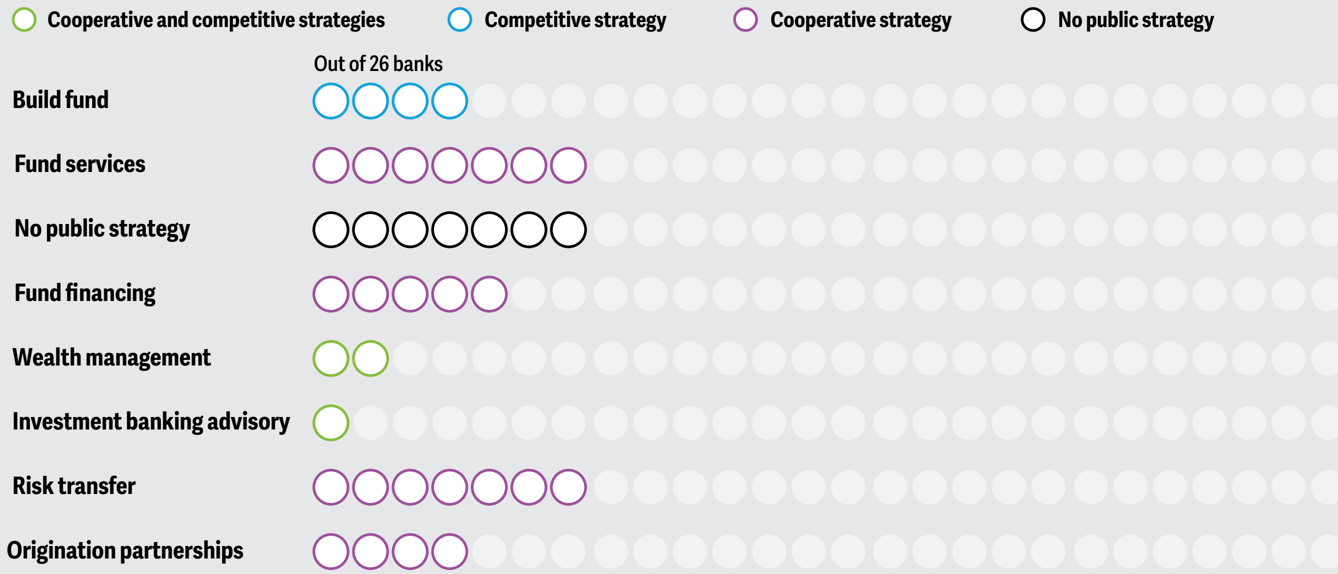
*Actions US GSIBs are taking*


Note: GSIBs refer to globally systemic important banks
Sources: Deloitte Center for Financial Services analysis, based on research of the 50 largest banks in the United States; see methodology for more details.

*Figure 8*

**How banks are responding to the growth of private credit**

*Actions regional banks are taking*




Sources: Deloitte Center for Financial Services analysis, based on research of the 50 largest banks in the United States; see methodology for more details.

In general, regional banks are integrating banking functions into the private credit ecosystem through fund services and fund financing. However, seven of the regional banks Deloitte researched have not yet made any public announcements on strategic initiatives to compete or cooperate (figure 8).

## Foreign banks lean into their wealth management teams to build capabilities

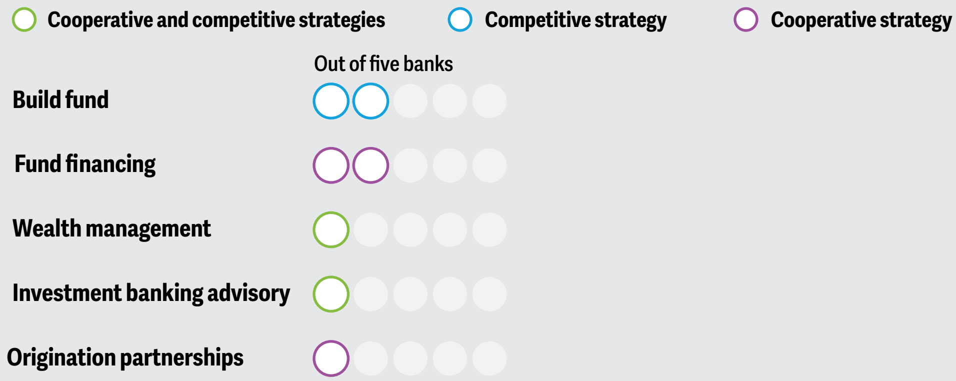
Given their large presence in their home countries, foreign banks are uniquely positioned to offer global wealth clients access to US-based private credit exposure. These companies often have the capabilities and scale to build their own funds and, in some cases, use their investment banking divisions to support deals.

Foreign banking organizations could also be using private credit as a means to help grow their presence in the United States (figure 9). Meanwhile, US intermediate holding companies are greatly expanding their wealth management product offerings (figure 10). For both, there can be an opportunity to build their own private credit funds as well. Pursuing more cooperative strategies could also help them grow their businesses and relationships across US markets.

*Figure 9*

## How banks are responding to the growth of private credit

*Actions foreign banking organizations are taking*

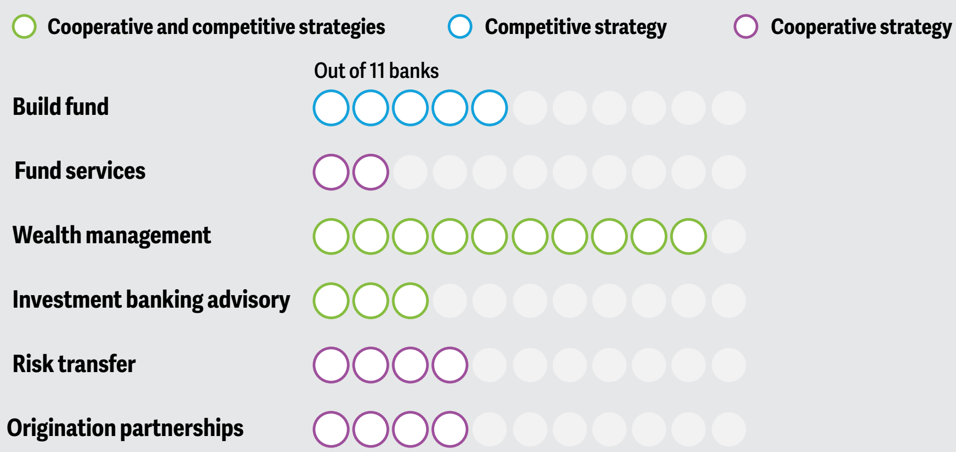



Sources: Deloitte Center for Financial Services analysis, based on research of the 50 largest banks in the United States; see methodology for more details.

*Figure 10*

## How banks are responding to the growth of private credit

*Actions intermediate holding companies are taking*




Sources: Deloitte Center for Financial Services analysis, based on research of the 50 largest banks in the United States; see methodology for more details.

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## Some banks pursue strategies according to their size

Deloitte used publicly available information to analyze common strategies the 50 largest banks in the United States are taking, and then categorized their actions and assessed the factors driving banks toward these initiatives. Below is our analysis of what some of the leading banks are doing (figure 11).

*Figure 11*

## How some of the leading banks are adopting strategies

| Bank example | Common strategies | Strategic drivers |
|---|---|---|
| US globally systemic important banks (GSIBs) | Mobilizing a whole-firm approach by:<br>• Building their own funds<br>• Forming origination partnerships with private credit<br>• Leveraging their wealth management and investment advisory services | US GSIBs are increasing exposure to private credit by adopting cooperative and competitive strategies to varying degrees. Their actions show private credit is becoming a more important asset class they want exposure to. |
| Regional banks | Developing cooperative relationships with private credit firms by:<br>• Creating fund servicing teams to remain part of the lending ecosystem<br>• Alleviating balance sheet stress with risk transfers | Regional banks are focused on cooperative strategies with private credit, primarily leveraging opportunities to operate in the private credit ecosystem and maintain some fee income. As they aim to strengthen their balance sheets, the growth of credit risk transfers will likely increase.<br><br>Some banks are finding ways to service both private credit and corporate clients through partnerships. |
| Intermediate holding companies | Developing cooperative relationships:<br>• Using wealth management teams to build relationships with private credit firms<br>• Generating additional fee income for investment banking teams who support deals | Private credit can help foreign banks increase their exposure to the US corporate lending market.<br><br>Private credit funds also provide products for wealth management divisions to diversify to other geographies. |
| Foreign banking organizations (FBOs) | Most FBOs are focused on cooperative relationships that:<br>• Expand their opportunities in the US market by lending to private credit through fund financing<br>• Leverage their home-country capabilities to build funds when possible | FBOs are leaning into private credit as an opportunity to expand their US presence, either by lending to funds or working on deals that would give them more noninterest income. |

Source: Deloitte Center for Financial Services analysis.

### Bank preparedness varies widely within and among bank sizes

Among the largest banks, there appears to be a sense of urgency in their efforts to scale capabilities to increase lending revenue and fee income. Most GSIBs are actively building their own private credit funds or scaling current funds. Based on public reporting and analysis by Deloitte, Goldman Sachs plans to grow its private credit portfolio from US$130 billion to US$300 billion over the next five years, exceeding its peers (figure 12).[12] Moreover, Goldman Sachs started to reduce investments on its balance sheet, from US$30 billion in the fourth quarter of 2022 to US$16.3 billion in the fourth quarter of 2023, to lower capital requirements and help boost return on equity.

GSIBs are also leaning into partnerships with private credit funds. For example, Wells Fargo partnered with Centerbridge to offer US$5 billion in direct lending through a subsidiary, Overland Advisors.[13]

### Regional banks may struggle without quick action

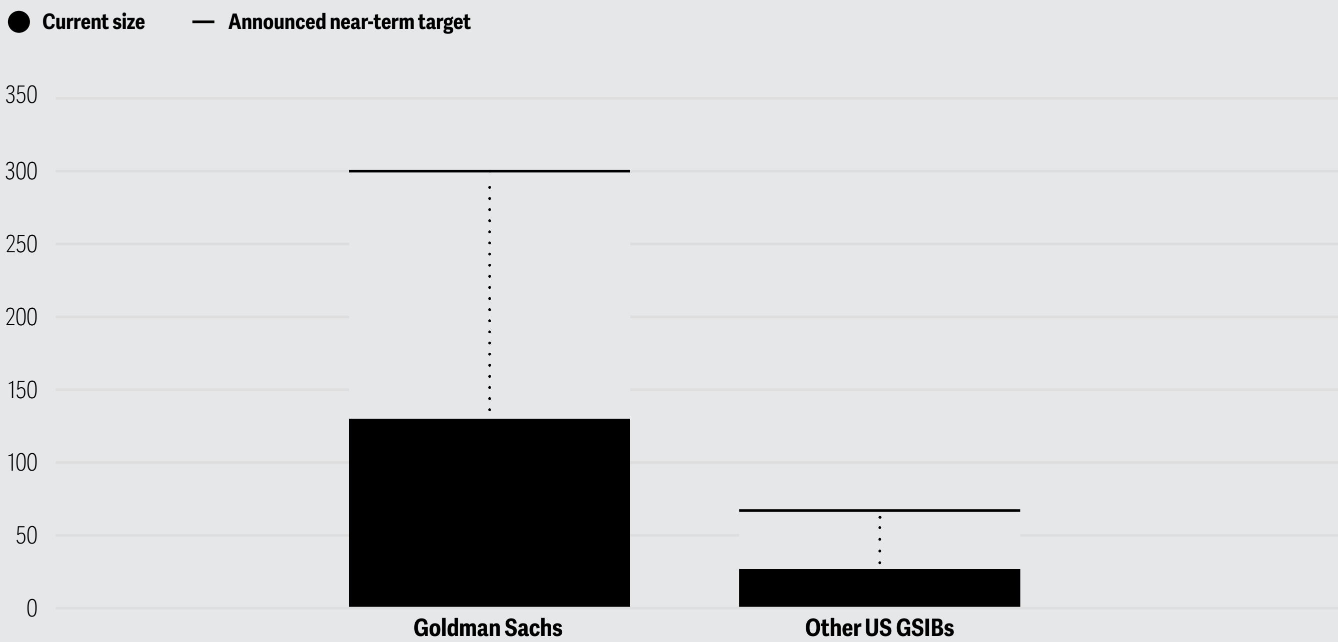
Regional banks may face the biggest threat from private credit, yet some appear to have not developed strategies. A study by The Brookings Institution found "the lending model of the larger regional banks appears to be most exposed to competition from nonbanks." Their report explains, "Unlike the community banks, which focus on relationship lending to the smaller firms of the economy, regionals have lost a good chunk of their core business lending franchise to the nonbank sector."[14] Since private credit is directly competing with regional banks for middle-market clients, the future for regional banks is more complicated than it is for GSIBs. Some regional banks may not have the economies of scale to compete, in which case, mergers or acquisitions may help.

With their deep local experience and information advantage in certain geographies, regional banks are well positioned to help support private credit funds and clients. They may find additional opportunities by partnering with private credit firms to offer fund services or fund financing.

*Figure 12*

## Investing in private credit: How one globally systemic important bank tops the rest

*Goldman Sachs versus other US GSIBs (US$ billion)*




Source: Deloitte Center for Financial Services analysis based on public announcements of US GSIBs.

Fund financing may be a large opportunity. Bank lending to nondepository financial institutions, which includes the whole universe of nonbank financial institutions, not just private credit funds, has more than tripled since 2015 (figure 13).[15] As private credit grows, there will likely be ample opportunities for banks to engage in fund financing. While fund servicing may be an opportunity for banks to maintain or generate new fee income, they should gauge whether these capabilities are worth the infrastructure investment.

## Balancing strategic moves into private credit with regulatory and economic challenges

Banks will likely face difficulties in the years ahead: a challenging regulatory environment and the aftereffects of a rapid rise in interest rates. Facing more uncertainty, understanding how and when to incorporate private credit as part of their lending arsenal will likely be important. It could still take several years for most banks to evolve fully to new conditions and effectively deploy strategic initiatives that embed private credit.

While some banks have made progress building their own capabilities or incorporating private credit lending capabilities, it has not yet reached a scale that maximizes the available opportunity. Banks should consider identifying their ability to compete or cooperate and create holistic strategies for this new era in credit. Failure to develop a strategy could put banks at risk of losing interest and fee income, as well as missing opportunities to arrange and divide deals to better serve clients.

An overarching question impacting bank strategy is the potential impact of Basel III endgame. Bank CEOs have been critical of the expected Basel III endgame rules. They've highlighted the constraints it would put on their banks' ability to lend as well as the unintended consequences, for example, more lending by less regulated entities, such as private credit.[16]

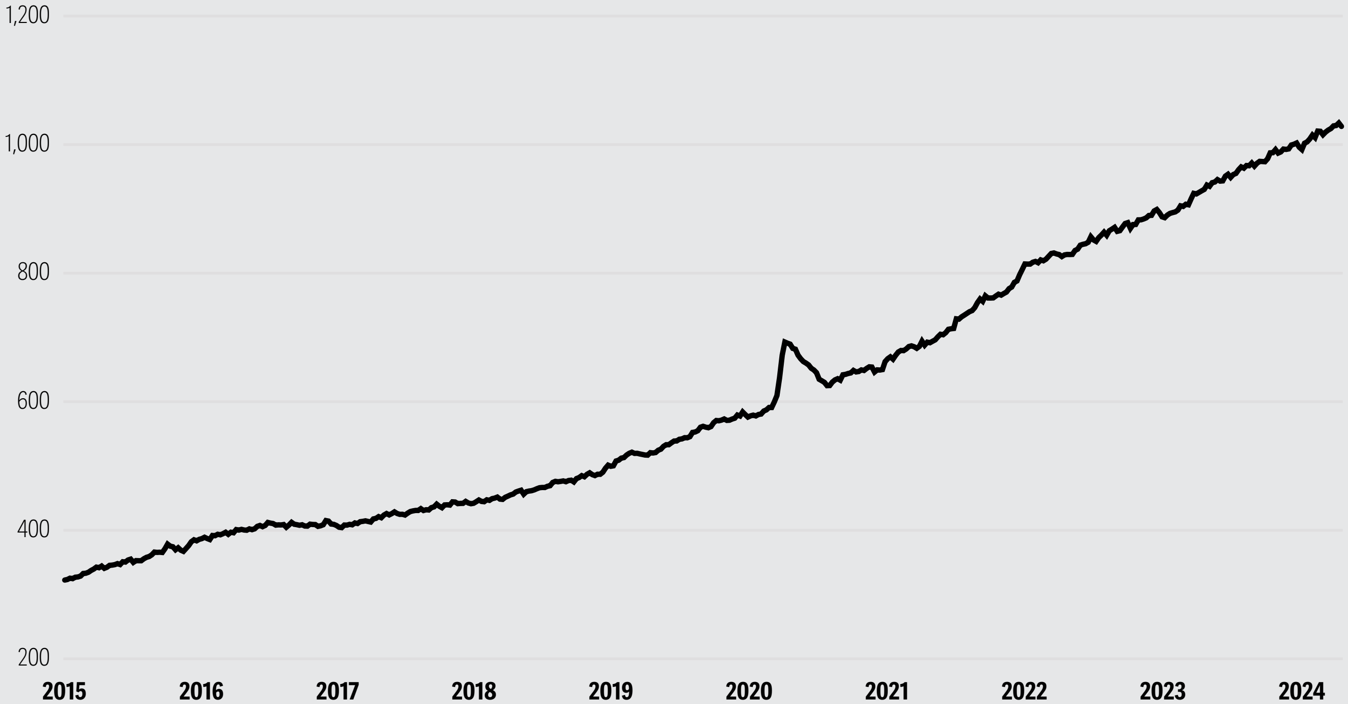
Similarly, there is expected to be uncertainty on how to incorporate private credit, especially because private credit is still relatively new, and it is unclear how it will perform in a downturn. Given the competitiveness among private credit firms, recent deals lack the stronger covenant protections that banks require.[17]

While it is difficult to estimate the performance of direct lending, one indicator is the growth of payment-in-kind (PIK) interest, noncash interest payments accumulated by a borrower. Bloomberg has tracked at least US$73 billion outstanding in PIK borrowings, nearly all below investment grade and with rates as high as 20%.[18]

*Figure 13*

**Bank lending to non-depository financial institutions**

*US$ billion*




Source: Federal Reserve Economic Data, as of April 17, 2024.

Banks should consider the availability of credit from their private credit partners if there is an economic downturn.

Additionally, regulators may take a greater interest in monitoring private credit as it grows. Acting Comptroller of the Currency Michael Hsu has expressed concerns in how "the blurring of the line between banking and commerce can lead to financial instability."[19] Among his examples were banks' increased exposure to capital calls and the growth of evergreen funds. Some banks may be cautious about entering into partnerships with private credit firms, given the increased regulatory scrutiny of banks' relationships with third parties.

But private credit funds also have reasons to work with banks. Bank partnerships can help private credit funds source deals in an increasingly competitive environment. Funds have ~US$430 billion of dry powder competing for fewer opportunities as buyouts decrease and companies are borrowing at significantly higher rates than prior years.[20] In some cases, banks may benefit from adopting a hybrid approach, using syndicated loans for senior credit and private credit for more junior debt.[21]

## Is the lending market big enough for banks and private credit firms?

Banking has become a smaller part of the overall credit market, continuing a decades-long trend. Private credit is the most recent prominent force in disintermediating the credit markets. But, in the end, this is less of a story about banking or private credit. It's more about what system best meets clients' borrowing needs.

# Endnotes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