

Reassessing Value for Insurers Across Europe's Credit Landscape



EXECUTIVE SUMMARY

- + In recent years, insurance companies have increasingly allocated to different forms of private credit, aiming to target higher returns, diversify credit exposures and benefit from excess liquidity.
- + As insurers evaluate the credit universe, it should be noted that credit is fungible, and borrowers tend to gravitate to the most advantageous terms available in the market.
- + Post-COVID, private credit lenders in Europe eased lending conditions and gained market share as banks grew less willing to underwrite syndicated loans and high yield bonds. More recently, banks have eased terms; with lower funding costs, they are capturing more refinancing activity in syndicated loan and/or high yield bond issues.
- + Looking forward, **investment returns for public and private European credit are likely to converge** as the two market segments compete for market share. However, publicly issued bonds and loans are more liquid, with better price transparency and lower costs compared with privately originated direct lending.
- + We believe **European leveraged loans and high yield bonds present a compelling investment case in today's market**, including as an alternative or complement to European direct lending. With their liquidity, transparent pricing and access to a broad issuer base, these instruments may provide insurers with enhanced flexibility and risk-adjusted return potential.



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European credit: An evolving market

As European credit markets have expanded over the last decade, high yield bonds, leveraged loans and direct lending have emerged as established funding channels for borrowers and attractive investment options for investors. The relative-value comparison depends heavily on interest rates, as periods when low rates prevail tend to favour private credit whilst higher-rate periods tend to favour public credit.

Liquidity and pricing as well as credit fundamentals are key considerations that vary dramatically across channels. The European high yield bond market's average rating is BB, and the leveraged loan market consists predominantly of collateralised loan obligation–suitable, single-B-rated credit. Although most direct lending deals are unrated, the market caters mainly to B3/B-rated credits through its unitranche structure.

Factors influencing the choice between public or private markets

Direct lending is a type of private credit strategy that makes direct, illiquid loans to middle market companies (typically those with €10–200 million of earnings before interest, taxes, depreciation and amortisation [EBITDA]). To access the syndicated loan or high yield bond markets, companies typically need EBITDA of at least €50 million, so syndicated loans and direct lending generally compete in the upper middle market (€50–200 million of EBITDA).

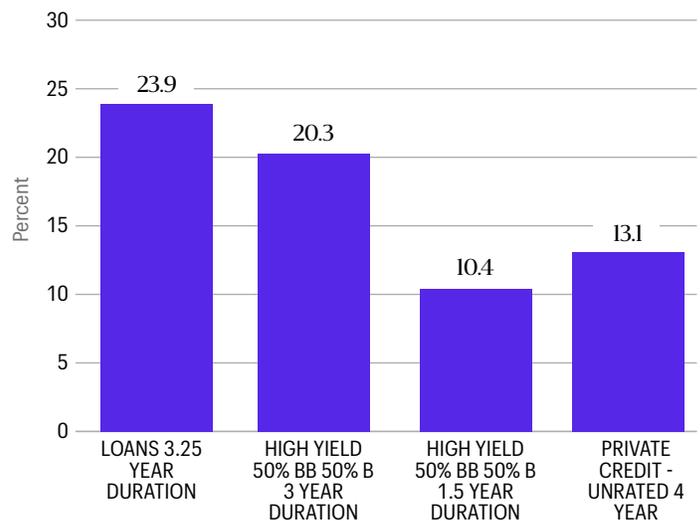
A host of factors may influence an issuer's decision to access private or public markets. Direct lending typically offers speed of execution, potential benefits resulting from dealing with a smaller group of lenders and structuring flexibility (payment-in-kind structures, second lien loans and no rating requirement). These aspects are useful for small and medium-size borrowers as well as for larger ones with outstanding debt that is difficult to refinance in the public markets. Public markets, on the other hand, offer significantly lower financing costs and more flexible legal documentation.

For investors, the asset classes provide a range of opportunities. The recent increase in market volatility could draw more lenders to put capital to work in the bond and loan markets as they opt for the higher credit quality and better diversification public markets offer, compared with the lower credit quality and more opaque direct lending space. Investors may also put their money to work more quickly in the bond and loan markets' liquid vehicles that offer broad diversification across industries and issuers. In contrast, direct lending may offer investors higher yields than either high yield bonds or syndicated loans as compensation for their illiquidity and higher credit risk. Some categories of investors also benefit from favourable regulatory capital treatment when investing in private markets.

Applying an insurance lens

The regulatory treatment of private debt for insurers varies between regimes—for both the capital requirement as well as any restrictions or approvals around the amount that can be recognised (e.g., for the Scenario-Based Approach in Bermuda). However, in general, many regimes (including the Standard Formula for Solvency II and Solvency UK) have treated private debt relatively favourably versus public market credit from a Solvency Capital Requirement (SCR) perspective, as shown in Figure 1.

FIGURE 1: PRIVATE DEBT IS OFTEN TREATED FAVOURABLY IN TERMS OF SOLVENCY CAPITAL REQUIREMENTS



Sources: Allspring and EIOPA Standard Formula, based on version effective 14 November 2024

Whilst private debt may have a relatively lower SCR than public market equivalents with broadly similar credit quality and duration profiles, we note that insurers are still expected to measure and allow for the overall risks inherent in private debt as part of their wider risk management and quantitative framework.

Given insurers' focus on asset-liability management, the **liquidity profile** of the underlying investments is critical. Bonds and loans issued in the public market offer transparent pricing and the ability to adjust risk positions with relative ease. Conversely, direct lending investments have little to no liquidity and reduced price transparency. The ratings-adjusted premium private credit offers to compensate for these risks currently is approximately 90 basis points (bps; 100 bps equals 1%) per year. Whether an individual insurer judges this to be sufficient will likely be a major driver of allocation decisions among the respective asset classes.

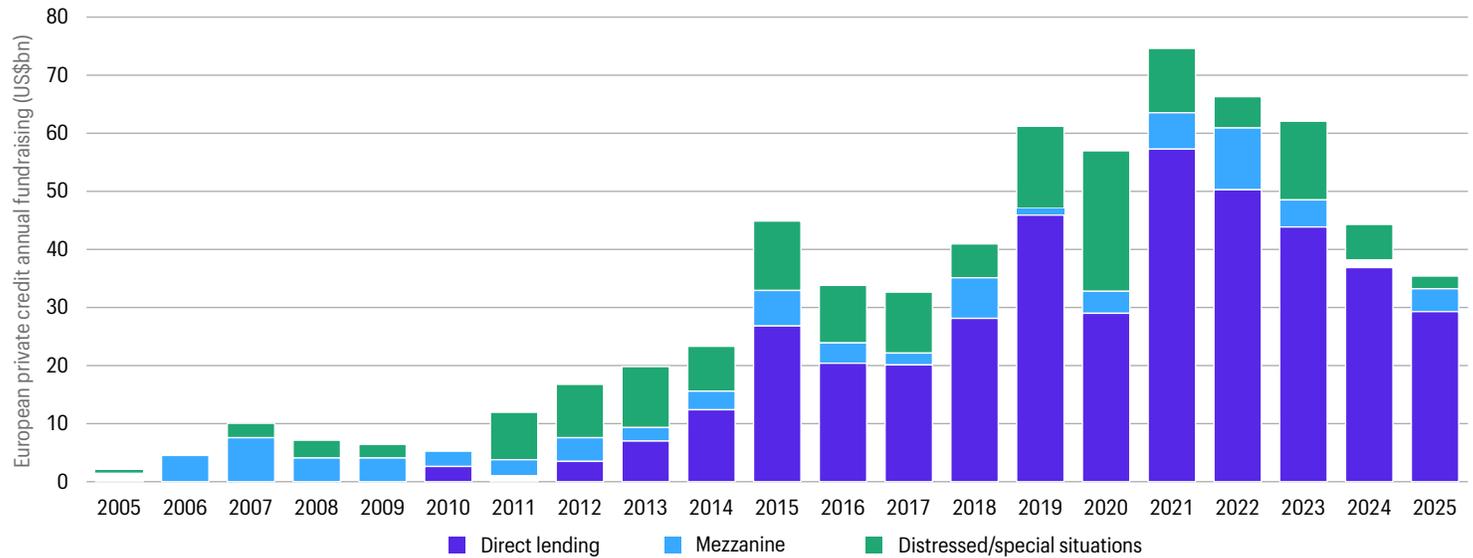


Private credit is increasingly financing investment-grade relative to sub-investment-grade assets

Whilst data for the private credit universe invariably show high levels of growth, it is important to note that private credit typically covers six sub-strategies: direct lending, asset-based finance, distressed debt, mezzanine lending, special situations and venture lending. The leveraged loan and high yield bond markets mainly compete with direct lending and, to a lesser extent, mezzanine lending and distressed debt.

Figure 2 shows that whereas growth in private credit continues, during the last four years, momentum has shifted away from direct lending. Indeed, the growth of private credit is increasingly being driven by asset-based finance—more specifically, by investment-grade assets such as infrastructure, real estate and data centres rather than by the traditional sub-investment-grade segments such as direct lending.

FIGURE 2: PRIVATE CREDIT FINANCING IS CHANGING



Sources: Allspring and JPMorgan, as of 31-May-25

Two factors at play here

First, regional and local European banks still play a substantial role in lending to small and medium enterprises. After a decade of double-digit growth, the direct lending market has reverted to a lower growth rate comparable with the rate of growth in the leveraged loan market, which can best be approximated by looking at collateralised loan obligation creation.

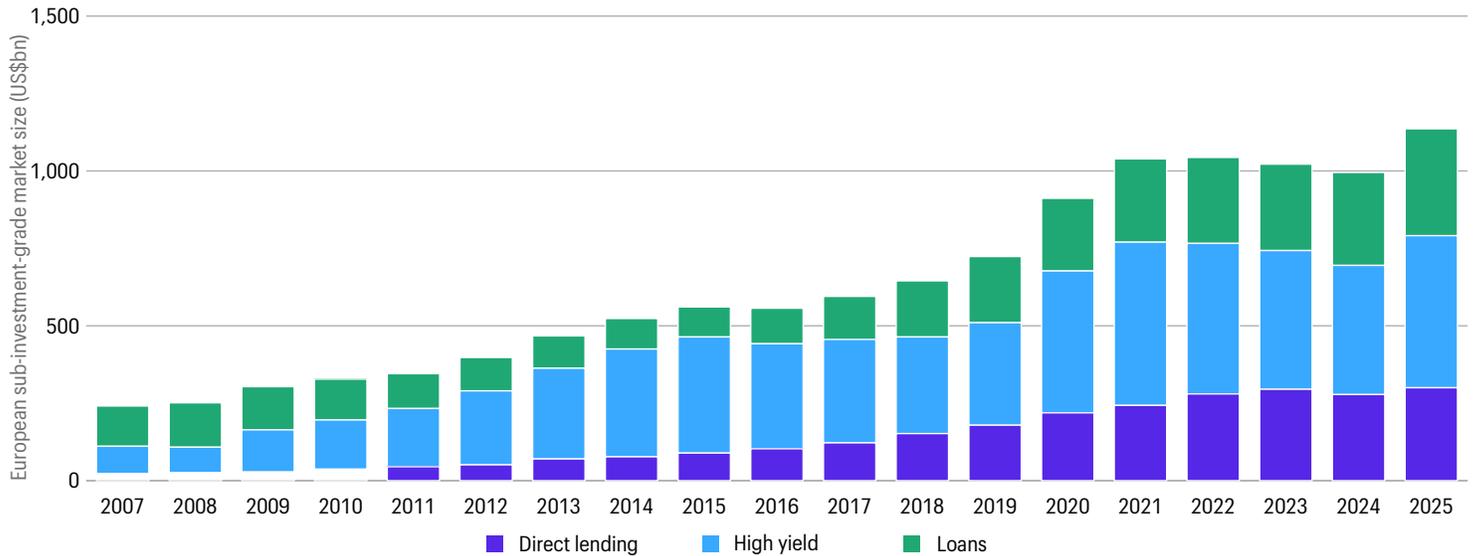
Second, with a lull in mergers and acquisitions and with interest rates persistently high, it has become more difficult for private credit companies to exit out of investments—especially those that are performing poorly or struggling. Underperforming loans can become the ones sitting in a fund at the end of its lifespan, as better credits within a portfolio can generally be refinanced or sold before maturity. This makes it harder for private credit companies to return cash to investors who, in turn, find it more difficult to commit more capital to the asset class. Private credit managers have started using new strategies and tools—such as continuation/rollover vehicles, net asset value-based financings and single-asset or concentrated portfolios—to address investor demand for liquidity.



Europe's borrowers and lenders now have three large markets in which to participate

The public and private credit markets are frequently portrayed as rivals competing for lending opportunities. Whilst it is true that direct lending became a funding alternative to the loan and high yield bond markets for borrowers of lower credit quality when banks' risk appetite was pressured by geopolitical and macroeconomic instability in 2022 and 2023, growth in these markets is not mutually exclusive and all three funding channels have thrived over the last two decades (Figure 3).

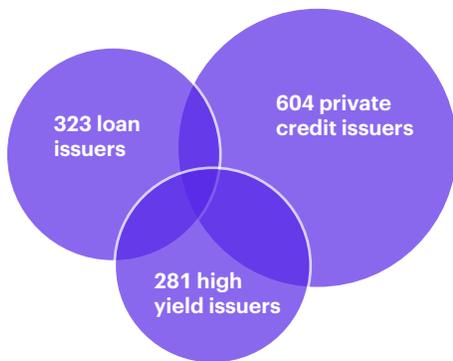
FIGURE 3: EUROPEAN SUB-INVESTMENT-GRADE MARKET HAS GROWN AND BROADENED OUT



Sources: Allspring and JPMorgan, as of 31-Dec-25

As the size of European sub-investment-grade markets has grown, issuers have increasingly used both public and private markets to borrow money. Figure 4 shows the number of borrowers that have issued debt in each respective market since January 2023, illustrating how issuers are increasingly tapping multiple forms of financing.

FIGURE 4: EUROPEAN BORROWERS ARE TAPPING MULTIPLE FORMS OF FINANCING



MARKET	OVERLAP	% OVERLAP
High yield/loans	45 companies	7.45%
Loans/private credit	35 companies	3.77%
High yield/private credit	8 companies	0.90%
High yield/loans/private credit	5 companies	0.41%

Sources: Allspring and 9Fin; review period January 2023 through May 2025

After a few years during which private credit encroached on the public markets, in late 2023, issuance momentum began shifting back to the public markets, mainly because they offer a distinct pricing advantage. As direct lending deals structured in 2021, 2022 and 2023 exited their non-call period, bankers started pitching refinancings in the syndicated loan or bond market at spreads that were typically 150–200 bps cheaper than borrowers were paying on their private credit deal. Over 2025 as a whole, €9 billion of new private lending activity came from borrowers that were previously financed in syndicated markets. Conversely, at least €13 billion of private loans were refinanced in public markets. We expect the shift back towards high yield bond and syndicated loan issuance to continue as banks compete aggressively with lower funding costs to win back market share from private debt funds.



Higher interest rates may have reduced the return advantage direct lending held over public markets

Whilst returns generated by private credit generally outpaced those of broadly syndicated loans during the period of low interest rates, that dynamic has changed in the last several years. Figure 5 shows that in 2023 and 2024, both the European high yield and leveraged loan asset classes outperformed private credit. During the first 9 months of 2025, high yield continued this trend of outperformance with leveraged loan returns only marginally behind private credit returns.

This reversal of roles is likely attributable to a few factors. In 2023, the public market rebounded following the 2022 sell-off, but at the same time, ever-increasing competition within private credit to win deals and the large amount of dry powder available contributed to a narrowing of spreads in that space. As we explain on the following page, lower direct lending spreads have led to lower expected and realised returns whilst higher interest rates have continued having a larger impact on direct lending borrowers. These companies are smaller in size, lower in credit quality and more exposed to geopolitical and macroeconomic volatility than their peers in the loan or bond markets.

FIGURE 5: COMPARING EUROPEAN SUB-INVESTMENT-GRADE RETURNS

	PRIVATE CREDIT	EUROPEAN HIGH YIELD BONDS	EUROPEAN LEVERAGED LOANS
2014	7.1%	5.3%	3.0%
2015	5.7%	0.5%	4.7%
2016	6.8%	8.5%	5.9%
2017	16.7%	6.2%	4.0%
2018	6.0%	-3.6%	1.6%
2019	8.3%	10.7%	4.8%
2020	4.6%	1.9%	2.8%
2021	13.7%	3.3%	5.0%
2022	4.0%	-10.9%	-3.1%
2023	9.2%	12.4%	13.6%
2024	7.7%	8.5%	9.2%
9M25	4.3%	4.5%	3.6%
FY25	N/A	5.2%	4.5%

Sources: Allspring, JPMorgan, S&P Global, Preqin, 9-Feb-26

Private credit represented by the Preqin Private Capital Index; euro high yield bonds represented by the Markit iBoxx EUR Liquid High Yield Index; euro leveraged loans represented by the J.P. Morgan European Leveraged Loan Index

Past performance does not guarantee future results.

Defaults and recoveries in private and public markets have been comparable

Default activity in the European private credit space appears to have closely resembled the experience in syndicated markets over the last year (Figure 6). As of 31 December 2025, the KBRA DLD Direct Lending Index trailing 12-month (TTM) par-weighted default rate compares closely with the TTM default rates for leveraged loans and high yield bonds.

Looking forward, we think default and recovery rates between the two markets will not differ significantly. Whilst the small lending group and strong relationship between borrower and sponsor in private credit may help facilitate debt-restructuring plans, we remain mindful that the direct lending market is more skewed towards lower-quality credits than the public market.

As of December 2025, in terms of recoveries, the recovery rate was 54% on a trailing-12-month basis for the KBRA DLD Direct Lending Index. By comparison, the recovery rates for leveraged loans and high-yield bonds, including distressed exchanges, were 45% and 41%, respectively. These recovery rates are for US-based markets; we do not have corresponding data for Europe.

FIGURE 6: COMPARABLE DEFAULT RATES IN PRIVATE AND PUBLIC MARKETS

	PAR-WEIGHTED DEFAULT RATE	
	EXCLUDING DISTRESSED EXCHANGE	INCLUDING DISTRESSED EXCHANGE
High yield bond	1.90%	2.80%
Leveraged loan	1.10%	2.50%
		INCLUDING NON-ACCRUALS
Direct lending	0.90%	1.70%

Sources: Allspring, JPMorgan; KBRA DLD, Solve, February 2026. The European private credit default rate is taken from European holdings of US Business Development Companies (BDCs) and so do not fully reflect the broader European private credit space.

1. In private credit, non-accruals refer to loans where interest income is not recognised due to reasonable doubt about the collection of principal or interest. This typically happens when repayment efforts have ceased, such as when a loan is past due for 90 days or more.



The relative cost of newly originated deals has fluctuated over time

Figure 7 provides an overview of direct lending and leveraged loan new-issue pricing since the start of 2022. Note that over the period under consideration, the pickup of private credit versus newly originated B3-rated loans averaged just 0.42% and quarterly fluctuations were quite meaningful.

The relationship was inverted, meaning that leveraged loans offered a higher yield to investors than direct lending did when syndicated markets were highly volatile during periods in 2022. In a further sign that the boundaries between public and private markets have been blurring, a number of investors attempted to capture the excess spread offered by syndicated loans versus private credit in 2022 by allocating some of their direct lending “dry powder” to syndicated loans. These trades were unwound in 2023 when the pricing relationship had normalised.

FIGURE 7: PRICING DIFFERENTIAL BETWEEN DIRECT LENDING AND B3-RATED SYNDICATED LOANS IN THE US

	PRIVATE CREDIT YTM (KBRA) (%)	B3 LEVERAGED LOAN YTM (%)	DIFFERENCE BETWEEN PRIVATE CREDIT AND LOANS (%)
Jan-22	7.01	6.35	0.66
Apr-22	7.49	8.16	-0.67
Jul-22	8.36	10.12	-1.74
Oct-22	10.31	12.81	-2.50
Jan-23	12.04	11.64	0.40
Apr-23	12.31	12.06	0.25
Jul-23	12.41	11.64	0.78
Oct-23	12.11	11.95	0.16
Jan-24	11.76	10.03	1.73
Apr-24	11.56	10.62	0.93
Jul-24	11.05	9.70	1.35
Oct-24	10.89	9.43	1.46
Jan-25	10.28	8.85	1.43
Apr-25	10.11	9.60	0.51
Jul-25	10.00	8.99	1.01
Dec-25	9.33	8.44	0.89

Sources: Allspring, JPMorgan and KBRA DLD, as of February 2026. Note: This data covers the US. YTM = yield to maturity

Balancing public vs. private credit for insurers

- Given ongoing changes in the market environment for credit, insurers should review the balance of their asset portfolios, including public versus private allocations.
- Growth in public and private markets is less about competition for the same assets and more about which market is best positioned to cater to borrowers' and lenders' needs.
- Due to the lagged impact of higher interest rates; the maturing of direct lending, high yield and leveraged loan markets; as well as the increased competition between these funding channels, our expectation is that the ratings-adjusted returns between direct lending, high yield bonds and leveraged loans will continue to converge, as witnessed over the last three years.
- European leveraged loans and high yield bonds offer a potentially strong investment proposition, particularly for insurers seeking to source high income and broaden their exposure within European credit markets. These instruments provide potential diversification benefits and may be a compelling alternative to direct lending thanks to their enhanced liquidity, broader issuer universe and more dynamic pricing environment against an uncertain macroeconomic and geopolitical backdrop. In the current market landscape, we believe they stand out as tactically and structurally attractive components of a well-balanced credit portfolio.



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