Harnessing private credit to strengthen DC outcomes



Private credit has become one of the most dynamic segments within private markets. Now a $2.0 trillion market[1], the asset class offers DC investors a broad spectrum of lending strategies and borrower types that traditional fixed income cannot easily replicate. As banks continue to step back from long-term lending, private credit has rapidly evolved, now providing access to a wider range of risk premia.

The primary attractions of the asset class include potentially higher returns due to complexity premiums, with an income profile anchored by contractual income flows and yields typically greater than those of public fixed income. With a greater focus on mid-sized borrowers, private credit often lends to sectors underrepresented by public lenders providing different sources of returns.

For DC trustees, private credit can align well across the DC glidepath. It can enhance growth in accumulation, support capital preservation, and income-stability pre-retirement, and deliver predictable cashflows through decumulation.

However, before Long-Term Asset Funds (LTAFs), were introduced in 2021, DC access to private credit was challenging. LTAFs were a new UK structure created to allow long-term investors, such as DC pension funds, to access illiquid assets without creating liquidity mismatches and address investor protection concerns. With LTAFs, a regulated, appropriately aligned structure, DC schemes now have a viable access route for exposure to a range of private markets assets. For DC savers seeking value for money, diversification, and more secure retirement futures, we believe private credit can offer a compelling blend of resilience, structural downside protection, and enhanced member-aligned return potential.

[1] Source: Preqin, Moody's Ratings, January 2025

The views expressed in this document should not be taken as a recommendation, advice or forecast, nor a recommendation to purchase or sell any specific security.

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested. Past performance is not a guide to future performance.

Private credit: a diverse and evolving opportunity set

Having rapidly emerged as one of the most dynamic areas within private markets, private credit is defined by its wide range of lending strategies and borrower types. With strategies spanning everything from corporate direct lending to real estate debt, this diverse asset class can offer DC schemes multiple risk-return profiles. It is also an asset class which has expanded to offer an increasing array of opportunities to finance the real economy, including a broad range of asset-based lending strategies.

Further, diversified private credit is able to help smooth capital deployment and cashflow: asset-based financing (ABF) and leveraged loan strategies reduce cash drag, direct lending can provide steady income and amortization, distressed debt typically offers less frequent but larger distributions. Combined, these strategies can help create a more predictable liquidity profile which is important for DC funds managing constant cashflow needs.

Most private credit strategies sit within two broad categories: corporate lending and asset based financing (ABF). Corporate lending focuses primarily on a borrower's ability to generate recurring income, rather than based on specific collateral.

Typical borrowers may have limited fixed assets, but strong margins or recurring revenues.

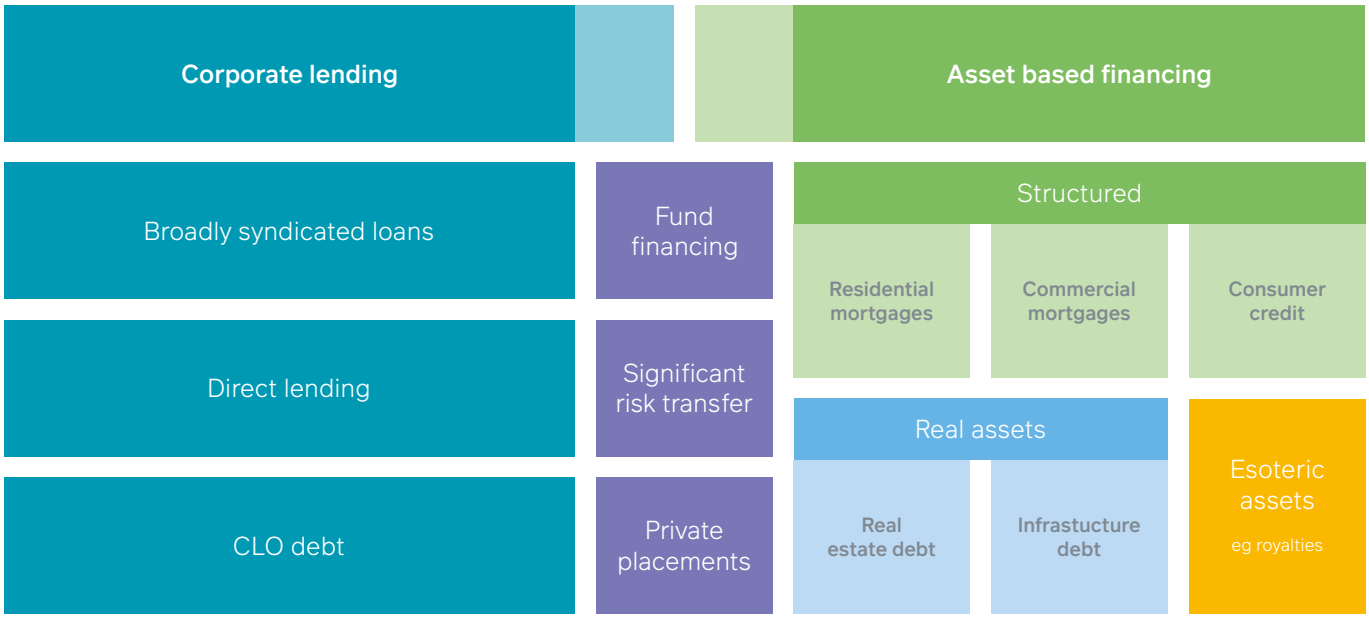
Direct lending and broadly syndicated loans are the main strategies, with lenders often having strong relationships, creating an ability to influence and gain detailed information to help with underwriting. From a portfolio perspective, private corporate lending provides diversification benefits as lending is typically to companies who do not issue in public markets.

With ABF, financing is secured against specific, identifiable pools of assets expected to generate predictable, reliable cash flows. Characterised by hard collateral such as infrastructure, autos, real estate and equipment as well as contracted cash flows, such as mortgages and mobile phone contracts, ABF offers diversification across many borrowers. It offers exposure to 'real economy' assets such as infrastructure, real estate, consumer credit and SME financing, exposures often less accessible through public markets.

Overall, private credit is best viewed not as a single product, but rather an ecosystem of distinct debt strategies serving diverse needs across different types of assets and across the capital structure. At an elevated level, it can be differentiated primarily by how the credit is assessed:

High level of diversification

Strategies can be broadly differentiated by the way credit risk is assessed



Source: M&G, Indicative only, not all strategies mentioned are represented in M&G products. CLO: Collateralised Loan Obligation

Supported by secular drivers

Private credit has grown exponentially over its relatively short 25-year existence. Today it is a $2.0 trillion market[2] having expanded by almost 400% in the last 10 years alone. This growth has been driven by the retrenchment of traditional banks, reducing lending to companies within certain segments. While this pullback has primarily been driven by tighter regulation (post GFC), it has also been supported by regulators, keen to diversify systemic credit risk and broaden capital provision channels. Additionally, companies are choosing to remain private for longer due to a subdued IPO market, and perhaps unrealistic valuation expectations.

Private credit has stepped in to fill this lending void, offering investors new and compelling opportunities. With illiquidity premiums providing potentially higher yields together with robust structuring characteristics, investors have embraced the gap in the market, driving the growth of the asset class.

This embrace by investors has been supported by greater recognition of its potential to deliver more attractive, risk-adjusted returns. Over the last decade, the asset class has matured significantly: deal structures have become more sophisticated and managers have refined their capabilities across origination, monitoring, and restructuring. This evolution of the asset class has proven beneficial, particularly in environments of higher interest rates where floating-rate private loans can offer appealing income streams.

A further factor supporting the asset class is that while private credit does not necessarily have better borrowers than public credit, it often has better lender protections. Typically part of a small group, private lenders negotiate directly with borrowers allowing them to secure valuable protections, such as first-lien security on assets, accounts receivable and intellectual property security and, generally, tighter covenant packages. In contrast, public bond markets have become increasingly covenant-lite. Most Investment Grade and High Yield bond markets are unsecured.

These attractions have not been lost on DC investors who are now estimated to allocate around 25% of their total illiquid portfolio allocation towards private credit. The core attraction for DC schemes is the breadth of private credit options, all with different risk/return profiles, enabling the tailoring of portfolios to align with investment goals at various stages of the retirement journey.

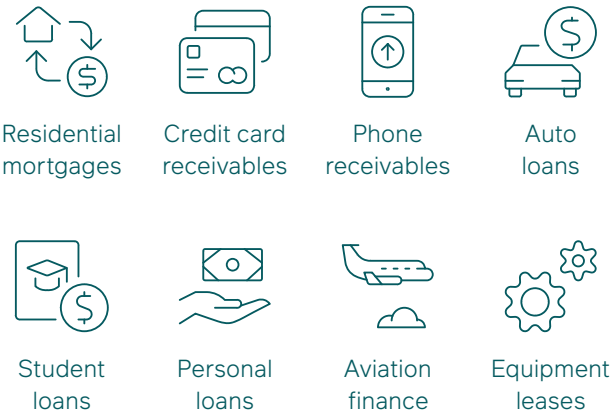
Private credit: its investment attractions

With DC schemes seeking to provide resilient retirement outcomes, private credit has firmly emerged as a compelling option. Historically used by defined benefit (DB) schemes and insurers, private credit is now an increasingly attainable option for DC schemes, also thanks to new LTAF solutions.

Diversification

Pre-2015, before the introduction of 'pension freedoms', c75% of DC members used their pension pots to purchase annuities[3]. Pre-retirement portfolios were consequently often built around duration-heavy assets, such as corporate bonds and gilts in order to help offset changes in annuity pricing at retirement. 2024 data suggests less than 10% of DC members today purchase annuity products, despite higher interest rates, with many preferring the flexibility of drawdown options available. Private credit can be attractive in this context due to the majority of this market being floating rate, helping reduce sensitivity to inflation and interest rate volatility.

This flexibility extends to the wide array of private credit assets available, spanning different borrower and risk profiles and able to provide both sector and regional diversification. Looking at just one private credit option, ABF, the wide spread of exposures can be seen with each offering distinct borrower and risk profiles:



[2] Source: Preqin, Moody's Ratings, January 2025

[3] Source: AJ Bell, Pension Freedoms: Seven Million Pension Pots Offered Flexibility a Decade on from Landmark Reforms', March 2025

The diversification benefits of private credit extend further due to its ability to access a materially wider opportunity set available within traditional fixed income allocations. As an example, there are approximately 1,500 listed companies in the UK, but 9,000 VC-backed firms and 3,000 PE-backed enterprises[4]. Private credit, lending predominantly to these private companies, can therefore offer investors greater sector and regional diversification.

The heterogeneous nature of private credit can give it the potential to deliver low common factor exposure relative to public credit markets, reducing reliance on broad equity and bond beta. With its diversity of risk drivers, it is more likely to deliver a predictable income stream. This feature makes private credit, in our opinion, a natural fit both for the pre and post-retirement phases.

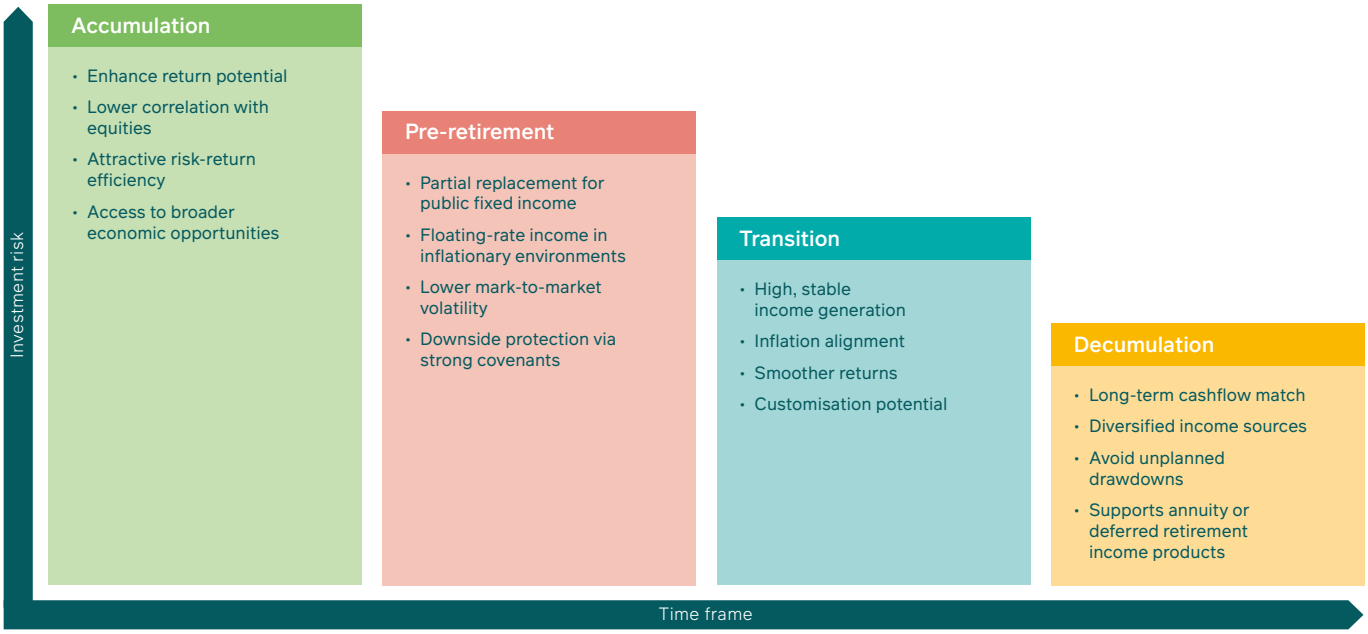
Yield enhancement

When assessing excess return in private credit, investors often focus on the illiquidity premium – the compensation for committing long-term capital. But in many parts of the market, returns also reflect a complexity premium: the additional spread available to managers with the specialist capability to source, structure and underwrite less standardised opportunities.

For borrowers, private credit can offer speed, certainty of execution, confidentiality and tailored financing solutions. For investors however, capturing this premium depends on manager skill. It requires disciplined origination, deep asset-level underwriting, robust legal structuring and intensive ongoing monitoring. This is essential to ensure complexity is properly understood, controlled and rewarded.

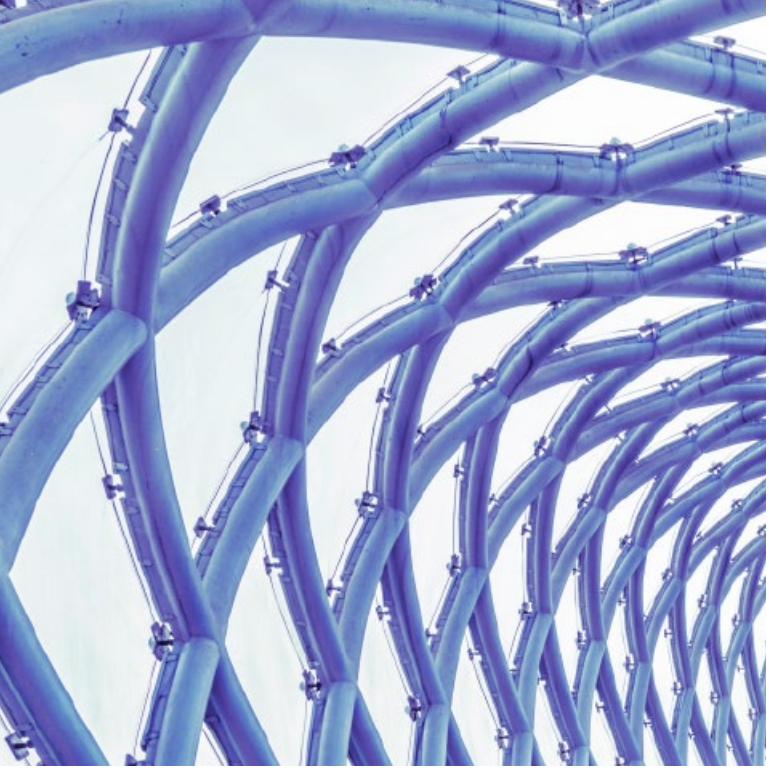
Private credit across the DC glidepath

With its spread of assets and investment characteristics, private credit can be a valuable addition across all stages of the DC glidepath:



Source: M&G Investments, March 2026.

[4] Source: Statista, June 2026, Burges Salmon, June 2025. Uk Private Capital, May 2025



Accumulation and pre-retirement stages

During these stages focus is on capital growth and, later, capital preservation. Private credit is valuable potentially offering enhanced return via high returning assets. Later, when risk tolerance declines, enhanced capital preservation can be achieved with strong covenants, predictable income flows and diversification beyond public markets.

Its floating nature helps mitigate interest-rate volatility as well as a degree of inflation protection. Appropriate strategies include senior direct lending, asset-backed lending and infrastructure and real estate debt.

Transition and decumulation stages

At this point DC members prioritise predictable cashflows as well as attractive risk-adjusted returns. As members transition towards retirement, higher-return assets remain important as members may remain invested for many years requiring long-term retirement adequacy. DC default and target-date are well suited to include less liquid, return enhancing assets such as private credit.

With members prioritising stability of income, particularly during decumulation, the lower volatility of private credit where valuations move with borrower fundamentals rather than market sentiment, can be compelling. With the risk of forced sales reduced, a smoother glidepath into drawdown can be achieved. Private credit does not remove risk, but it changes the timing and shape of it, and decumulation is primarily about timing.

LTAFs: an ideal structure for DC?

DC schemes have long faced a structural challenge: how to give members access to the higher potential returns of private markets, particularly private credit, without compromising liquidity, operational simplicity, or regulatory compliance. LTAFs represent a step-change, specifically designed to help DC schemes access less liquid asset classes, offering a regulated mechanism to bring private credit into the default strategy in a controlled, transparent, and operationally workable way.

Addressing illiquidity and governance complexity

While private credit assets are intrinsically illiquid, LTAFs were created explicitly to accommodate such assets. Mandated to invest at least 50% of assets into unlisted and long-term assets (such as private credit), LTAFs were introduced as a home for genuinely patient capital. LTAFs offer liquidity mechanisms allowing private market exposure to be managed within an open-ended framework. Preset redemption intervals, gating and notice periods, allow liquidity to be managed in a way that suits private credit's long term profile offering DC funds a route to incorporate illiquid assets: liquidity is calibrated to the needs of the portfolio rather than legacy expectations of daily dealing.

A further benefit of LTAFs is they provide a governance-friendly, regulated, open-ended structure that simplifies operational complexities for DC trustees, enabling continuous investment in private credit without the administrative burdens typical of traditional limited partnerships. As evergreen vehicles, they allow continuous deployment and reinvestment. For DC trustees, this means operational simplicity without sacrificing sophistication.

Ensuring member fairness

A diversified private credit approach can potentially offer DC schemes higher returns than public fixed income, supported by illiquidity premia and structural protections such as collateralisation. For DC schemes with long investment horizons, this is particularly relevant. Members across all stages of the DC glidepath can benefit from the consistent income streams and lower correlation to public markets that private credit provides. Crucially, LTAFs' transparent valuation, regulatory oversight and controlled redemption windows help ensure fairness between joining, exiting, and ongoing members.

Importance of manager selection

Having decided to invest in a diversified private credit sleeve within the portfolio, the next crucial question is which private credit manager to select. And the decision is not just about performance. As with all fixed income investment, the risk is asymmetrical with the avoidance of loss paramount. For this reason, considerations such as experience across cycles, proven process, robust due diligence, and risk management matter with manager selection.

Experience

The last decade in private credit has been an untypical and benign environment. With many private credit managers new to the asset class, they may have limited experience managing private credit assets amidst fluctuating market conditions, or across normal economic cycles. This is where time in the market matters. Managers such as M&G Investments, one of the earliest private debt managers in the UK, can demonstrate 20+ years' experience in the asset class, offering a mature and well-considered perspective.

Additionally, different institutional investors have dissimilar needs – their objectives, risk tolerances and regulatory regimes may differ greatly. Does a private credit manager have a depth of experience specifically within the DC market, understanding the industry considerations which need to be considered? If so, they are more likely to become a partner rather than simply a manager.

Breadth of capabilities

Building a diversified private credit portfolio requires manager expertise not simply across one strategy but across many. The ability to leverage insight and experience from colleagues involved in the spread of private credit strategies is invaluable. Managers with an array of private credit capabilities in-house can also offer DC investors portfolio modelling and scenario analysis capabilities.

Process

Credit analysis sits at the heart of identifying attractive opportunities. With banks withdrawing from certain lending segments, and private credit stepping into filling the void, the number of available transactions has never been greater. Discriminating between these is key, requiring robust analysis and due diligence. By illustration, within the M&G Direct Lending team, at first screen, 70% of all prospective opportunities are rejected, rising to a 95% rejection rate by the time full credit analysis is concluded.

Risk management

With loss avoidance being the key focus for any fixed income manager, where stress and possible default situations arise, a key factor in manager selection is establishing proven work-out capabilities. Over a prolonged period, can a manager demonstrate a track record of being able to renegotiate with borrowers and potentially restructure loans?

Conclusion

We now see private credit as a strategically key component of DC portfolio design, offering diversified sources of return, structural income resilience, and reduced sensitivity to traditional market drivers. Its breadth allows DC schemes to tailor exposures across the glidepath, from accumulation through to decumulation. With attractive illiquidity premia, floating-rate structures, and bespoke covenant protections, a diversified private credit approach can help schemes enhance long-term member outcomes while mitigating volatility and improving portfolio robustness in varied economic regimes.

The evolution of structures such as LTAFs now enables DC schemes to access these benefits in a governance-friendly and operationally practical manner, aligning liquidity tools with the long-term nature of the asset class. With the right implementation, private credit can play a meaningful role in strengthening retirement adequacy, supporting smoother member journeys, and delivering more resilient outcomes across the full DC glidepath. □

M&G Investments

Marketing Communication for Professional Investors only. Not for onward distribution. No other persons should rely on any information contained within. This information is not an offer or solicitation of an offer for the purchase of shares in any of M&G's fund. This financial promotion is issued by M&G Investment Management Ltd. Registered Office: 10 Fenchurch Avenue, London, EC3M 5AG. **OCT 26 / W1713403**