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Managing private markets risk for US banks

Implications from Bank of England private markets exploratory scenario

Summary

The Bank of England's (BoE's) second System-Wide Exploratory Scenario (SWES) tests how stress in private equity (PE) and private credit (PC) could transmit through banks and non-banks, amplifying shocks via leverage, valuation opacity, ratings reliance, and data gaps, and ultimately constraining financing to the UK corporate sector. The findings will be directly relevant to US banks given growing committed liquidity to PC vehicles and rising business development company leverage. It points to concrete priorities: consolidated exposure and contingent-liquidity mapping; feedback-aware stress testing; stronger collateral and data-integrity controls; liquidity-first facility management; valuation governance; and cross-jurisdiction alignment for multinational firms.

Most large banks already manage private markets exposure through existing credit and liquidity infrastructure: 1) underwriting and counterparty limits in fund and sponsor finance; 2) covenanting, borrowing-base, and collateral monitoring; and 3) enterprise stress testing and internal liquidity stress testing (ILST). The principal gap is that exposures are monitored on a fragmented basis rather than as a single ecosystem view, and contingent liquidity risk may be under-captured. Banks must be proactive and operationalize the SWES lessons without waiting for a formal US analogue by focusing on three buildable capabilities:

- Map the ecosystem: Build a single exposure and contingent-liquidity ledger that unifies funded and committed positions across private market financing channels and aggregate to surface common-shock concentrations and key contractual triggers.
- Manage facilities as liquidity risk with feedback effects: Run a two-round internal stress testing exercise focusing on correlated draws, haircut/advance-rate tightening, and refinancing shutdowns; convert results into facility limit add-ons, contingent funding buffers, and "tighten-early" playbooks before liquidity is pulled.
- Harden controls where losses start: Test and strengthen collateral and data integrity, eligibility and lien-perfection processes, valuation governance (including stale-mark and dispute assumptions), and cross-border taxonomy/limit alignment, so information shocks and documentation failures don't cascade into liquidity events.

Private markets in the US

US banks' exposure to nondepository financial institutions (NDFIs)—part of the broader "shadow banking" ecosystem where intermediation occurs outside insured depository balance sheets, but with bank backstops—has drawn attention from markets and supervisors. In response, US banking agencies implemented Call Report revisions effective December 31, 2024 that expanded and clarified the NDFI definition and introduced more granular NDFI reporting to improve transparency and monitoring of these exposures. The new NDFI detail was reported on a best-efforts basis in 2024 Q4 and 2025 Q1 and total banking-sector exposure – defined here as aggregated loan balances plus unused commitments to NDFIs – increased 34.5%, from $1,736bn (2024 Q4) to $2,334bn (2025 Q4).

PC, a component of the NDFI ecosystem, is now similar in size to PE markets, but is usually funded with term capital rather than runnable deposits, so classic maturity transformation is limited. Yet the sector can still face liquidity stress because loan origination and portfolio leverage often rely on bank funding lines that can reprice, tighten, or be pulled when in stress. A significant portion of PC-related exposure is captured in the Call Report subcategory "Loans to business credit intermediaries." The FDIC describes business credit intermediaries[1] as including direct lenders, private debt funds, and business development companies (BDCs),[2] but also includes a wider set of structures such as CDO/CLO vehicles, asset-backed commercial paper (ABCP) conduits,[3] leasing companies, and Small Business Investment Companies (SBICs).[4] Accordingly, this item should be viewed as a broad proxy that includes PC but is not limited to it. On this measure, exposure to business credit intermediaries increased 59%, from $318bn (2024 Q4) to $506bn (2025 Q4), with unused commitments comprising approximately 33% of the total. Exposure is highly concentrated: more than 96% is held by the largest 25 banks (by total assets), and more than half is held by the top four.

PE is also predominantly funded with locked-up, closed-end capital commitments, which limits maturity transformation at the fund level. However, the PE ecosystem remains exposed to liquidity shocks the same way PC is. Similarly, a tightening in bank lending standards or market liquidity can quickly compress refinancing windows, raise default risk, and transmit stress across interconnected sponsors, funds, and lenders. Bank lending to PE funds is proxied by the "Loans to private equity funds," although much of a banks' exposure to PE remains embedded in traditional C&I and leveraged lending portfolios rather than from the NDFI category. On this measure, exposure to PE increased 90%, from $299bn (2024 Q4) to $568bn (2025 Q4), with unused commitments comprising approximately 40% of the total. Exposure is highly concentrated: approximately 93% is held by the largest 25 banks (by total assets), and more than 40% is held by the top four.

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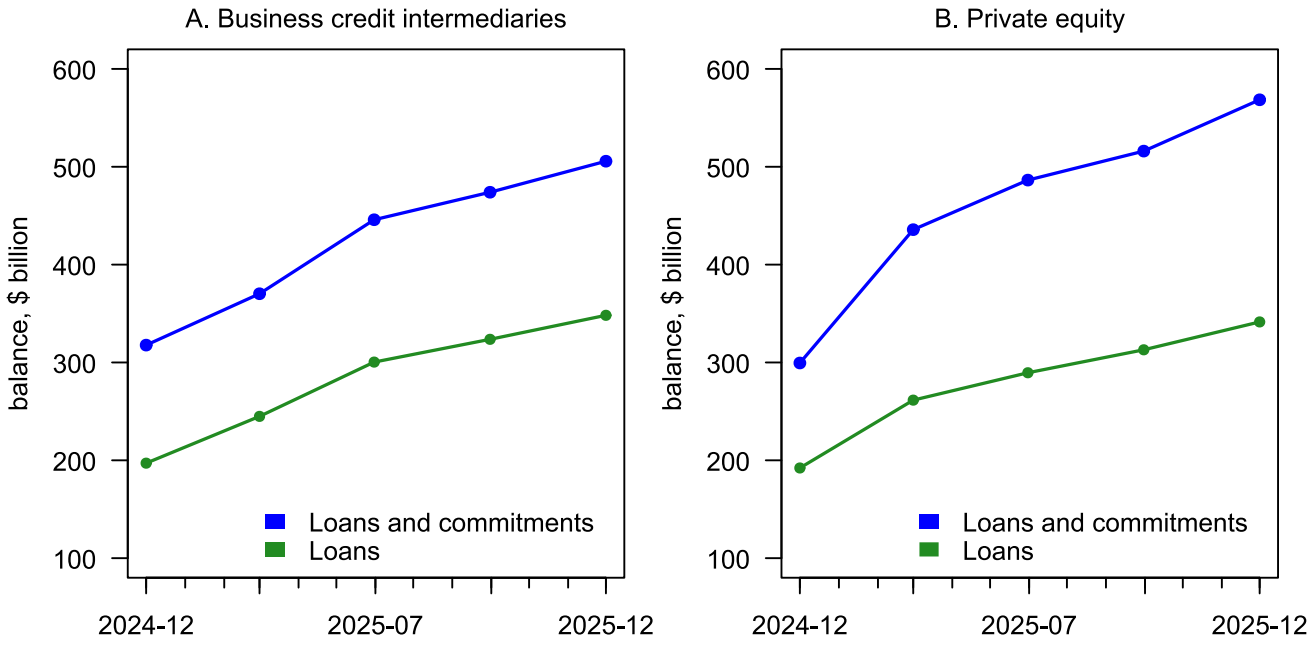
1 For details, see the FDIC Quarterly 2023 Vol 17 No 2 available at **https://www.fdic.gov/analysis/bank-lending-nondepository-financial-institutions.pdf**.

2 Business development companies (BDCs) are regulated closed-end investment companies established under the Investment Company Act of 1940 and created to channel capital to small and mid-sized US companies. BDCs invest primarily in debt of private companies. They often use secured credit facilities and other borrowings and are subject to asset coverage (leverage) requirements. With many BDCs being public companies, they provide quarterly public disclosures (10-Q, portfolio statistics, non-accruals, leverage, NAV marks), which are among the most observable parts of the private-credit ecosystem.

3 An ABCP conduit is a bank-sponsored special purpose vehicle (SPV) that funds itself by issuing short-term commercial paper and uses the proceeds to buy or fund pools of financial assets such as receivables (credit-card, auto, trade receivables), consumer loans, leases, or other structured exposures. ABCP SPVs engage in maturity transformation as they rely on short funding and invest in long-maturity assets.

4 An SBIC is an investment fund or company licensed by the US Small Business Administration (SBA) and operating under an SBA regulatory framework to provide financing to eligible small businesses. SBICs issue long-term notes that are guaranteed by the SBA and use the proceeds to make loans or equity investments in eligible small businesses.



Given the scale private markets have reached and the speed of their growth, they warrant closer scrutiny. The Bank of England has initiated a system-wide exploratory exercise on UK private markets, and US policymakers have signaled that a comparable system-wide assessment is increasingly necessary in the United States.

Exploratory Scenario for private markets

The BoE has launched its second SWES, focused on the private markets ecosystem –PE and PC – to measure how stress could propagate across banks and non-bank financial institutions (NBFIs) and ultimately affect financing to the UK corporate sector.[5]

Private market activities in scope include: (i) PE funds investing in UK firms; (ii) credit financing PE-sponsored corporates, including PC and substitutable leveraged-credit products such as leveraged loans, high-yield bonds, and collateralized loan obligations (CLOs); and (iii) PC to non-PE borrowers, including investment-grade corporates.

These markets are intermediated by three core participant groups:

- Alternative asset managers as PC lenders, arrangers/structurers, and holders;
- Banks financing PE funds and PE- and non-PE-sponsored borrowers, providing market intermediation and liquidity; and
- Institutional investors (insurers, pensions, endowments, foundations) as the capital providers to PE funds.

The exercise does not focus on venture capital, growth equity, and commercial real estate.

[5] See BoE News Release "Bank of England launches system-wide exploratory scenario exercise focused on private markets" dated December 4, 2025.

BoE notes that private markets finance a material share of the UK real economy. PE-sponsored corporations account for ~15% of UK corporate debt and ~10% of private-sector employment, according to BoE. Participating AAMs also represent a substantial footprint in the UK ecosystem, including about half of UK PC activity to corporates.[6]

SWES is a system-wide, not a firm-level stress test. It explicitly is not intended to assess the resilience or capital adequacy of individual firms, and findings will be presented at the system-level. A key design feature is a two-round structure designed to identify feedback and amplification channels:

- **Round 1:** Participants model impacts of a severe but plausible downturn and their intended actions.
- **Round 2:** BoE aggregates behaviors and outcomes from Round 1, allowing participants to revise actions—explicitly targeting system-wide amplification effects and sensitivities.

BoE plans to run the stress-scenario phase in 2026, publish interim findings during 2026, and issue a final report in early 2027. BoE will publish scenario details and the full participant list in 2026.

Targeted vulnerabilities

SWES's first objective is to identify and quantify the vulnerabilities and transmission channels through which stress in private markets could amplify shocks across banks, insurers, and leveraged-finance markets. Core vulnerability hypotheses include leverage at both the fund and portfolio-company levels, valuation opacity and lags, reliance on credit ratings and rating transitions, and spillovers via adjacent leveraged-credit markets, e.g., leveraged loans and high-yield bonds.

A second objective is to reduce data gaps that limit authorities' ability to assess system vulnerabilities. This includes a determination of who ultimately holds risk, who funds it (and on what terms), and how shocks transmit through financing chains, margining, and market liquidity.

These objectives directly map US PC concerns. Federal Reserve staff analysis reinforces a similar "interconnected ecosystem" framing. In the US, banks provide committed liquidity and financing to PC vehicles, creating tail risk of correlated drawdowns and second-round liquidity effects under stress.[7] This FRB analysis finds that bank commitments to PC vehicles increased from roughly $8B in 2013 Q1 to about $95B in 2024 Q4 with utilization around $56B or 59%.

The study also highlights that business development company (BDC) leverage has risen materially. The debt-to-assets ratio increased from approximately 40% in 2017 to 53% in 2024 in a sample of public BDCs, underscoring that financing-channel risk can build even when loan-level delinquency and default indicators appear benign.

Finally, the Tricolor and First Brands episodes in September 2025 underscore that PC stress can originate as an information shock, not a conventional credit-cycle shock. Allegations include misrepresented loan data and collateral issues (Tricolor) and invoice irregularities or double-selling (First Brands), illustrating how

[6] AAMs also account for one-third of UK PE leveraged buy-out activity and around 40% of employment in UK PE-sponsored corporates over the past three years.

[7] See Berrospide et al. (2025).

operational failures can translate quickly into liquidity demands, legal uncertainty, and loss crystallization across intermediaries.[8]

Implications for multinational US banks

The SWES design provides a practical template for how large multinational US banks can strengthen their private markets risk framework.

First, stress testing should be designed around an "ecosystem" view, not a product silo view. BoE's hypothesis is that private markets transmit stress through interactions. These include fund financing and margining, portfolio-company refinancing, investor allocation shifts, and spillovers into substitutable public leveraged-credit markets. For US banks, this implies maintaining a consolidated exposure map that links: (i) lending and contingent facilities to funds/vehicles *e.g.,* net asset value (NAV)/sub lines, revolvers, prime/derivatives relationships, (ii) lending to PE-sponsored corporates, and (iii) exposures to adjacent leveraged-loan / high-yield / CLO-linked markets that may amplify stress through spread widening and reduced refinancing capacity.

Second, banks can replicate BoE's structure internally by running an initial scenario and then re-running it after imposing plausible "system reactions," such as tighter terms, higher haircuts, or reduced market liquidity. This approach captures behavioral feedback loops. When funds draw on committed lines, banks tighten their lending standards, refinancing windows close, defaults rise, and liquidity demand increases.

Third, addressing data gaps is critical. SWES recognizes that risk management cannot assume the level of transparency typical of public markets. For US banks, the minimum standard is to answer quickly and consistently (i) who ultimately holds the risk, (ii) who funds it and on what terms, and (iii) what happens to liquidity demand and loss recognition if funding is withdrawn or terms tighten.

Fourth, new failure modes should be considered in scenario design. The Tricolor and First Brands episodes illustrate that PC stress can originate as an information shock that can rapidly translate into liquidity stress and legal uncertainty in warehouse and structured-finance facilities. Incorporating these failure modes directly into stress testing aligns with BoE's goal of identifying system-wide amplification channels, not just borrower credit deterioration.

Recommendations for US banks

US banks can prepare for and proactively mitigate PC risk by treating it as an ecosystem liquidity-and-information problem, not just a borrower-credit problem. Proactive steps a bank can take include:

1. **Building a single ledger of exposure and contingent liquidity**

   Private markets create hidden correlation through common counterparties and simultaneous draws. Banks need a unified inventory that captures both credit exposure and contingent liquidity across the same sponsor, manager, and vehicle.

[8] See US DOJ (SDNY) press release about indictment of Tricolor's CEO available at **https://www.justice.gov/usao-sdny/pr/ceo-cfo-coo-charged-connection-billion-dollar-collapse-tricolor-auto**, and Financial Times' coverage of FirstBrands, available at **https://www.ft.com/content/7e077ab9-9d96-4642-b6ec-2d8306acf2cb**.

Track committed exposures across fund finance and NAV facilities, warehouse lines, repo/prime, total return swaps, liquidity puts, and letters of credit, and add common-shock concentration views (top-N counterparties and sponsors, sponsor rollups, refinancing walls).

2. **Modeling feedback effects explicitly in internal stress testing**

   A standard single-pass stress can miss second-round amplification—lender tightening, investor reallocations, and market dysfunction. Banks should implement an iterated stress approach: (i) prolonged downturn with impaired refinancing capacity; (ii) re-run with system reactions (haircuts widen, advance rates tighten, warehouse capacity falls, liquidity deteriorates); then translate outputs into liquidity buffers, commitment limits, and contingent funding add-ons anchored to a drawdown logic.

3. **Developing fraud-resilient underwriting**

   Losses can originate from data integrity and collateral verification failures that trigger liquidity stress and legal uncertainty. Tightening underwriting and monitoring can prevent "information shocks" from becoming systemic drains. First, banks should strengthen eligibility rules and repeatable lien-perfection/lien-priority controls and expand independent verification (risk-based file audits/field exams). Second, they should embed contractual protections to shorten the time between issue detection and exposure reduction. These include data-integrity representations, audit rights, and automatic borrowing-base/margin triggers tied to independently validated data.

4. **Treating PC as liquidity risk first, credit risk second**

   Utilization can jump when economic conditions worsen even if ex ante credit risk appears low. Banks should use stressed draw assumptions that are explicitly correlated across related vehicles, apply LCR/ILST-style overlays to ensure draws are fundable without forced sales, and set funding concentration limits to prevent any single shock from overwhelming an entire funding channel.[9]

5. **Consideration of and monitoring of valuation uncertainty**

   Valuation opacity is a control problem: detection speed and margin confidence matter. Banks should use conservative haircuts and liquidation horizons for private-asset collateral, govern valuation methods and overrides with model-risk discipline, and hard-code dispute/latency assumptions into stress tests and limit frameworks, as lags happen when liquidity exposure spikes.

6. **For multinational banks, aligning cross-jurisdiction governance now**

   Fragmented taxonomies, limits, and scenario assumptions can result in missed stress correlations. Banks should establish a single global risk taxonomy and control standard for private markets exposures so UK/EU expectations, US CCAR/ILST, and internal ICAAP/ILAAP are consistent and mutually reinforcing.

Conclusions

The BoE's SWES underscores that private markets stress can propagate through interconnected financing chains via leverage, valuation opacity, ratings dynamics, and data gaps. It creates correlated liquidity demands and second-round amplification across banks and NBFIs. For US banks, the practical takeaway is

[9] Liquidity coverage ratio (LCR) is a Basel III liquidity metric and internal liquidity stress testing (ILST) is a standard component of liquidity risk management.

to treat PC as an ecosystem liquidity-and-information risk by strengthening consolidated exposure/contingent-liquidity mapping, feedback-aware stress testing, collateral and data-integrity controls, valuation governance, and cross-jurisdiction alignment.

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