Shadow Banking and Private Credit: What It Is, Why It's Used, and Why It's in the News

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You have probably seen "shadow banking" and "private credit" splashed across recent financial headlines. While they may sound like buzzwords, these terms, and the market structures behind them, are not new. Rather, they describe a rapidly expanding segment of the credit market operating outside traditional banks while remaining tightly intertwined with them. Understanding how these systems work is essential to understanding today's lending landscape.

1. What Are "Shadow Banking" and "Private Credit"?

Shadow banking, formally known as non‑bank financial intermediation, generally refers to credit activity that occurs outside regulated banks. It includes lending by finance companies, private funds, and other non‑bank entities. The Financial Stability Board (FSB) defines it simply as "credit intermediation involving entities and activities outside the regular banking system."

Private credit has emerged as one of the most important and fastest‑growing segments within the shadow banking umbrella. It generally refers to loans made by non‑banks to operating companies, negotiated privately and typically held to maturity rather than traded. Although traditional banks are not the lenders making these direct loans to operating companies, they remain deeply connected to the private credit ecosystem. Traditional banks typically engage with private lenders by providing direct financing to private lenders; lending to and investing in private credit funds and business development companies (BDCs); and acting as counterparties in fund finance and derivatives transactions. In other words, traditional banks may not originate loans to operating companies, but they often fund the private lenders who do.

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Below is a streamlined, at-a-glance breakdown of the two main types of private credit structures and where traditional banks fit into each.

Type 1: Bank Credit to Non-Bank Lenders (Warehouse/Asset-Backed Finance)

- **What it is:** A bank lends to a private lender or specialty-finance company using a revolving or term facility. The non-bank then originates loans to its own borrowers and pledges those loans back to the bank as collateral. Collateral is monitored through borrowing-base tests, concentration limits, and advance-rate rules.
- **How it connects:** This is "shadow banking" in its classic form: traditional banks fund the private lenders, but the private lenders, not the traditional banks, create the credit. The traditional bank's risk is exposure to the private lender and the performance of the underlying loan pool.

Type 2: Direct Lending by Private Market Credit Providers

- **What it is:** Non-bank private credit providers, such as private equity credit arms, BDCs, and family offices, lend directly to operating companies using capital from their respective structures, often supplemented by modest leverage. These loans can take the form of senior secured/unitranche, second-lien, mezzanine, or bridge financing. They are often loan-to-own strategies where the lender is positioned to take control of a borrower if a default occurs.
- **How it connects:** Traditional banks are not the company-level lenders but, rather, support the finance lenders by providing subscription lines, capital-call facilities, net asset valuation (NAV) loans, secured or unsecured corporate credit to BDCs, and derivatives or repo financing to fund vehicles. Some banks also purchase BDC or fund equity/debt, creating indirect credit exposure at the fund level.

Together, these two structures illustrate how private credit sits outside the traditional banking system, yet remains closely linked to it. Understanding this interconnected architecture helps to explain

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why private credit has expanded so quickly, and why it draws so much regulatory and market attention today.

2. Why Private Credit is Used: The Necessity and the Benefit

Private credit tends to flourish when traditional bank lending tightens. After periods of regulatory recalibration, such as the post‑2008 reforms — or during sector‑specific stress, including recent uncertainty in commercial real estate — traditional banks have periodically reduced lending in certain categories. Private lenders step into that void, providing capital to borrowers who may be too small, too complex, or too risky for traditional banks or the public debt markets. The Federal Reserve and the FSB have historically acknowledged these benefits, even while flagging the existence of data gaps and valuation opacity in parts of the non‑bank lending ecosystem.

Additionally, borrowers often choose private credit because it can be faster to arrange and more flexible than syndicated bank or bond financing, with the private creditor performing the due diligence and offering the ability to close on shortened timelines.

Scale has followed. Global private credit assets under management now exceed $3.5 trillion, according to the Alternative Credit Council's December 2025 findings. This reflects not only growth, but also a significant broadening of the market. While previously concentrated primarily in corporate direct lending, private credit has expanded into asset‑backed finance, real estate credit, infrastructure, and other specialized forms of private lending. As the market continues to grow, private credit is reshaping how non‑bank capital reaches borrowers and filling financing needs that traditional lending channels can no longer consistently meet.

3. Why Is Private Credit in the News?

Two developments have pushed private credit into the spotlight. First, large losses stemming from borrower fraud in 2025 sparked a broader debate about whether problems in less transparent market segments tend to emerge in clusters. Then, in late 2025, a highly

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respected CEO of a financial institution made a public remark that was widely interpreted by the finance industry as a warning that history suggests additional bad actors may be exposed in the near future.

Second, the discussion intensified in 2026 as attention shifted to traditional banks' exposure to specific sectors and to how private credit portfolios might perform in a slowdown, particularly those with significant concentrations in software. Rapid advances in artificial intelligence have added perceived pressure to software-sector borrowers, and several private credit funds with notable software exposure recently reported redemption requests near or above their quarterly limits, prompting measures such as capped withdrawals, pro-rata tenders, or other liquidity tools. At the same time, headlines have highlighted mounting concerns about borrower performance: recent borrower bankruptcies and the risk of an increase in loan defaults have been cited as key threats to fund returns and future fundraising. These developments have renewed focus on liquidity, valuation practices, and the design of periodic-liquidity fund structures.

Taken together, these shifts likely reflect a period of normal cycle-testing for a now-significant asset class rather than a verdict as to long-term viability. Most market participants recognize that private credit brings both strengths and vulnerabilities. The practical focus is on how lenders, borrowers, and their banks structure deals, collateral packages, and covenants in today's environment.

Regulators, meanwhile, have not signaled a pullback. At the end of 2025, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation issued an interagency statement rescinding earlier leveraged-lending guidance. They explained that the prior framework had been overly restrictive and had pushed lending activity from banks to non-bank private credit firms. In its place, the agencies emphasized a return to general principles of safe-and-sound banking practices. This approach gives banks more flexibility while still requiring disciplined risk management.

Private-sector outlooks for 2026 forecast continued growth in private credit, alongside greater attention to liquidity management,

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transparency, and portfolio-level risk. Market analysts project further expansion in assets under management and a wider mix of strategies, even as they underscore rising interconnectedness risks that will require ongoing monitoring.

Key Takeaways

Shadow banking is not new, but private credit's scale and linkages to traditional banks have expanded, making it a central pillar of today's financing landscape. For borrowers, the appeal remains speed and flexibility. For regulators and risk managers, the focus is transparency, valuation discipline, and the mechanics of bank/non-bank connections. For traditional banks, the imperative is to map direct and indirect exposures to private credit channels while identifying prudent ways to participate in a growing segment of finance.

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If you have any questions about this article or would like to discuss how private credit or other non-bank financing developments may affect your organization, please reach out to the authors or any member of FBT Gibbons' Finance Industry or Regional and Community Banks teams.

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