

Private Credit Stress: Compensation Implications

Key Takeaways

- **Private credit is facing its first real liquidity test with significant compensation implications**
- Years of rapid growth loosened underwriting discipline, borrowers forced to refinance at higher rates, AI disrupting software sector ($\cong 20\%$ of credit portfolios), and redemption requests range from $\cong 10\%$ to 40% across select BDC platforms
- Incentives likely to decrease on current 2026 projections, but compensation outcomes will be bimodal (platforms with performing credit vs. those facing significant redemption pressure)
- Middle market platforms face the sharpest pressure; without diversified business lines, compensation trade-offs are more immediate and ability to cross subsidize from other strategies is limited
- The stress will extend into private equity, banking, insurance, asset management, and wealth management
- As carry loses retention power, firms must sharpen headcount discipline and differentiate cash compensation more aggressively
- AI simultaneously enabling leaner platforms (fewer analysts, more automation), furthering headcount implications

The Contagion Chain

1

Underwriting Weakens

AUM boom drove covenant-light deals with lighter diligence and higher leverage.

2

Borrowers Struggle

Materially higher refinancing rates.
AI disrupts software valuation.
Payment in kind masks stress.

3

Redemptions Force Gating

Investors demand withdrawals.
Illiquid loans can't meet redemption demand.
Funds cap access.

4

Credit Economics Strained

Lower AUM and fees compress economics.
Bonus pools shrink.
Retention risk spikes from carry concerns.

5

Broader Industry Impact

Stress across industry.
Private equity, banks, asset management, insurance, wealth management all impacted.

Compensation Themes

Carry losing retention power.

Distributions stalling and hold periods extending. Mid-level professionals sitting on increasingly theoretical economics. Consider bridging mechanisms where carry value has deteriorated

Headcount impact on bonus pools.

Reducing headcount frees meaningful dollars for top performers. Fewer but better paid people results in stronger retention. Disproportionate cuts to support (important to maintain origination capacity).

Cash compensation increasingly in focus.

As carry increasingly discounted by participants, firms need sharper differentiation in an industry historically linked to ladder progression. More to critical talent and top performers, less to replaceable roles.

Pressure across financial services.

Asset managers, including bank and insurance captives, expanded aggressively into credit. Business units face the same pressure as standalone platforms. Stress test adjacent compensation structures from private credit loss scenarios.

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Private Credit Stress: Compensation Directions

What Compensation Leaders Should Consider

Cash Compensation and Differentiation

Differentiate aggressively toward most critical roles. Flat reductions do not send clear messages. Top performers should see meaningfully different outcomes than underperformers. Investment and fundraising professionals should be a key focus.

Increased importance of cash compensation. The traditional low-cash / high-carry ladder breaks down when employees are heavily discounting carry. Ensure current cash is appropriate if carry underperforms. Consider targeted retention awards for high flight-risk roles where carry alone is not sufficient.

Build scenario-based comp budgets. Establish agreed-upon philosophy for how base, downside, and upside cases affect pool sizing and allocation. Stress-test incentive funding against current conditions to prevent reactive decisions under pressure.

Benchmark against the right peer set. In recent years, the cash compensation gap between private credit and private equity has narrowed. In a stressed credit environment, these trends may see a reversal. Increasingly important to benchmark specifically against same AUM and strategy.

Carried Interest

Update carry projections to avoid surprises. With distributions stalled and timelines extended, restate carry using current assumptions. Optimistic projections are mentally discounted and hurt credibility. Silence erodes trust faster than a difficult message.

Consider tapping carry reserves. Consider accelerating awards rather than waiting for original timelines. Delivering value sooner reinforces retention and credibility.

Evaluate team carry split. When raising new fund, opportunity to reset carry allocations — broader eligibility, recalibrated splits, or enhanced participation for professionals critical to the raise.

Revisit carry terms for effectiveness. Vesting schedules, leaver provisions, and clawback thresholds were designed for a different return environment. Punitive terms in a stressed market push departures earlier.

Address co-investment exposure. Co-investments now causing unintended financial exposure. Factor into total compensation discussions alongside cash and carry.

Retention Risks and Headcount

Map retention and motivational risk by role and level. Mid-level professionals (VP through Principal) with unrealized carry are largest risks — senior enough to have other opportunities with only loose handcuffs. Newer hires with limited vested economics are particularly vulnerable.

Prepare for bidaways in transferable roles. Professionals with skill sets applicable across financial services could receive stronger near-term economics. Identify the roles and individuals with the highest flight risk and address proactively. On the flip side, consider talent upgrades.

Proactive headcount reductions. Natural attrition may lead to most critical employees leaving first. Focus on redundancies.

Protect origination and deployment capacity. Firms that cut too deep will miss the recovery pipeline. The cost of replacing experienced investment and sales professionals often exceeds the cost of continued employment.

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