Unmasking the potential: navigating opportunities, myths and strategies in EM Private Credit

July 2025

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Executive Summary

EM Private Credit has a severe unmet need for capital

Private Credit has grown c.10-fold since 2008, but funding shortages remain particularly pronounced in Emerging Markets (EM), which hold c.90% of the global population and c.50% of GDP but less than 10% of Private Credit AuM.

Despite the significant untapped opportunity in EM Private Credit, **investor allocations to date have been underweight** due to various perceptions around borrower quality, jurisdictional suitability and risk-return profile strength amongst other factors.

Perceptions of EM Private Credit often diverge from practitioner experience

Our survey issued to 75 institutional investors identified **FX risks and contract enforcement issues as the most frequently cited concerns when considering allocations to EM Private Credit**. However, insight from market participants suggest that these risks may be overstated or not reflective of current structures and practices.

While enforceability of contracts is often seen as a key barrier, **only 29% of surveyed investors reported having such issues in practice. Most EM Private Credit transactions are structured under English or US law** with borrower assets usually held under an offshore holding corporation, helping to support enforceability and creditor protections.

FX risks can also be actively mitigated using hard currency lending, hedging mechanisms, and borrower selection criteria that prioritise exporters or businesses with demonstrated ability to mitigate FX risk through the cycle.

Historical data also indicates that **EM corporate default rates are often lower than those implied by sovereign ratings and show limited correlation to high-risk developed market products**, suggesting potential diversification benefits for global portfolios.

Investors may be overlooking the broader benefits of EM Private Credit

Diversification is the leading motivation for investors considering EM Private Credit, with 73% of survey respondents citing it as a reason for allocation. 57% cited capitalising on economic trends and short-term opportunism as motivators, while asset class growth and control over terms and conditions were cited by just 33% and 14% of investors, respectively.

EM Private Credit's risk-return profile is becoming increasingly favourable compared to that of Developed Markets (DM) Private Credit due to divergences in competition dynamics.

The limited supply of capital in EM Private Credit allows lenders to **select only the highest quality borrowers and negotiate favourable commercial and risk management terms into deals**. Negotiated lender friendly terms with corporate borrowers include upside kickers, sculpted amortisation schedules, heavy covenants, and strong governance rights.

In contrast, **competition in DM Private Credit is intensifying** and yields are being compressed, while borrowers are negotiating light covenants that give them more freedom to raise additional capital and become more highly leveraged. First movers in **EM Private Credit stand to extract the most gains** before subsequent entrants erode the benefits derived from competitive dynamics.

EM Private Credit also compares favourably to other classes outside of Private Credit. Data shows that EM Private Credit **returns in the last 5 years have exceeded those of EM Private Equity**, while recovery rates from EM Private Credit defaults are significantly higher than for EM bond indices.

Infrastructure and Asia are most popular, while MEA appears to be underestimated

Infrastructure debt is the most popular product in EM Private Credit with 67% of investors deploying capital to it; the **Middle East and Africa have the lowest infrastructure debt default rates globally**, while the US has the highest rates.

Institutional investors believe **South Asia and Southeast Asia are the most promising regions** for EM Private Credit over the next 5 years, while **infrastructure and real estate were considered as the sectors with the most potential.**

Sub-Saharan Africa was considered least attractive by allocators; however, its low infrastructure default rates, favourable competition dynamics for lenders, sizeable young population, growing urban middle class and abundant natural resources suggest it has large overlooked potential.

Key Highlights in Figures

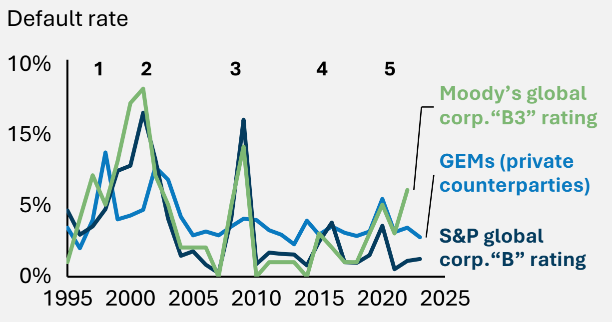
Investors are looking to increase allocations to EM Private Credit

90% of investors surveyed expect EM Private Credit AuM to grow or remain stable over the next 5 years

EM Private Credit risks are overstated when compared to DM

Comparison Of Annual Default Rates In Emerging Markets Against B-Grade Investment Companies In Developed Markets[7, 16, 20, 21]

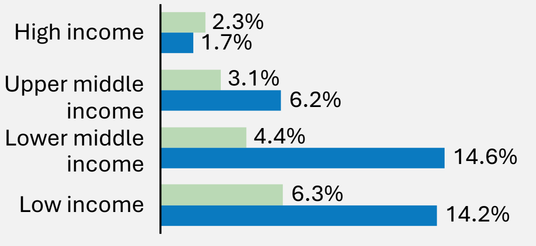
(1): Asian Financial Crisis, (2) Dot.com bubble, (3) Global Financial Crisis, (4) Commodity Price Crisis, (5) COVID-19



GEMs Avg. Default Rates Vs Country Rating[16]

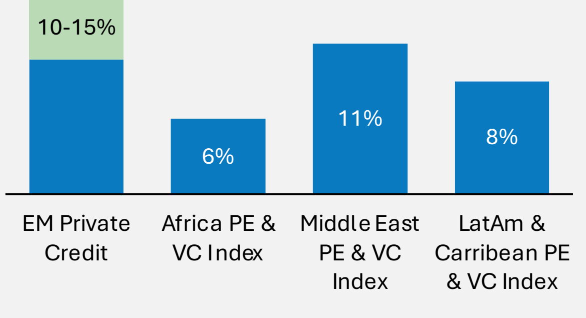
GEMs default rate

Implied rate from historical country sovereign ratings



EM Private Credit outperforms EM PE

Benchmarking EM Private Credit returns with adjacent asset classes



Manager selection matters

"Our best-performing EM private-debt deals have all hinged on one thing: sourcing loans through in-country teams who negotiate bilateral terms and then enforce tight, data-driven covenants. Local origination gives us wider spreads and lower leverage up front, while real-time monitoring lets us spot trouble early and intervene before collateral erodes."

Investment Committee Member, US Foundation

Overview of EM Private Credit

EM Private Credit today

Introduction to EM Private Credit

Since the 2008 Global Financial Crisis, Private Credit has emerged as one of the fastest-growing asset classes in the investment industry, with a growing network of non-bank institutions entering the market to plug the structural funding gap left by capital-constrained banks.

In the era of near-zero interest rates, investment managers struggled to meet yield targets in more conventional asset classes, and Private Credit offered a viable route to higher yields with a favourable risk-return profile compared to investment-grade and high-yield bonds. The asset class has typically offered returns from c.200-300 basis points above traditional fixed income products to c.400-800bps[1], depending on the relative risk of the lending arrangement.

During COVID-19, Private Credit growth accelerated further as corporates demanded flexible capital to weather shocks to their operations, and this was best met by investment managers offering customisable loan structures through regionalised funds globally. Post-2022, the end of the near-zero interest rate era has led to higher returns for Private Credit investors, further boosting the asset class's attractiveness and accelerating growth in terms of net flows.

The culmination of the factors above has driven a near 10x increase in Private Credit AuM since 2008[2], reaching an estimated c.$1.8tn in 2024[3] (see Figure 1). Allocations in Private Credit are expected to continue double-digit growth over the next decade, driven predominantly by institutional, and to some extent, retail investor capital. These growth factors apply to Private Credit in emerging markets (EM) even more so than in traditional or developed markets (DM) due to an accentuated lack of bank appetite, heightened capital constraints, and the higher interest rates typically applied in EM. In this report, emerging markets are defined as all geographies outside of North America, Europe (ex. CEE), Japan, Australia and New Zealand.

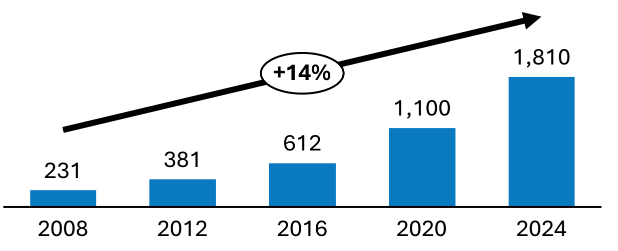
Emerging markets contain c.90% of the world's population[4] and c.50% of total GDP today[5]. With faster population growth rates and evolving economic maturity, these proportions will increase further in the coming years - by 2035, EMs will contribute c.65% of global economic growth, with nine of the top 20 economies categorised as EM[6]. Consequently, the opportunity within emerging markets is simply too extensive to ignore.

Despite the obvious potential, the nascency of EM Private Credit has fuelled a range of generalised concerns from prospective investors, largely rooted in concerns over borrower quality, economic volatility and political stability. These concerns have resulted in limited allocations to date.

"Private Credit has only really emerged in the last decade and is even more nascent than that in emerging markets. I expect a similar adoption curve for EM Private Credit."

Head of Sales, Europe, EM investment manager

Figure 1: Growth Of Private Credit AuM (2008-2024), $bn[2,3]



This report will explore the vast potential in EM Private Credit and highlight that many of the concerns around the space are largely unsubstantiated assumptions from investors (also referred to as Limited Partners). Managers (General Partners) operating within EM Private Credit are well informed on best practices and have evolved highly practical means to mitigate key risks. With a capable manager, this asset class, which may be perceived by outsiders as one with high potential but high risk, can in fact offer attractive returns at relatively low risk.

"EM Private Credit offers one of the most asymmetric risk-return opportunities globally, but only for those who understand how to navigate its complexity.

While public capital markets in these regions remain underdeveloped, private credit fills a crucial financing gap for SMEs, infrastructure, energy transition projects and sectors that often fall outside the scope of traditional banks or DFIs."

Investment Committee member, APAC insurer

Investment strategies

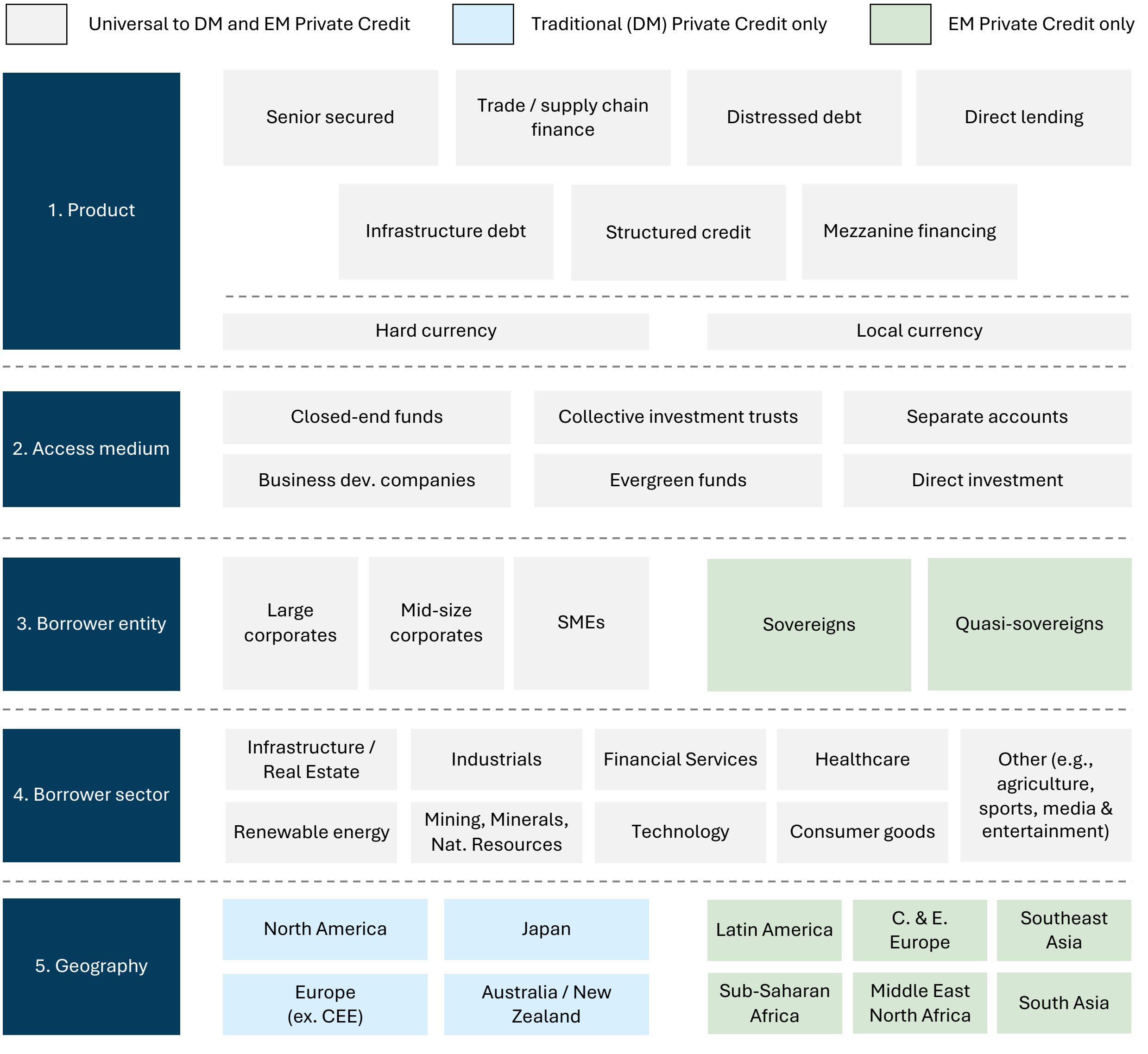
Ways to invest in Private Credit can be looked at through five lenses: product, medium of access, nature of borrower, industry and geography (see Figure 2), with preferences driven by risk-profile appetite, in-house experience, network strength and nuanced perceptions on economic outlook.

However, in EM Private Credit it must be stressed that most investment managers do not operate under a rigid framework and tend to look at any credible opportunity that has attractive characteristics. This is driven by the nascency of the sector, and the lack of proliferation applies to the type of product most out of all dimensions. While Private Credit in DM has reached maturity, with the market segmented into various niche structures to allow for differentiation, product structuring in EM tends to be more fluid in its approach.

"A lot of the time, we start with a blank piece of paper and create a tailored agreement that works for both parties."

Portfolio Manager, EM investment manager

Figure 2: Overview Of Private Credit Dimensions



1. Products within the asset class

The broad range of products in Private Credit allows investors to adopt various investment strategies to cater to their risk appetites. In addition to the products above, some investors may opt to pursue a fund of funds approach or a highly ESG-centric strategy.

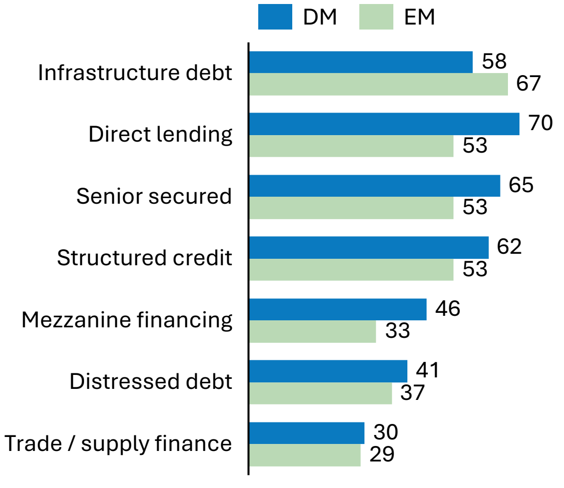
When comparing Private Credit product adoptions between emerging markets and developed markets one would expect several differences. An obvious example is the higher use of hard-currency-denominated debt in EM, due to the relative volatility of currencies and the exchange risk that comes with it.

Our market survey issued to 75 institutional investors globally, of which c.50 actively allocated to EM Private Credit, indicates that despite variances in product adoption between EM and DM preferences are broadly similar (see Figure 3). This suggests that allocators branching into EM unsurprisingly focus on what they know from their experiences in DM.

Despite similarities between EM and DM, infrastructure debt is particularly popular in EM. Not only was it the most invested-in product in our survey, but it was the only product where adoption rates were higher in EM than DM. While infrastructure debt's relatively lower yields might make its popularity unexpected in EM, its high adoption is driven by its inherent stability and security as a product. Furthermore, its specific project-based nature may make investors more comfortable with what they are allocating to in comparison to other EM Private Credit structures and allows for enhanced measurement of ESG performance.

While distressed debt and mezzanine financing are understandably not within many investors' risk appetites given the existing perceptions of EM, the underserving of trade finance presents a vast opportunity for investors in EM Private Credit. This will be touched upon later in the report.

Figure 3: Proportion Of Allocators Investing In Different Private Credit Products, DM vs EM (%)



Also of note from our survey is the fact that allocators to EM Private Credit did not have a strong preference for hard currency over over local currency. As will be covered later (see Changing perceptions in EM Private Credit), hard currency requirements are a highly recommended mitigation for the FX risks associated with lending to borrowers in emerging markets.

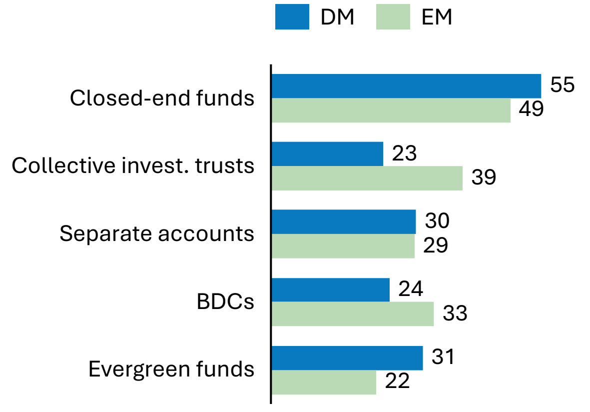
2. Mediums of access

Allocators have a range of vehicles available to tap into the asset class (see Figure 4). Closed-end funds were the most popular medium in both EM and DM, most likely due to the potential for managers to allocate to illiquid assets. Driven by their low-cost structures, Collective Investment trusts were also relatively popular in emerging markets and used to a much greater extent than in developed markets.

BDCs (Business Development Companies) were also more popular in EM than in DM, which can be explained by their exposure to untapped niches within the space that offer higher returns. However, the higher risk and regulatory burden associated with lending to smaller and mid-sized firms may be deterring managers from using them. Similarly, while separate accounts offer opportunity to customise financing arrangements, their popularity is limited by operational and cost burdens.

Evergreen funds were the least popular medium in Emerging Markets. This may be attributed to the longer investment timelines of the vehicle and limited frequency of redemption windows.

Figure 4: Proportion Of Allocators Investing In Different Private Credit Vehicles, DM vs EM (%)



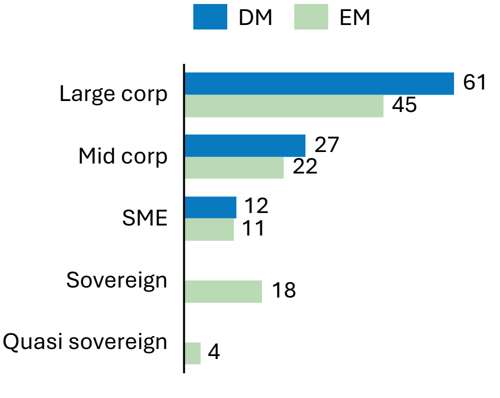
However, most allocators prefer to co-invest with direct investments in Private Credit, regardless of whether they target developed markets or emerging markets. Our survey found that 65% of respondents invested directly into DM Private Credit, with the same proportion of respondents directly investing in EM Private Credit. Due to uncertainty, allocators prefer to actively manage their investments and risk protocols. Direct investments were particularly popular amongst DFIs (Development Finance Institutions) and foundations, while they were least popular among pension funds.

3. Borrower segments

Investment managers have varying preferences between lending to sovereigns, quasi-sovereigns (i.e., government-backed or affiliated entities), large corporates, mid-size corporates, and in some instances, SMEs.

Larger borrowers tend to be preferred due to their relative stability and capacity to repay loans while weathering external shocks that impact cash flows (see Figure 5). However, a minority of investors do focus on lending via micro-finance institutions, placing a relatively higher degree of prioritisation on heightened local impact.

Figure 5: Weighted Average Portfolio Allocations Of Lending To Borrower Entities, DM vs EM (%)



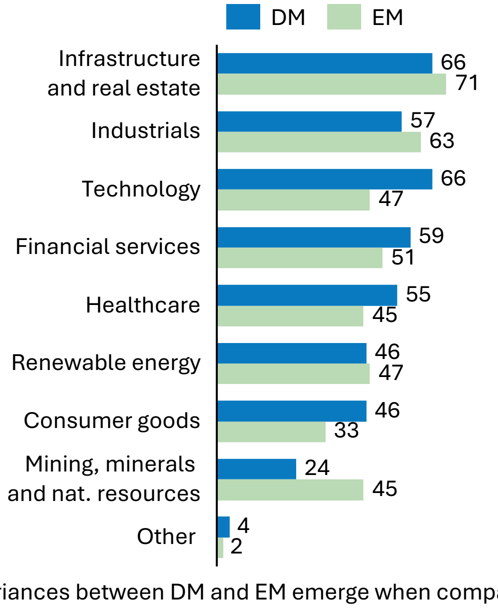
4. Borrower sectors

In DM, managers tend to segment their appetite into niches where they believe they have a right to win, while most managers in EM pay less attention to sectors. With EM Private Credit's nascency, most managers invest in fundamentally attractive projects regardless of their sector to capture the best growth opportunities and support diversification efforts. However, they still retain sectors of particular interest due to:

a) internal specialist expertise at their disposal
b) market trends influencing perceived attractiveness of segments
c) generation of themes for impactful investing

Our survey responses suggest that certain sectors are perceived as more attractive by institutional investors than others, and preferences are broadly aligned between DM and EM for core sectors (see Figure 6). For example, in both market sets infrastructure and real estate are the most popular sectors while industrials also had strong investor presence. These sectors are generally popular due to the stable long-term cash flows of borrowers.

Figure 6: Proportion Of Allocators Lending To Borrower Sectors, DM vs EM (%)



The variances between DM and EM emerge when comparing 'old world' and 'new world' sectors. Mining, minerals and natural resources shows significantly higher allocation rates in EM (by c.19 percentage points), reflecting the relative growth rates of the sectors in their respective economies and forward-looking expectations on their prospects. In contrast, technology and consumer goods have significantly higher allocation rates in DM (c.19 and 13 ppts respectively), reflecting the nascency and relatively higher historical default rates in these sectors for EM (c.6.1% vs c.3.6% from 1994-2023)[7]. However, there are nuances to sector allocation; for example, although technology coverage is limited, practitioners cite pockets of opportunity in Southeast Asia economies such as Indonesia and the Philippines.

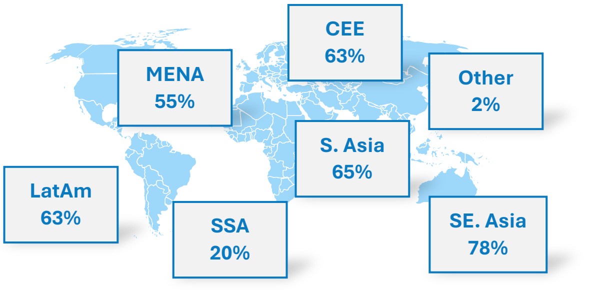
While sectors with high allocation rates may reflect perceived attractiveness, sectors with low allocation rates may be underestimated and untapped due to common misconceptions (see 'Changing perceptions about EM Private Credit').

5. Geographies

Investment managers are also not overly selective in their choice of geographies but do have regions of preference. Of the EM Private Credit investors in our survey, 61% made the distinction in their portfolios between emerging markets and frontier markets (i.e., the least developed and integrated economies within emerging markets). However, throughout this report emerging and frontier markets are assumed to be one category under the 'emerging markets umbrella'.

When asked to score what motivated their regional allocation within EM Private Credit from 1-5, where 1 was not a significant factor and 5 was a major factor, elevated risk-return was cited as the predominant driver of decision making (3.8). Institutional knowledge (3.7) and political stability (3.6) were also ranked as significant factors, while manager mandate (3.1), maturity of capital markets (3.3) and historical default rates (3.4) were cited as less significant in relative terms.

Figure 7: Proportion Of Allocators Lending To Borrower Geographies, DM vs EM (%)



With regards to specific regions, Southeast Asia was the most popular among EM Private Credit allocators (see Figure 7) with 78% of respondents investing in the region, reflecting its relative size and maturity compared to other emerging markets. In comparison, Sub-Saharan Africa (SSA) is highly untapped today due to perceptions that the opposite factors apply. The region has c.15% of the global population[4] but receives capital from just c.20% of investors in EM Private Credit. In contrast, LatAm (c.8%) and CEE (c.4%) have smaller proportions of global population but both receive investment from almost two thirds of investors. As covered in the next section (The opportunity in EM Private Credit), the true risk-adjusted opportunity in Africa is much larger than most allocators may realise.

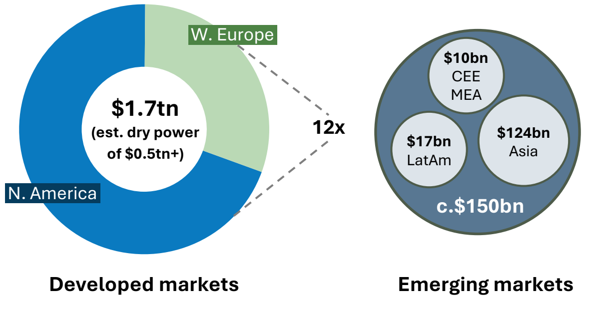
While the Middle East & North Africa ranked lower than other regions in terms of the proportion of active allocators, those who did invest in the region tended to take much larger positions. MENA ranked only behind Southeast Asia on a weighted portfolio size basis. Other regions such as Central Asia had residual coverage.

The opportunity in EM Private Credit

Less than 10% (c. $150bn) of Private Credit AuM is based in emerging markets (see Figure 8). Approximately $124bn of this is based in Asia, leaving just c. $26bn for other emerging market geographies[2]. There is a clear unmet need among these emerging markets, where government debt represents c.71% of GDP in comparison to c.113% of GDP in developed markets, while debt to corporate borrowers represents c.127% of GDP in the former and c.193% in the latter[8].

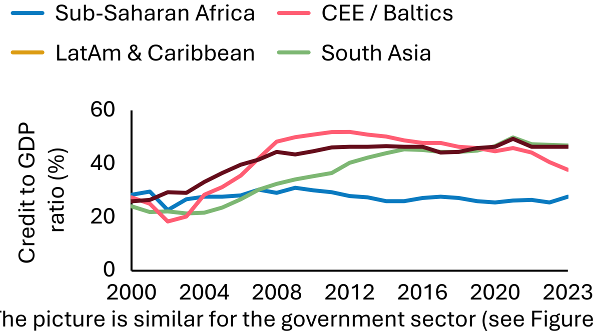
In APAC, SMEs face a substantial $2.5tn financing gap[9], while Africa's infrastructure and trade finance requires an additional c.$270bn annually[10,11]. The combination of abundant natural resource assets and young, growing populations to propel economic growth presents a unique opportunity for sustainable and long-term investments in the Global South.

Figure 8: EM Private Credit As A Component Of Private Credit – Funds Raised Over The Last 10 Years[2,3]



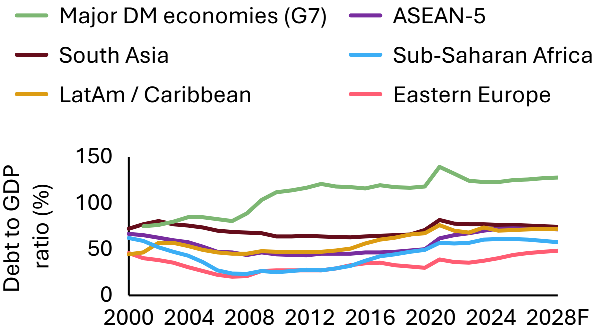
There is some disparity in availability of banking credit to the private sector by region, with Sub-Saharan Africa significantly underbanked for example, but collectively EM private sectors lag DM private sectors with regards to access to capital (see Figure 9).

Figure 9: Domestic bank credit to private sector, by region (% of GDP)[12]



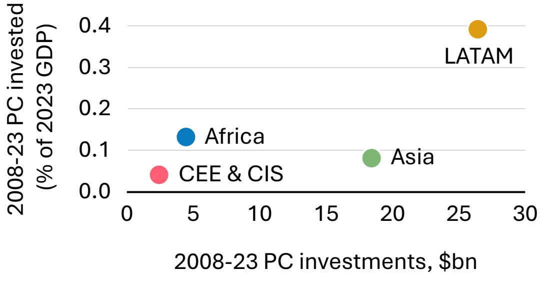
The picture is similar for the government sector (see Figure 10). Though Public Debt / GDP ratios rose in emerging markets during the pandemic years, they remain well below DM Public Debt / GDP atios. Whilst this is arguably justifiable due to smaller tax and welfare systems, the underlying growth dynamics of these economies makes the opportunity compelling.

Figure 10: General Government Gross Debt (% of GDP)[13]



Data from GPCA[14] shows total private credit investments into EM stood at $52bn over 2008-23, representing just 0.1% of those regions' GDP (see Figure 11). While LatAm has a higher proportion in relative terms at 0.4%, there remains clear untapped potential in EM regions.

Figure 11: Private Credit Investments Into EM By Region (% of GDP vs USD, bn) [12]



The severe unmet needs of EM borrowers, combined with their favourable demographics and expected acceleration in economic growth, make them an area of high potential for investors both now and in the long-term.

> "In developed markets you have the same 5-6 players after every deal so the yields aren't as good as they could be. At some point we will hit an inflexion point, where many allocators jump on the EM Private Credit bandwagon because it is the trend to do so."
>
> **Investment Associate, EM Investment Manager**

The rest of this section will show that there are potentially significant benefits on offer to those who allocate to EM Private Credit, most of which are rooted in competitive dynamics as lenders use their bargaining position to secure favourable terms. Consequently, the largest degree of benefit is available to be extracted in the short to medium term by first movers, before subsequent entrants crowd out the space in a similar fashion to DM Private Credit in recent years.

Scarcity of capital

Lending from banks in emerging markets has regressed in recent years due to regulatory and capital constraints imposed upon them. While lack of available capital for borrowers can limit their growth ambitions, this also provides opportunity to lenders in the space by way of negotiating favourable contractual terms. This includes:

1) Implementing sculpted amortisation structures where feasible, rather than interest only structures which require refinancing or liquidity event to exit.
2) Avoiding conflict with other lenders by holding a high share of the borrower's financing arrangements
3) Ensuring high-quality documentation is in place (i.e., heavy covenants over light covenants)
4) Retaining governance rights and the ability to dictate borrower strategy and activity, especially in relation to risk management
5) Inserting upside kickers that deliver additional yield to lenders
6) Purchasing existing EM Private Credit assets below market value during times of dislocation

In relation to point (1), the sparse investor base ensures that capital structures are simpler than scenarios where there are multiple investors in competition over debt collection protocols. In developed markets, borrowers can cause disagreement between lenders, pitting them against each other over the priority order of loans and negotiating favourable terms such as extended repayment periods, penalty reductions and increased access to capital. This compares to EM where lenders often have negative or even positive control over making changes to terms.

In relation to point (2), the scarcity of capital provision in emerging markets means that lenders can dictate comprehensive covenant terms under English or US legal frameworks, with extensive security arrangements and strong creditor rights in place. Under such old-style arrangements, borrowers are restricted in terms of dividend payments, asset transfers and disposals for example.

In contrast, the relative abundance of private capital in developed markets enables borrowers to negotiate covenant-light, PIK-weighted debt structures that may reduce early identification of risks. In Europe, lenders have had to increasingly adopt light covenant contracts as means to differentiate against competition[15]. Such covenants reduce the constraints around minimum cash flow, capital expenditure and leverage among other factors that borrowers need to abide by.

> "We often offer flexibility to our borrowers, but that is never at our detriment. We will always ensure that there can only be upside from such flexibility."
>
> **Investment Associate, EM Investment Manager**

In relation to point (3), the lack of competition allows lenders to adopt a tailored, flexible approach that accommodates borrowers that otherwise may have been out of appetite. For example, a lender could lower the interest payment coupon for the borrower and simultaneously insert upside requirements such as equity kicker payments upon exit.

Despite a resurgence in bank lending in EM in recent years, the funding needs of EM are so vast that crowding out of Private Credit providers is unlikely in the short and medium term. Nevertheless, it is clear that first movers will have the advantage in establishing themselves before new entrants join the market.

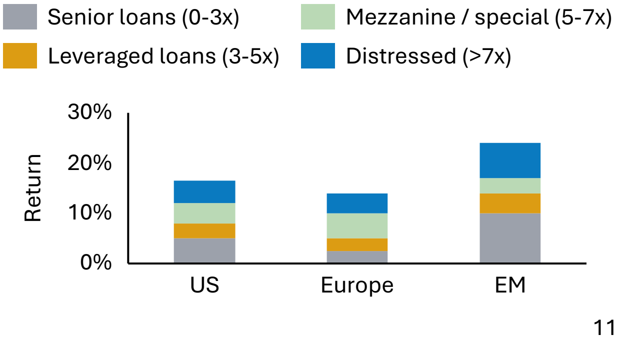
> "Bank financing in emerging markets has improved but there will always be a case for private investors. We typically get the terms we want, hold a large slice of the pie, retain governance rights, and receive kickers we could never negotiate in DM."
>
> **Investment Associate, EM Investment Manager**

To summarise, less competition and an excess of local demand for financing allows for positive selection bias on the lender's part; they can pick the very best projects that deliver enhanced returns while retaining strict risk management protocols. In comparison, increased competition in DM private credit has led to lower returns and the rise of covenant-light, PIK-weighted structures. As rates fall in the medium term, this will only be exacerbated with intensified competition in the Private Credit space. While there is still substantial opportunity in DM Private Credit, it is further along the maturity curve than EM Private Credit and therefore is subject to constraints that do not currently apply to the latter.

Favourable risk-return profile

EM corporate borrowers tend not to be as highly leveraged as DM corporate borrowers (<3x in EM vs 5-6x in DM), have more conservative LTV ratios, and have better cash coverage ratios when borrowing. With better coverage ratios, EM corporates can complete principal repayments in under five years, and given the relatively short timeframes market conditions will not change extensively beyond when the original agreement was signed. As Figure 12 shows below, much higher leverage is needed from DM borrowers to achieve the same yield as those from EM.

Figure 12: Market Estimates On Risk-Reward Balance Of EM Corporates vs DM Corporates (typical borrower leverage)



When asked to rate the relative risk of EM Private Credit in emerging markets against developed markets, where 1 was significantly less risky, 5 was the same level of risk, and 10 was significantly riskier, investors in EM Private Credit rated the asset class at 7.5 on average, while investors who did not allocate to EM Private Credit today rated the asset class at 8.0. However, when asked to rate the relative risk-return profile, where 1 was a vastly inferior profile, 5 was an on-par profile, and 10 was a vastly superior risk-return profile, allocators to EM Private Credit gave the asset class a score of 6.8 and non-investors gave the asset a score of 5.9. The general consensus, therefore, is that while EM Private Credit is perceived as significantly riskier than DM Private Credit, the relative risk-return profile is considered superior by a material margin.

Importantly, due to selective loan underwriting, strong structuring and being unlevered at the fund level, managers are able to offer their investors limited downside capture.

Diversification opportunity

Another key benefit of EM Private Credit is the opportunity to tap into a wider range of economic trend exposures and bring stability to the portfolio through diversification. 73% of allocators to EM Private Credit stated that this was a significant driver for their participation in the asset class, making it the most popular reason for allocation.

Correlation between default rates in Emerging Markets and Developed Markets B-grade investments is limited; a study of 15,000 loans for developing country borrowers in the Global Emerging Markets (GEMs) database across 1994-2023 noted that the correlations between the GEMs loan portfolio and the Moody's B3 and S&P B portfolios were 0.33 and 0.46 respectively[16]. Furthermore, the GEMs portfolio had lower default rates than the S&P and Moody's portfolios during the Dot Com bubble and the Global Financial Crisis (see Figure 22).

Within Emerging Markets Private Credit itself, the broad variety of projects across different sectors and regions under various financing agreements offers further diversification opportunities within the asset class.

> "People treat Emerging Markets as an asset class, but I would not say that this is the case. EM is really a collection of asset classes, from long-dated stable assets such as utility and infrastructure investments, to highly short-term, high-yielding assets such as trade finance and commodity finance. In my view EM is just a label, and you get a huge diversification benefit within a very vast region."
>
> **Portfolio Manager, EM Investment Manager**

Impactful investing and ESG goals

Though not a universal lens of interest, a material proportion of investors in the market see EM Private Credit as a unique opportunity to fulfil goals around impactful investing. Financed projects cover a range of development themes, and managers typically collaborate with borrowers to deliver ou stcomes linked to the UN Sustainable Development Goals (UN SDGs) as an additional incentive to do business (see Figure 13).

Figure 13: Impact Investment Themes Fulfilled By EM Private Credit Investing And Relevant UN SDGs

Investment theme	Relevant UN SDGs
Renewable energy transition – helping emerging markets to access modern sustainable energy	7 Affordable and clean energy; 13 Climate action
Financial empowerment and equality – providing micro-credit access to women through FinTech	5 Gender equality; 10 Reduced inequalities
Connectivity and innovation – providing society with access to new technologies	8 Decent work and economic growth; 9 Industry, innovation and infrastructure
Resource management & critical minerals – ensuring emerging markets gain from the E-revolution	12 Responsible consumption and production; 17 Partnerships for the goals
Sustainable agriculture and food security – ensuring fast-growing populations can subsist	1 No poverty; 2 Zero hunger; 3 Good health and well-being
Clean water and sanitation – securing access to water supplies and drainage	6 Clean water and sanitation

ESG initiatives can involve complex trade-offs. For example, infrastructure projects may raise political concerns regarding rights and interests of indigenous peoples, while mining projects may create jobs but also have a negative impact on the environment. However, it is worth noting that EMs are following similar development tracks as DMs and make small contributions to global emissions – for example, Africa contribution is below 4%[17]. Therefore, while it is important to consider externalities of EM investments, EMs should be allowed to grow without being held to the same standards as DMs today.

> "Our investors tend to be more commercially driven, but I can see that a lot of prospective investors we are speaking to will likely have interest in the ESG element of our work."
>
> **Sales Director, EM Investment Manager**

ESG focus from the investment management community has developed in waves by geography, with little variation by investor types in the space. Though some may argue that ESG interest is diminishing and exclusions are applying downward pressure on allocations to EM Private Credit, there is recognition that the ESG angle offers an opportunity to source deals and differentiate against other lenders by generating returns and social impact simultaneously. Regardless of perceptions, there is no doubt that EM Private Credit is inherently impactful.

Market outlook

Expectations for EM Private Credit

Based on our proprietary market survey, current investors in EM Private Credit are generally optimistic about the asset class's prospects. 57% expect the growth rate in AuM to accelerate over the next 5 years, followed by 33% who believe it will remain consistent. Just 10% expect a decline in growth rates.

With regards to their own EM Private Credit allocations, 51% expect the asset class to occupy a materially larger proportion of their portfolio five years from now, while 39% believe the proportion would remain broadly in line with today and 10% expect a decrease.

Expectations for DM Private Credit were also optimistic, though not to the same extent as for EM Private Credit. 39% of allocators expected their DM Private Credit allocation to materially increase in the next five years, while 43% expected this to stay largely the same and 18% expected a decrease. Furthermore, most of this optimism was concentrated among the allocators who did not allocate to EM Private Credit; the pool of EM Private Credit allocators had a Net Promoter Score (NPS) of just +5% towards DM Private Credit vs an NPS score of +57% for the allocators not involved in EM Private Credit at all.

Figure 14: Expected Impact Of Trends On Allocator Outlook On EM Private Credit Over The Next 5 Years

(1 = strong negative impact, 3 = indifferent, 5 = strong positive impact)

Group A refers to investors who do not actively allocate to EM Private Credit, Group B refers to investors who do

Trend	Total	A	B
Demand for alt. finance	**3.88**	3.79	3.92
Stable EM econ. growth	**3.79**	3.63	3.86
Low DM econ. growth	**3.68**	3.50	3.76
Better EM legal systems	**3.65**	3.42	3.76
New EM entrants	**3.60**	3.63	3.59
Interest rates	**3.52**	3.29	3.63
Bank regulation change	**3.45**	3.29	3.53
Political stability	**3.32**	3.29	3.33

Allocators (Group B) expected the growing demand in emerging markets for alternative financing to be the most likely factor driving their positive outlook on EM Private Credit, followed by more stable economic growth in emerging markets, weak economic growth in DM, and improvements to EM legal frameworks.

Investors who do not allocate to EM Private Credit (Group A) had similar views on which factors were most likely to improve their outlook on the class, though they showed heightened interest in new entrants in the asset class.

This suggests that their concerns are rooted in the limited track record of the asset class. If other investors and their managers can demonstrate tried and tested means of success, they may possibly follow.

Sweet spots for growth

Given the broad nature of the EM Private Credit landscape, allocators believe there are some areas that offer more potential than others for investments and have the freedom to be highly selective in what they invest in.

On a product basis, investors (Group B) are most bullish on the prospects of infrastructure debt, direct lending and senior secured loans, reflecting the preference for the relative stability that these products offer and the abundance of infrastructure deals on offer in emerging markets.

Distressed debt and local-currency-denominated debt were perceived as having the least potential, driven by their exposures to borrowers with poor fundamentals and FX volatility, respectively. These factors will be explored further in the 'Changing perceptions of EM Private Credit' section. Existing EM Private Credit allocators were also particularly keen on structured credit products, while this enthusiasm was not matched by investors who did not allocate to EM Private Credit.

Investors not actively allocating to EM Private Credit were more polarised in their views than current allocators – they were significantly more bullish on the potential of infrastructure debt and senior secured loans, while they had a stronger aversion to distressed debt and mezzanine financing.

Figure 15: 5-Year Outlook On EM Private Credit Products

(1 = strong negative outlook, 3 = indifferent, 5 = strong positive outlook)

Group A refers to investors who do not actively allocate to EM Private Credit, Group B refers to investors who do

Product	Total	A	B
Infrastructure debt	**4.05**	4.21	3.98
Direct lending	**3.68**	3.75	3.65
Senior secured loans	**3.61**	3.83	3.51
Trade /supply finance	**3.59**	3.79	3.49
Structured credit	**3.45**	3.21	3.57
Hard currency debt	**3.35**	3.67	3.20
Mezzanine financing	**3.09**	3.00	3.14
Distressed debt	**2.91**	2.67	3.02
Local currency debt	**2.87**	2.88	2.86

With regards to borrower entity type, outlooks mirror current allocation patterns. Allocators are most bullish on large corporate borrowers, with general concerns over EM borrower quality driving interest in the largest and most stable partners. SMEs were perceived as the least attractive client segment among investors, with those not allocating to EM Private Credit today even giving the segment a net negative score overall. However, there are investors in the market who focus solely on smaller loans to smaller institutions and have cited successful portfolio scale-ups via local partner banks and MFIs.

Figure 16: 5-Year Outlook On EM Private Credit Entities

(1 = strong negative outlook, 3 = indifferent, 5 = strong positive outlook)

Group A refers to investors who do not actively allocate to EM Private Credit, Group B refers to investors who do

Borrower entity	Total	A	B
Large corporates	**4.08**	4.08	4.08
Mid-sized corporates	**3.65**	3.46	3.75
Sovereigns	**3.53**	3.33	3.63
Quasi-sovereigns	**3.35**	3.38	3.33
SME	**3.13**	2.79	3.29

Similarly, when looking at borrower sectors, infrastructure and real estate were by far perceived as the most attractive sectors in EM Private Credit. However, existing EM investors saw significantly higher potential in Technology and Mining, Minerals and Natural Resources than non-investors. Given Technology has a particularly low allocation today in EM, this could be a sector to watch for high growth in the short to medium term. As previously mentioned, some market practitioners have observed significant opportunities with the Technology sector in Southeast Asia.

Figure 17: 5-Year Outlook On EM Private Credit Sectors

(1 = strong negative outlook, 3 = indifferent, 5 = strong positive outlook)

Group A refers to investors who do not actively allocate to EM Private Credit, Group B refers to investors who do

Borrower sector	Total	A	B
Infra and real estate	**4.00**	4.00	4.00
Renewable energy	**3.71**	3.79	3.67
Industrials	**3.69**	3.58	3.75
Technology	**3.60**	3.29	3.75
Healthcare	**3.59**	3.58	3.59
Financial services	**3.56**	3.63	3.53
Mining, minerals and natural resources	**3.48**	3.29	3.57
Consumer goods	**3.33**	3.21	3.39

In terms of regional preferences, respondents saw most potential in Southeast Asia and South Asia. While Southeast Asia already receives a high proportion of existing allocations and this trend is set to continue, South Asia appears to be an area of high potential that will begin to receive large increases in allocations.

Figure 18: 5-Year Outlook on EM Private Credit Geographies

(1 = strong negative outlook, 3 = indifferent, 5 = strong positive outlook)

Group A refers to investors who do not actively allocate to EM Private Credit, Group B refers to investors who do

Borrower region	Total	A	B
South Asia	**3.96**	3.96	3.96
Southeast Asia	**3.95**	3.88	3.98
Latin America	**3.65**	3.58	3.69
Middle East / N. Africa	**3.55**	3.21	3.71
Central Eastern Europe	**3.52**	3.58	3.49
Sub-Saharan Africa	**2.64**	2.21	2.84

Investors not allocating to EM Private Credit had similar perceptions, though they had a more positive outlook on South Asia than Southeast Asia and had a relatively more favourable view of the Middle East when compared to Central and Eastern Europe. Universally, the respondents did not have a strong outlook on the potential of Sub-Saharan Africa. This suggests that even those in the space today may be overlooking the sector's potential due to undue stigma about security and default rates.

Default rates in Africa tend to be misperceived; across DM and EM regions globally, the continent boasts the second-lowest default rates for infrastructure project financing (after the Middle East)[7], driven by positive selection bias, conservative deal structuring, and government support in many cases. The region with the highest default rates was in fact the US, due to the abundance of financing available even for lower quality borrowers and the ability to secure light covenants. This is particularly relevant when considering that infrastructure debt is by far the most popular product in EM Private Credit today. Sources suggest Africa shows vast opportunity – the continent is home to over 60% of the world's uncultivated arable land, holds the majority of critical minerals[18], and offers unparalleled solar energy resources. Annual investment required in its Energy Infrastructure until YE 2030 is c.$64bn[19].

When asked overall what would make them increase allocations to EM Private Credit, stronger risk-adjusted returns (cited by 71% of respondents) featured as the most prominent answer among allocators, followed by improved political and economic stability (67%). This underlines that although current EM Private Credit allocators have a more favourable view of risk-return than other investors in the market do, they are still acutely aware of the risks themselves and therefore actively take steps to monitor them along with their managers (see 'What to look for in an EM Private Credit Manager').

Changing perceptions of EM Private Credit

Sentiments on the asset class

Our market survey, in addition to exploring current Private Credit allocations and expectations, aimed to uncover reasons why institutional investors allocate or do not allocate to Private Credit in emerging markets.

Motivations for investing in Private Credit

Survey responses show that portfolio diversification was cited as the most popular motivation for allocating to EM Private Credit by a large margin (see Figure 19). Short-term opportunism and impacts of economic trends were also popular reasons, while past performance and the ability to dictate terms and conditions were not cited frequently. The focus on diversification as a motivator suggests that even current allocators to EM Private Credit may not yet see the full potential in the asset class today, which was explored in the previous section. This is also reflected by survey respondents holding small EM Private Credit allocations among larger diversified portfolios; c.53% of investors had allocations below 10%.

While diversification benefits of EM Private Credit apply to all institutional investors, certain characteristics, such as a longer investment horizon or a development-focused thesis make the asset class a more natural fit for some investors than for others, such as endowments and DFIs.

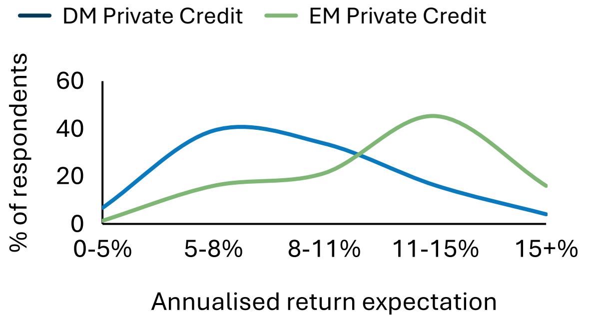
Figure 19: Motives For Allocating To EM Private Credit

Proportion of respondents citing factor as a motivation for allocating to EM Private Credit (%)

Factor	% of allocators
General portfolio diversification	**73%**
Short-term opportunism	**57%**
Econ. trends favouring EM Private Credit	**57%**
Client demand	**39%**
Local market growth exposure	**35%**
Strong observed EM Private Credit growth	**33%**
Strong DM Private Credit performance	**24%**
Weak performance of other classes	**18%**
Controls over Ts & Cs	**14%**
Lower perceived risk	**12%**

Allocators do acknowledge the stronger risk-return profile in EM Private Credit than DM. When asked which factors influenced their preference for emerging markets over developed markets in Private Credit (if at all), a stronger risk-return profile was cited as the strongest factor, followed by economic trends in emerging markets (see Figure 20). Interestingly, ESG ranked at the bottom of motivations, suggesting most investors seek returns first before impact. Generally, survey respondents expect annualised returns of c.5-8% in DM Private Credit and c.11-15% in EM Private Credit (see Figure 21).

Figure 20: Annualised Return Expectations For EM And DM Private Credit



Deterrents to investing in EM Private Credit

When asked to score deterrents to investing in EM Private Credit from 1 to 5, non-EM allocators scored FX risks (4.1) and contract enforcement (4.1) as the strongest factors, followed by political instability (4.0) and market liquidity (4.0), as shown in Figure 21. The first three factors showed heightened variance to the same respondents' scores for DM Private Credit. In other words, liquidity is a more fundamental concern with Private Credit in general, but FX risk, contract enforcement and political instability are heightened concerns when considering the emerging markets element in isolation.

Of the top three deterrents, political stability was considered the most legitimate concern by those who actively allocate to EM Private Credit. 65% of allocators had experienced political instability materially impacting their investments, while 41% had experienced negative impacts from FX risks. Just 29% of investors had been affected by contract enforcement issues in EM. Investors in the EM Private Credit space gave relatively less importance to contract enforcement concerns and more importance to factors such as market liquidity (2nd) and macroeconomic volatility (3rd). The 'Addressing legitimate concerns' section will explain how FX risks can be mitigated by imposing hard currency and hedging requirements on the borrower. It will also explain that enforceability in EM is very viable with English law contracts and extra-jurisdictional holding companies.

Figure 21: Deterrents For Allocations To EM Private Credit (based on Top 5 deterrents for non-investors)

Group A refers to investors who do not actively allocate to EM Private Credit, Group B refers to investors who do

Deterrent	A	B
FX risk (incl. availability)	**4.1**	3.7 (4th)
Contract enforcement	**4.1**	3.5 (6th)
Political instability	**4.0**	3.9 (1st)
Market illiquidity / exits	**4.0**	3.8 (2nd)
Borrower credit quality	**3.7**	3.7 (5th)

Dispelling misconceptions

The previous section has highlighted several deterrents to investing in EM Private Credit cited today, the most prominent of which are FX risks, contract enforcement issues and political instability. While the commonly held assumption is that many of these factors apply to a much greater extent in EM than DM, this section will address the concerns above and aim to demonstrate that:

while there are cases in which these concerns do manifest into reality, the rate of occurrence in EM is much lower than otherwise believed (Dispelling misconceptions about EM Private Credit)

competitive dynamics ensure that, in many cases, these concerns tend to apply more to DM than EM

there are numerous mitigation strategies that investment managers can apply to ensure that they are pursuing a high-quality investment (see 'Addressing legitimate concerns' & 'Best practices' sections for further details)

Comparison to EM Private Equity

Crucially, EM Private Credit is gaining credibility as a standalone asset class, not just within Private Credit, but also when compared to other private market strategies such as Private Equity. This report has already touched upon the benefits of EM Private Credit over DM Private Credit, but the asset class has also performed favourably against EM Private Equity.

"There's a widespread perception that equity is about returns and debt is about risk. In reality, EM Private Credit has done much better than EM Private Equity."

Portfolio Manager, EM Investment Manager

By realising returns in excess of 10-15% p.a., investors in EM Private Credit have cited superior five-year gross annualised IRRs to several EM Private Equity indices[14]:

- Africa PE & VC Index: +5.6%
- Middle East PE & VC Index: +11.2%
- LatAm & Caribbean PE & VC Index: +8.4%

EM Private Credit tends to be supported by contractually defined repayment schedules and amortisation features, which offer stable cash flows amidst uncertain market conditions. In contrast, asset classes such as EM Private Equity may face challenges finding liquidity and facilitating exits when market conditions deteriorate.

"EM Private Equity is a standard asset class now, but from a structural point of view, if you invest in Private Equity you need to believe capital exists there for the targets to function."

Portfolio Manager, EM Investment Manager

Regardless of comparisons between Private Equity and Private Credit, all company capital structures rely on both debt and equity, and hence the viability of the two asset classes in EM are inextricably linked.

High default rates

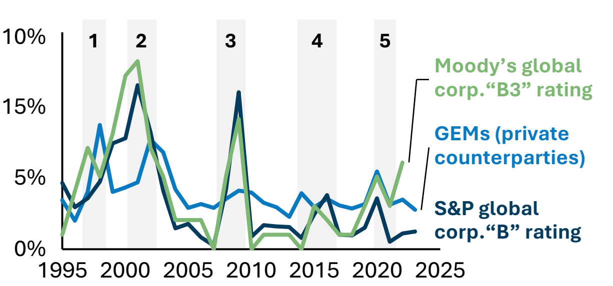
Although default rates are often cited as a key deterrent to investing in EM Private Credit, market data suggests that actual corporate default rates in emerging markets are lower than credit ratings imply.

The aforementioned GEMs database study of 15,000 loans showed that the simple average rate of default was c.3.6% from 1994-2023, lower than the corresponding figure of 4.0% for Moody's Global Corporate "B3" rated companies[16], and marginally higher than the rate of c.3.3% S&P Global Corporate B-rated entities[20].

Observing Figure 22 below, the default rates in the GEMs portfolio are also lower than the S&P and Moody's portfolios during the Dot.com Bubble and Global Financial Crisis, indicating that there are also clear diversification benefits to be gained from the limited correlation between emerging and developed markets.

Figure 22: Comparison Of Annual Default Rates In Emerging Markets Against B-Grade Investment Companies In Developed Markets[7, 16, 20, 21]

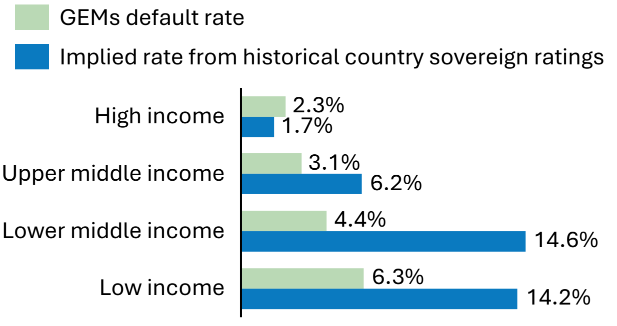
(1): Asian Financial Crisis, (2) Dot.com bubble, (3) Global Financial Crisis, (4) Commodity Price Crisis, (5) COVID-19



Furthermore, the same GEMs database suggested that sovereign ratings are creating inflated perceptions of default rates for lower-income countries and may be deterring investors unnecessarily (Figure 23). Actual default rates in low-income countries (5.3%) were significantly lower than default rates implied by their sovereign rating (14.2%)[16]. In contrast, sovereign ratings appeared to be lenient for high-income countries, with actual default rates of 2.3% being marginally higher than the rates implied by the rating of 1.7%[16].

Our market survey corroborates this insight, with just 35% of investors in EM Private Credit stating that high default rates had a material negative impact on their portfolios.

Figure 23: GEMs Avg. Default Rates Vs Country Rating[16]



Why might default rates be lower than expected? This is fundamentally driven by underwriting quality – as explained previously, the excess demand for financing allows lenders to positively select the highest quality options across EMs. Borrower ratings are capped at the sovereign rating of the domicile in which they operate, regardless of whether a substantial proportion of activity occurs elsewhere. Therefore, there are many high-quality borrowers that will perform much better than their credit ratings would ever imply.

Market practitioners broadly agree that default risk is not inherently tied to whether a borrower is domiciled within a developed or emerging market. Instead, defaults are driven by the fundamental financial health of the borrower's business and external market factors that may directly disrupt their cash flows. Lenders typically also have the mandate to intervene and require course-correction from borrowers at risk of default.

"We haven't seen many defaults, and when we have, this was largely due to factors that disrupted cash flow such as general market conditions, challenges with pricing or equipment, and logistical issues. I wouldn't say defaults are driven by DM vs EM."

Investment Associate, EM Investment Manager

A case can be made that logistical challenges are more likely in emerging markets due to inferior infrastructure, and this can hinder borrower operations. For example, a country with limited port capacity is likely to drive supply chain and export bottlenecks that disrupt cash flows for a borrower. However, as infrastructure quality improves in Ems, due to increased investor interest in infrastructure opportunities, this is expected to diminish as a risk.

Low recovery rates

If defaults do occur, a common assumption is that little to none of the lent capital is recoverable from the borrower. Our survey indicated that 67% of managers not allocating to EM Private Credit cite this as a significant reason (scoring 4 or 5 out of 5) for not investing. Analysis of the GEMs portfolio shows that 72% of the value of defaulted loans were recovered, with a similar value for Moody's Global Loans at 70%[16]. Values for bonds were lower at 59% for Moody's Global Bonds index, and 34% for JP Morgan's EM Corporate High Yield Bond index[22].

"It is true that Developed Market corporates have more valuable security and real estate assets to provide as physical collateral, but we will always have security in place through our contractual arrangements."

Investment Associate, EM Investment Manager

Best-in-class investors secure full collateral cover for their loans, ensuring substantial recovery in the event of default. It is common practice to transfer borrower assets under a lender friendly jurisdiction. This ensures that in the event of a default the lender already has better access to the borrower assets as well as direct access to cash flows. Whereas similar methods have been adopted over the years in DM, competitive pressure on underwriting standards have made these structures hard to negotiate with sponsors in many cases.

Unenforceability of contracts

To ensure that repayment or recovery occurs to fulfil expected yield, contractual clauses need to be adhered to by the borrower. A common fear among investors and managers who operate within EM Private Credit is that certain emerging markets may not offer sufficient legal protection to ensure enforcement, or that they do not understand local legislation sufficiently to impose the necessary conditions and enact the required protocols.

When asked to score the significance of deterrents to investing in EM Private Credit from 1 to 5, 88% of investors who do not allocate to EM Private Credit stated that contract enforceability is a significant deterrent (scoring 4 or 5 out of 5) , while just 29% of existing EM Private Credit allocators cited this as an equally significant reason for not increasing allocations.

Market practitioners believe this is perhaps the largest of all the myths associated with the asset class. This report has already covered how documentation is generally stronger in EM than DM – in EM, contracts are almost always under UK or US law, while a material and growing proportion of agreements in DM are under covenant-light structures that allow the borrower more flexibility around cash flows, capital expenditure and additional financing arrangements[15]. Furthermore, as stated above, lenders can hold borrower assets in offshore holding companies within jurisdictions that recognise lender rights to recover assets.

Outside of specific contracts, managers in EM Private Credit will always undergo extensive legal consultations to ensure they understand the nuances of local legislation and bankruptcy laws to enable recoveries. Typically, they will focus on larger jurisdictions with more familiar legislation and proven track records of enforcement.

Creditor rights relative to the borrower can be stronger in emerging markets than in several developed markets, such as some European nations. When a debtor objects to enforcement in Italy, courts can take up to 9 years to finalise foreclosure, while this is 24 months in France (provided it is not interrupted by insolvency proceedings that can last up to 10 years)[23]. In contrast, the UK timeframe is typically 6-12 months and requires minimal court involvement[24], and emerging economies such as Brazil, South Africa (both c.2 years) and India (c.4 years)[24] are well below the European durations.

Credit quality

Another prominent critique of EM Private Credit is that borrowers may have lower credit quality than their counterparts in developed markets. They can be prone to unstable profit margins, which creates challenges in servicing their debt.

Although the lack of alternative capital options to the existing loan arrangements suggests that EM borrowers are less leveraged and therefore have a lower debt burden, they may be limiting their business growth and, in turn, their ability to repay debts by having to draw on their own capital.

"It's hard to grow faster than the local economy over the long term for a local business, and with depreciating currencies as well. You almost need to outperform the market and then some more to make enough money to transfer into dollars to pay back your loan."

Investment Associate, EM Investment Manager

Borrowers often face the dual challenge of outpacing local market growth and offsetting local currency depreciation in order to meet debt servicing obligations, which are priced at interest rates high enough to compensate investors for the perceived risk introduced into their portfolios.

Concerns around borrower credit quality were evident in our market survey: 31% of allocators reported a negative impact on their portfolios due to credit issues, while 57% cited credit quality as a significant deterrent to increasing their allocations to EM Private Credit, rating it either 4 or 5 out of 5 as a factor.

To limit this risk, investment managers can execute several mitigating actions:

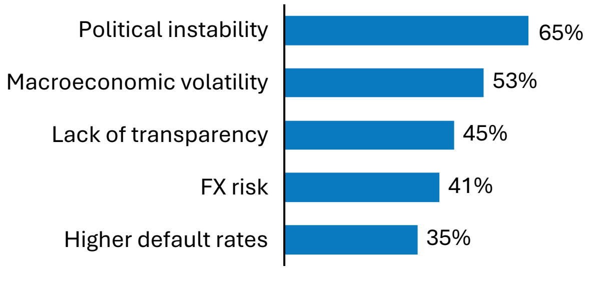
1) Focus on corporate borrowers with lower leverage – many EM borrowers will have low leverage ratios already as they have limited access to capital
2) Focus on larger borrowers that are likely to have greater resilience to outside operational shocks
3) Adopt amortising structures, i.e., no interest-only loans, to ensure ongoing repayment
4) Negotiate higher collateral rank positions to prepare for the event of defaults

As outlined in earlier sections, lenders in EM Private Credit typically enjoy stronger bargaining power and greater selectivity, allowing many of the aforementioned risk mitigants to be incorporated into portfolios and negotiated into contracts with relative ease. In recent years, concerns around credit quality have increasingly emerged in developed markets, where competitive borrower dynamics have led lenders to accept more complex and potentially riskier deal structures in order to maintain yields comparable to those available elsewhere.

Addressing more legitimate concerns

Beyond prevalent myths associated with EM Private Credit, there are some investor concerns that do have greater substantiation behind them. Figure 24 shows the five most prevalent factors that EM Private Credit allocators have experienced impacting their portfolios. However, the scarcity of Private Credit in emerging markets often means that managers can select only the highest quality deals and use their bargaining power to negotiate conditions that mitigate most of their concerns.

Figure 24 - Proportion Of EM Private Credit Allocators Who Have Experienced Material Impacts From Commonly Cited Concerns – Top 5 (%)



Geopolitical concerns

Investment managers concede that geopolitical factors are a valid concern. 65% of EM Private Credit allocators cite that geopolitical instability, in the form of regulatory and investment policy changes among other factors, has negatively impacted their investments in the past. 69% of existing investors cite that this is a significant deterrent (scored 4 or 5 out of 5) to increasing their allocations in EM Private Credit, while 79% of non-investors state that this is a deterrent to allocating to the asset class at all.

"Geopolitical issues are a more material concern as they are ultimately out of the investor's control. The risks are country specific and require the investor to get up close to the geopolitical forces and understand them."

Investment Associate, EM Investment Manager

Although emerging markets are generally more prone to political instability, governments have strong incentives to support corporate borrowers in theory, given their vital role in generating tax revenues and creating employment. Furthermore, they are increasingly aware of the adverse consequences that come from policy decisions that are unfriendly to foreign investors.

However, investors and managers should still be wary of individual interests and track records in the countries where they operate. Countries with track records of armed conflicts, and weak investment treaties or trade relations with other nations will tend to be avoided.

Though political risk cannot be truly eliminated, managers could choose to purchase Political Risk Insurance (PRI) to mitigate risk around certain political events. During the life of the loan, they will also actively monitor the geopolitical landscape of countries through risk management frame-works and engage local officials to discuss policy changes.

When asked about which factors they expected to improve their five-year outlook on EM Private Credit the most, existing allocators were least optimistic about the impact of changes in political stability. 47% of allocators expected this to have a positive impact on EM Private Credit, while 22% expected a negative impact. Institutional investors who do not allocate to EM Private Credit shared this sentiment, with 33% expecting a positive impact and 13% expecting a negative impact.

Macroeconomic challenges

Macroeconomic uncertainty, in the form of high inflation, sudden rate changes, and export tariffs among other factors was another deterrent ranking highly among investors. 53% of EM Private Credit allocators cited that macroeconomic instability had negatively impacted their investments in the past.

73% of allocators rated this concern as a 4 or 5 out of 5, marking it as a major obstacle to further allocations in EM Private Credit; the non-EM Private Credit allocator figure was similar at 67%. In contrast, 43% of EM Private Credit allocators and 30% of non-EM Private Credit allocators saw macroeconomic challenges as a significant deterrent to investing in DM private credit.

However, investors are significantly more optimistic about the economic outlook in emerging markets over the next five years. Among current EM Private Credit allocators, 73% expect macroeconomic stability to positively influence their outlook on the asset class, while 65% anticipate a positive impact from continued economic growth. Similarly, for investors who do not allocate to EM Private Credit today 67% expect a positive impact from economic stability and 54% expect a positive impact from growth.

> "A key success factor for us has been positive economic developments and being able to ride the wave of any instability along the way."
>
> **Chief Investment Officer, US Family Office**

Regardless of economic outlooks, investment managers apply several levers to mitigate potential macroeconomic risks when engaging individual lenders. Firstly, floating rate loans can be adopted to ensure real-term returns are not impacted by inflation. Secondly, lenders can focus on borrowers who either a) have export-focused businesses that can expand beyond the local economy and earn foreign currency, or b) have substantial market presence within the home country that ensures they are large and stable enough to pay their debts. Lenders will also prefer businesses that are less cyclical in nature and have a reliable stream of income. More broadly, when examining individual countries, lenders avoid jurisdictions with challenging macro-economics. While some jurisdictions may be red lines for managers in terms of investment opportunities, it must be stressed again that they tend to focus on specific opportunities first, rather than profiling specific countries to do business in.

Currency risks

A common, and to some extent, valid concern is the foreign exchange risk tied to borrower repayments in local currencies, and the volatility that accompanies them. 41% of survey respondents allocating to EM Private Credit stated that this phenomenon has had a material effect on their investments in the past.

However, a simple mitigant for this is imposing hard currency requirements on the borrower to avoid risks of depreciation. Just 37% of our survey respondents indicated that they use hard-currency-denominated debt as a product in EM Private Credit, suggesting that this simple strategy is underutilised today in the market. This figure was similarly low in DM Private Credit, at 35%.

> "People have focused on Private Equity, which has greater local currency exposures and lack of exit opportunities. Private Credit allows you to achieve returns without going there by using hard currency."
>
> **Portfolio Manager, EM Investment Manager**

A counterargument to using hard currency obligations may be that borrowers will struggle to ultimately service them, but such concerns can be allayed for three key reasons:

1) Lenders have discretion to select borrowers that generate foreign currency by default, such as commodities and other export-focused businesses.
2) For borrowers that don't generate foreign currency, lenders typically impose hedging requirements to ensure that they can obtain hard currency ahead of when payments are due.
3) Corporate borrowers in emerging markets have lower leverage ratios than borrowers in developed markets, providing a buffer to manage FX risk through the cycle.

Ultimately, these measures help to ensure the lender is taking on minimal currency risk. Although using a hard currency may decrease the interest that can be charged to a borrower on a risk premium basis, hard currencies almost eliminate the fundamental risk of volatility that commonly deters investors. While 75% of investors who do not allocate to EM Private Credit cited fears of meeting currency requirements as a key deterrent to allocating (score of 4 or 5 out of 5), this figure was 59% for investors who do allocate to the asset class. Of the investors in EM Private Credit, 41% have had their portfolio affected by currency issues.

In summary, while a range of concerns exists when investing in EM private credit, each with varying degrees of validity, many of the more substantive risks can be effectively mitigated through robust investment management processes. Figure 25 below outlines how these key risks can be addressed in practice.

Figure 25 – Misconceptions, Legitimate Concerns, And Their Mitigating Actions

Deterrent to allocation	Verdict	Supporting evidence or mitigation strategy
"EM Private Credit offers lower returns than EM Private Equity"	Misconception	• EM Private Credit returns have exceeded EM Private Equity returns over the last five years. • EM Private Credit repayment schedules ensure stable cash flows and liquidity, whereas EM PE can be more sensitive to market cycles and have limited exit opportunities.
"Default rates are high in EM"	Misconception	• EM corporate borrower default rates can be much lower than sovereign ratings imply, driven by lender ability to apply positive selection bias for quality deals and active monitoring of borrowers. • EM default rates are comparable to B-rated borrowers in DM (with limited correlation and higher yield).
"Recovery rates are low in EM"	Misconception	• Recovery rates for EM Private Credit are significantly higher than those for EM bonds. • EM Private Credit lenders can hold lender assets in offshore HoldCos over the duration of the loan, ensuring complete recovery in the event of default.
"Market exits and achieving liquidity are difficult in EM"	Misconception	• EM Private Credit deals can have accelerated amortisation schedules vs DM Private Credit due to lenders' competitive bargaining position. • If borrower assets are held in an offshore HoldCo, lenders have direct access to borrower cash flows in the event of a default.
"Contracts are generally unenforceable in EM"	Misconception	• Due to competitive dynamics, most EM Private Credit deals are under English or US law and have heavy covenants - in contrast, the majority of DM Private Credit deals are now under light covenants, which allow borrowers more flexibility around cash flow, expenditure and additional financing arrangements. • Managers will undergo extensive legal consultations prior to investing to ensure they understand local laws.
"Borrower credit quality in EM is poor relative to DM"	Misconception	• Lenders can focus on borrowers with less leverage - EM borrowers are generally less leveraged than DM counterparts due to their limited access to capital. • Lenders can focus on larger borrowers with greater resilience to external operational shocks. • In terms of arrangements, lenders can focus on amortising structures to ensure ongoing repayment and negotiate higher collateral rank positions.
"EMs can be prone to geopolitical instability"	Legitimate concern	• Managers are advised to get close to the geopolitical forces shaping EMs and understand their implications, both before and during investments. • Countries with track records of armed conflict or a lack of democracy and trade relations are generally avoided. • Managers can also purchase PRI or PRGs to limit liabilities from political events.

Table continued on the next page...

Figure 25 (continued) – Misconceptions, Legitimate Concerns, And Their Mitigating Actions

Deterrent to allocation	Verdict	Supporting evidence or mitigation strategy
"EMs can be prone to macroeconomic volatility"	Legitimate concern	• Lenders can focus on businesses that are less vulnerable to economic shocks (i.e., large stable businesses, export focused businesses earning hard currency, businesses less cyclical in nature). • Most managers are optimistic about the outlook of EM economies and their impact on Private Credit.
"EM borrowers can pose FX risks to lenders"	Legitimate concern	• Lenders can mandate hard currency requirements in their loans, as opposed to exposing themselves to the volatility of local currencies. • When hard currency is required, lenders can focus on borrowers that generate foreign currency by default (e.g., commodities and other export-focused businesses). • Where borrowers do not generate foreign currency, lenders can impose hedging requirements to ensure they do; EM corporates tend to have lower leverage ratios than DM borrowers and therefore accessing foreign currency in theory should not be difficult.

What to look for in an EM Private Credit Manager

Best practices in the asset class

This report has already alluded to the fact that a skilled investment manager is essential to help mitigate the challenges associated with investing in EM Private Credit, from sourcing high-quality opportunities to monitoring allocations diligently, and redeploying capital to ensure yields are optimal. This section will cover best practices managers adopt to ensure optimal risk-return outcomes for their investors.

Conducting in-depth due diligence

Leading managers in EM Private Credit place emphasis on conducting thorough due diligence on individual opportunities to assess their suitability for allocation. This ensures that significantly risky projects are avoided, but also that high-quality opportunities are not overlooked due to sweeping generalisations about borrower profiles (geography, sector, entity-type).

Opportunity fundamentals are assessed with stress-testing of the following :

- Cash flow generation
- Debt sustainability and operational leverage
- Availability of collateral
- Refinancing risks
- FX risks

Furthermore, managers perform assessments of documentation quality and legal frameworks, consider reputational and compliance risks, and layer on ESG considerations when making their decisions on investments.

Given the degree of specialist knowledge involved, managers operating in particular niches of the EM Private Credit space will typically hire in-house experts who can provide the required expertise to assess borrower prospects with more granularity. For example, an investment manager that focuses on mining in Africa will contract a host of mining experts with knowledge of the region.

In scenarios where a project is in a relatively unknown space to the manager, for example in a new geography, sector or product, the manager will typically co-invest with specialists who do have prior experience of such investments.

When asked what type of investment manager they look to invest with, 82% of allocators selected sector specialists, 63% selected large investment managers with proven track records and 55% chose local experts. Therefore, knowledge of the borrower business is perceived as more important than scale or knowledge of a country environment in relative terms.

However, country knowledge should not be overlooked. Familiarity with legal architecture and local bankruptcy laws around creditor rights and collateral monetisation can prove highly useful when assessing downside risks. When asked what managers should do to differentiate in this space, 65% stated that local knowledge was a key factor.

Beyond country knowledge, managers can go one step further to ensure they tap into high-quality opportunities by developing strong in-country presence and building long-term relationships with reliable partners to originate deals.

"The key success factor in our EM instruments has been selecting fund managers with deep local presence and strong origination networks. Not only do they source quality deals, but they also maintain hands-on borrower engagement throughout the investment lifecycle."

Product Head, North America-based DFI

"Our best-performing EM private-debt deals have all hinged on one thing: sourcing loans through in-country teams who negotiate bilateral terms and then enforce tight, data-driven covenants. Local origination gives us wider spreads and lower leverage up front, while real-time monitoring lets us spot trouble early and intervene before collateral erodes."

Investment Committee Member, US Foundation

"The key success factor is ensuring there is a thorough risk management process, including detailed and specific DD for the placement, as well as for the territory in the macro-sense. The risk management should evaluate borrower creditworthiness, local legal frameworks, currency, and geopolitical risks."

Geopolitical risk consultant

Monitoring and governance of individual deals

a) Once an investment opportunity has been selected, best-in-class managers will ensure they have:

b) Access to granular management information with regular data inflows informing health of the borrower

c) Strong lender governance rights in relation to the strategy of the borrower

d) Effective contingency plans for all foreseeable scenarios

Lenders will engage company management on an ongoing basis to ensure its performance aligns with the investment thesis on which the loan was made, mandating interventions whenever necessary. Consequently, they can manage assets in in a fashion more closely aligned to how Private Equity firms operate. This also ensures managers can offer some degree of flexibility to the borrower while ensuring this does not create any undue risk for themselves as the lender.

> "We have good access to information and a strong mandate to impose changes in the borrower. The way we manage our investments is essentially Private Credit with a Private Equity approach."
>
> **Portfolio Manager, EM Investment Manager**

Outside of the borrower's business itself, managers will actively monitor the environment in which the business operates, including political stability, macroeconomic policy and local market conditions. Survey respondents emphasised keeping an eye on the business environment and regulations on a daily basis, and constantly engaging local authorities, as key success factors.

Practising holistic risk management

Most importantly, investment managers need to have a robust risk management framework in place across their entire portfolio. Risk management practices and strategies were considered the most important factor to consider when choosing an EM Private Credit manager in our survey. Having a superior risk management framework was also cited as the 2nd most differentiating factor for managers, after understanding of local markets. In other words, all investment managers are expected to have robust risk management practices, but it can still prove to be a differentiator given the extent of investor concerns.

Engagement committees will approve entry into new countries, analysing transaction fit with the manager's wider business plan. They will also consider reputational, compliance and regulatory risks, and provide budget for any due diligence needs, including ESG risk considerations.

Investment committees will support setting limits and allocations for individual funds, considering risks and mitigation, exit strategies and economics of individual transactions, including collateral and security packages. Further committees are held for comprehensive risk management, as shown in Figure 26.

In addition to these committees, a quantitative and risk management team would monitor portfolio risk and inform analysis on hedging. Counterparty risk would be managed by diversifying collateral balances across vetted counterparties, and liquidity risk would be managed by weekly cash flow forecasts. 10% of Fund NAV in unencumbered cash is generally targeted to cover margin calls in stressed market environments.

More broadly, investment managers aim to diversify geographically and sectorally across different borrower-types and avoid over-indexing in volatile segments such as cyclical industries and commodity-reliant economies.

Figure 26 – overview of additional committees

Risk Committee	Valuation Committee	Operational Risk Committee
Monthly	Monthly	Quarterly
Limits, return analysis, VAR and stress tests	Valuation of all positions versus external providers	Controls & process; Cybersecurity

Balancing agility and duration

Managers face a balancing act between higher yields and higher liquidity. Longer duration assets may be more attractive during times of economic stability, while shorter duration assets may be attractive during times of instability and concerns over interest rates and liquidity requirements. The risk-reward trade-off on the long end of the curve in EM is also something to be wary of[25].

Understanding the different merits of underlying investment vehicles is crucial given the different opportunity set in EM. For example, the ability to take advantage of short-term volatility and adapt to different scenarios is much greater in an evergreen fund than a closed ended fund.

Additional considerations

Investment managers should consider how they can diversify their capital structures and create new product offerings that allow participation across the risk-return spectrum, either via developing new origination and underwriting capabilities internally, or forging value-accretive partnerships with other specialists.

They should also give due consideration to the possibilities unlocked by technology, for example, AI and machine learning augmentation of underwriting decisions and portfolio monitoring, automation of credit processes, and improved digital user journeys.

Understanding the different merits of underlying investment vehicles is crucial given the different opportunity set in EM. For example, the ability to take advantage of short-term volatility and adapt to different scenarios is much greater in an evergreen fund than a closed ended fund.

Who is looking at EM Private Credit

Interest in EM Private Credit is rising as intensifying competition strains yields in DM Private Credit and investors wake up to the opportunity presented by emerging markets. Investors expect insurance companies and foundations to show the largest increase in activity in this space over the next five years, while they do not expect asset managers and sovereign wealth funds to show the same levels of growth due to their already-existing presence (see Figure 27). Market practitioners do not yet expect to see extensive involvement from retail investors in the asset class for the foreseeable future.

"I wouldn't see retail investors entering this space as a standalone product, but I can definitely see EM Private Credit as a component of private market LTAFs from a diversification perspective."

Head of Sales, EM Investment Manager

Figure 27 – investors anticipated to show the biggest increase in activity in EM Private Credit over the next 5 years (1 to 5)

1 = no significant increase , 5 = major increase

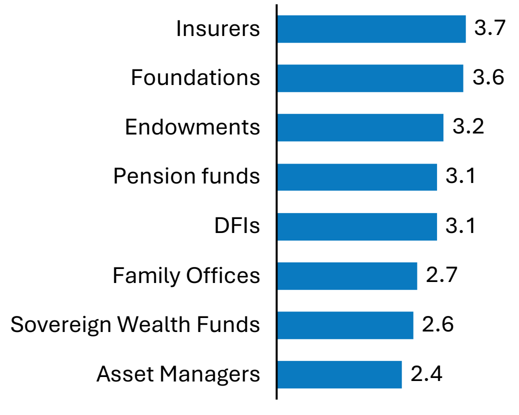
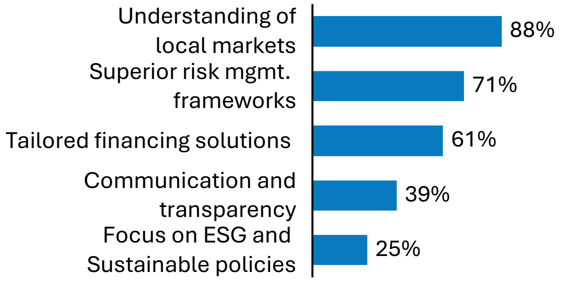


Figure 28 – largest investment manager differentiators in the EM Private Credit space perceived by allocators

Proportion of respondents who cited factor (%)



With growing competition in this space, managers need to show investors that they understand the environments in which they operate and have robust risk management frameworks to address all concerns held about emerging markets and private credit. As Figure 28 shows, these factors are the most significant differentiators perceived by investors looking to deploy capital to the asset class.

"EM Private Credit offers compelling opportunities for yield generation, diversification, and impact, particularly when structured with local insight and strong risk management.

However, greater industry-wide transparency, standardized reporting, and collaboration between DFIs and private capital are needed to build long-term confidence in the asset class. We believe the next phase of growth will be driven by managers who can balance credit discipline with developmental outcomes."

Head of Product Division, North American DFI

To conclude, EM Private Credit offers a vast opportunity, and interest is quickly growing as the sector's tangible results become apparent. This report has explored the many benefits and opportunities of operating in the space, and explained how many concerns over emerging markets and private credit are either misconceptions or can be mitigated with sound investment manager practices.

In the DM Private Credit market, those who entered the space first were able to develop the scale, origination networks and underwriting expertise to establish themselves and realise material gains before the market became crowded out. Similarly, prospective investors in Emerging Markets Private Credit should give credence to its very real and extensive opportunities sooner rather than later.

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Appendix: methodology

Abbreviations & definitions

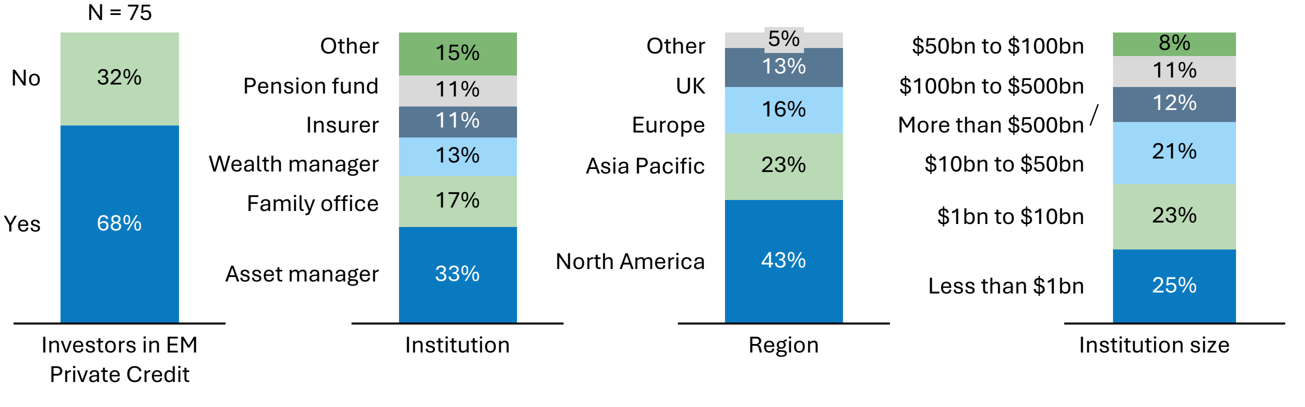
- EM = Emerging Markets, which refer to all geographies outside of North America, Europe (ex. CEE), Japan, Australia and New Zealand
- DM = Developed Markets, which refer to North America, Europe (ex. CEE), Japan, Australia and New Zealand
- Investors / institutional investors / allocators / Limited Partners (LPs) = the end investors providing capital to investment managers in the Private Credit space
- Managers / investment managers / market practitioners / General Partners (GPs) / lenders = the delegated parties lending the investors' capital to EM and DM borrowers
- NPS = Net Promoter Score, which is calculated by the difference between the % of promoters (score of 4 or 5 out of 5 in our survey), and % of detractors (score of 1 or 2 in our survey)
- Ppts = percentage points, used to show the difference between two separate percentage scores (this does not reflect percentage change)
- HoldCo = holding company, which does not produce goods or services itself but exists primarily to own shares of other companies
- PIK = payments-in-kind, referring to interest payments are made in additional securities or a form of non-cash payment, helping borrowers to manage their cash flows effectively

Survey methodology

75 institutional investors were approached to participate in our survey, which sought to understand existing allocation patterns, forward looking outlooks across the Private Credit market, and respective motivations and deterrents for investing in the space. Respondents were segregated into two survey tracks depending on whether they were investors in EM Private Credit (referred to as allocators or Group B), or non-investors who knew enough about the space to comment on its features, trends and their reasons for not investing (referred to as Group A). Frontier and emerging markets were assumed to fall under one umbrella category of emerging markets throughout the survey.

Our respondent demographics are broken down below:

Note: Other institutions include foundations, endowments, development finance institutions (DFIs), sovereign wealth funds and funds of funds. Other regions include Middle East, Africa and Latin America.



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