Emerging market private credit: A different risk-return proposition?



Michael Wehrle, CEO, BlueOrchard



Daniel Freedman, Senior Portfolio Manager, BlueOrchard

Why institutional investors should look beyond established private credit markets

Private credit has become a significant part of institutional portfolios. Pension funds and insurers have steadily increased their allocations, seeking income, diversification and returns beyond traditional fixed income markets. Yet much of this capital remains concentrated in North America and Europe, often in similar lending structures and borrower segments.

As allocations grow, a question becomes increasingly relevant: how much diversification do investors actually gain from adding exposure to the same developed market lending segments?

Emerging market (EM) private credit offers an interesting alternative. It provides access to businesses and financial institutions exposed to different economic drivers, while selected lending opportunities can offer relatively conservative leverage, strong contractual lender protections and attractive pricing. Financing is frequently directed towards business expansion, productive investment and working capital rather than leveraged acquisitions.

Despite these characteristics, institutional allocations remain modest. According to the International Monetary Fund's (IMF) Global Financial Stability Report of April 2026, EM account for less than 5% of global private credit assets under management. Nevertheless, capital invested in EM private credit transactions rose from approximately USD 14 billion in 2024 to more than USD 22 billion in 2025.

Part of the explanation lies in market access. Unlike developed market direct lending, where institutional investment infrastructure is well established, EM private credit requires extensive origination networks, local underwriting expertise and the ability to manage exposures across different jurisdictions. Building diversified portfolios on an institutional scale has therefore been difficult, despite the underlying lending opportunities.

Meanwhile, competition has intensified in developed market private credit. McKinsey's June 2026 analysis found that median spreads on new direct-lending transactions narrowed from 716 basis points in March 2023 to 544 basis points by the end of 2025, while median leverage on new-issue transactions remained close to five times EBITDA.

For institutional investors, these developments make a closer examination of EM private credit timely. Its appeal lies in the potential for differentiated returns, diversification and lending structures that may compare favourably with those available in more established markets.

Diversification beyond developed market private credit

Diversification within private credit deserves closer attention as institutional allocations expand. Developed market direct lending portfolios can have considerable overlap in their borrower profiles, private equity sponsors, industries and transaction structures. Even portfolios spread across several managers may share exposure to similar economic conditions and credit risks.

EM private credit opens access to a different range of borrowers. These include financial institutions serving domestic households and businesses, established companies financing expansion and enterprises investing in productive capacity.

Their performance may be driven by domestic consumption, financial deepening, infrastructure investment and regional economic growth. These factors can differ from the private equity sponsor led acquisition and refinancing cycles that shape significant parts of developed market private credit.

Historical default data lends support to the diversification case. In its October 2024 research, Reassessing Risk in Emerging Market Lending, the International Finance Corporation (IFC), a member of the World Bank Group, examined statistics from the Global Emerging Markets Risk Database (GEMs) Consortium. It found correlations of 0.46 and 0.33 between GEMs default rates and those of S&P B-rated and Moody's B3-rated corporate borrowers, respectively.

These relatively modest correlations suggest that EM credit cycles do not necessarily follow the same patterns as those of predominantly developed market borrowers. Although the figures measure default-rate rather than investment-return correlations, they indicate differences in underlying credit dynamics.

The economics of emerging market lending

The underlying lending structures offer another reason to look more closely at EM private credit.

In developed markets, a significant proportion of direct lending finances private equity-sponsored acquisitions, leveraged buyouts and refinancing. Competition among lenders has an important influence on pricing, borrower leverage and contractual protections.

In EM, financing needs are often different. Companies borrow to expand operations, purchase equipment or finance working capital. Financial institutions seek funding to extend credit to businesses and households in markets where access to financing remains constrained.

This lending is frequently linked to business growth and investment rather than ownership changes or financial restructuring, with implications on leverage ratios and the terms available to lenders.

In some EM lending segments, borrowers operate with more conservative leverage than companies financed through highly leveraged acquisitions. Lower indebtedness can provide greater financial flexibility and more capacity to withstand pressure on earnings or cash flow.

The availability of long-term financing also varies considerably across markets. Where suitable funding remains scarce, experienced lenders with established relationships and local expertise may be in a position to negotiate attractive pricing, financial covenants, security packages, bespoke structuring and reporting obligations. These provisions can strengthen creditor protection and provide greater oversight of borrower performance.

For institutional investors, the combination of pricing, borrower leverage and lender protections is particularly relevant. Attractive contractual yields supported by manageable indebtedness and appropriate safeguards can offer a compelling alternative to more competitive developed market lending segments.

Evidence of competitive investment returns

The return potential of EM private debt is increasingly supported by empirical evidence.

A World Bank study published in October 2026, Returns to Private Debt in Emerging and Developing Economies, analysed realised cash flows from

4,109 IFC loans, representing approximately USD 115 billion of financing across 127 countries.

The findings show that privately originated EM loans can generate returns competitive with established public market investments. For loans originated over the last five years, the study found that returns exceeded those of both the J.P. Morgan CEMBI Broad Diversified Index and US Treasuries, with public market equivalents (PMEs) of 1.05 and 1.14, respectively. The PME methodology compares performance while accounting for the timing of cash flows.

The longer-term results, covering loans originated between 2002 and 2024, provide further perspective. Despite including the global financial crisis, private lending returns remained broadly comparable with EM corporate bonds and exceeded those of US Treasuries. Performance varied across vintages, with more recent lending periods producing stronger relative results.

The study is particularly valuable because it draws on realised investment cash flows rather than projected returns. Although the results reflect IFC's specific lending experience, they provide evidence that EM private debt can deliver competitive financial performance across diverse markets and economic conditions.

A substantial track record of credit performance

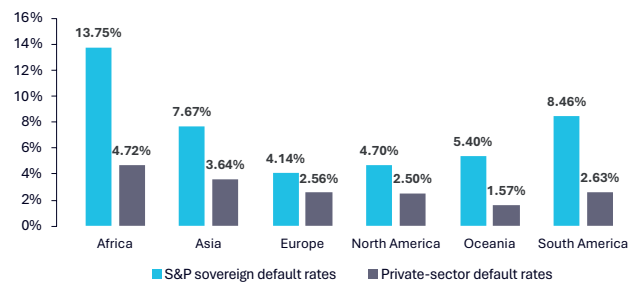
The evidence on EM credit performance has also become more extensive.

The latest GEMs Consortium statistics, released in October 2026, draw on more than three decades of lending experience from multilateral development banks and development finance institutions.

Covering 10,409 private sector counterparties across 159 countries and EUR 437.5 billion in signed financing between 1994 and 2025, the database reports an average annual default rate of 3.29% and an average recovery rate of 69.8% on defaulted contracts. Private-sector counterparty default rates have also remained below the corresponding S&P sovereign default rates (see Figure 1).

The breadth of this dataset allows investors to examine EM credit against an extensive record of actual defaults and recoveries, providing a more informed perspective than broad assumptions about country risk.

Figure 1: Private-sector default rates vs. sovereign default rates by continent (1994-2025)



Source: Global Emerging Markets Risk Database Consortium. (2026, October 6). Default and recovery statistics: Private lending 1994–2025, page 3

The statistics reflect lending by institutions with established underwriting, structuring and monitoring capabilities. While their experience cannot be generalised to the entire private credit market, it provides useful insight into credit performance under disciplined lending practices.

Borrower fundamentals, leverage, contractual protections and ongoing monitoring remain important determinants of investment outcomes. Local expertise is essential in assessing currency exposures, regulatory developments and the enforceability of creditor rights.

Bringing emerging market private credit to institutional investors

Access to attractive EM lending opportunities relies on specialist origination capabilities, local market knowledge and established borrower relationships.

Over several decades, development finance institutions have built extensive lending networks and credit expertise across EM. Combining these capabilities with specialist asset management creates opportunities for institutional investors to participate in lending markets that have traditionally been difficult to access.

The collaboration between the International Finance Corporation (IFC) and BlueOrchard Finance Ltd, part of the Schroders Group, illustrates this approach.

IFC contributes its established lending platform, including borrower origination, credit assessment, underwriting and deal structuring. BlueOrchard brings more than 25 years of experience in EM debt investing, with responsibility for portfolio construction, diversification, ongoing investment management and risk oversight.

Through this partnership, individual credit exposures can be assembled into a diversified portfolio designed for institutional investors. IFC's origination network and execution capabilities provide access to a broad pipeline of loans, while BlueOrchard constructs and manages the portfolio. For evergreen structures, liquidity management is particularly important, requiring careful alignment of loan repayments, portfolio cash flows and redemption arrangements.

For pension funds and insurers, this approach provides access to an established global lending platform with strong local presence and substantial deal flow, complemented by a dedicated portfolio management expertise overseeing portfolio construction, diversification and risk management.

This flexibility allows for effective management of country and sector concentrations, while maintaining consistent investment criteria and exposures as the portfolio grows. Within a framework of defined portfolio limits, ongoing monitoring and institutional reporting, these capabilities help translate individual lending opportunities into a scalable investment strategy.

Japanese insurer Tokio Marine Group provided a USD 300 million anchor investment at launch of the initiative in October 2026. The investment illustrates how institutional capital can access EM private lending through a dedicated investment structure.

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