



# *Policy Note*

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## THE RETAILIZATION OF PRIVATE MARKETS AND THE RISE OF PONZI FINANCE

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### **Introduction**

Following the 2008 financial crisis, the US entered an economic environment characterized by low interest rates, cautious banks, and tighter financial regulations. As a consequence, businesses that were too small to issue securities faced a credit crunch while money managers were on the hunt for higher yielding assets. Private markets that have existed for decades have provided a solution to that double problem by offering to channel funds provided by money managers into credit-constrained businesses. As of 2025, private equity funds hold \$24 trillion worth of assets globally (Edlich et al. 2026, 24) and private debt funds have \$2.6 trillion of assets under management (Hinds et al. 2026, 5). While there have been recent worries about developments in private debt markets, regulators and private equity firms have been quick to brush these worries aside, arguing that the private debt market is small, private debt deals have a lot of equity buffer (leverage is low), covenants attached to private debt deals allow for a quick correction of problems in a way that promotes the long-term success of businesses, and low default rates reflect the inherent soundness of private markets. Instead, private capital firms and regulators have pushed for “democratizing” private markets (White House 2025) by “unlocking broader access to sophisticated strategies that were once out

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of reach for everyday savers” (CEO of Great Gray Trust Co., in Bodamer [2025]) in order to use dormant savings in banks to “channel them into productive investments” (Rachel Lord, head of international at BlackRock, as quoted in Dunkley [2026]).

Based on an in-depth analysis in Tymoigne (2026), this note challenges such a narrative. Almost 20 years after the worst post-World War II financial crisis, there are signs that private markets are major contributors to the growth and spread of financial fragility. The financial practices that preceded the Great Recession are once again becoming more common: loose underwriting and credit rating; the growing use of interest refinancing; the growing use of opaque asset-pricing methods; the rise of financial engineering that hides leverage, embeds leverage, and generates ephemeral liquidity; and a policy environment that promotes deregulation, desupervision, and deenforcement. Together with the growing interdependence of private debt markets, private equity markets, banks, and money managers, these dangerous financial practices generate a financial environment in which fraud can grow quickly and financial instability can materialize. The retailization of private markets is not only a source of instability for personal finances, it also reinforces the risk of financial instability in the economy. The retailization of private markets will lead to a rapid inflow of funds, far beyond the needs of the small and medium enterprises currently considered creditworthy. This will incentivize further loosening of underwriting as new deals must be found and as competition increases within private markets and with banks and public markets. Given the fundamental contradiction between the purpose of private markets and the desire to engineer liquidity in order to grow them, regulators need to intervene. Regulators should limit access to private markets to money managers with (1) the ability to judge the risks involved, (2) portfolio-management mindsets geared toward patience and the operational success of the business enterprises, and (3) liquidity and financial buffers large enough to sustain expected and unexpected losses. The decision to enter private markets requires a strong tolerance for high risk, careful analysis, and patience.

### **Priming the Demand for Private Market Products: Regulatory Loosening and Credit Rating Shopping**

Retail money managers hold tens of trillions of dollars of assets, but accessing such a financial boon to expand private markets is not straightforward. The clearance of this hurdle has necessitated regulatory guidance and the aggressive use

of credit ratings. In terms of regulatory guidance, Blackstone, Apollo, and Kohlberg Kravis Roberts (KKR) have long lobbied Congress to gain access to participant-directed individual account retirement plans (401(k), 403(b), IRA, etc.). While the Trump administration provided regulatory guidance in 2020 that encouraged the inclusion of private equity, the Labor Department under the Biden administration concluded that private equity was not prudent for retail pension plans (US Department of Labor 2021). However, the Department of Labor under the second Trump administration has encouraged fiduciaries of retail pension funds to consider private market financial instruments, as well as other “alternative assets” such as cryptoassets (White House 2025). Under the leadership of Chairman Atkins, the Securities and Exchange Commission (SEC) has removed private-asset allocation limits on closed-end funds offered as portfolio choice to retail clients. The retailization of private markets is expected to shift the retail portfolio allocation in private markets from less than 5 percent “toward double-digit exposure across all advisor channels by 2030” (Edlich et al. 2026, 27). This threshold has already been reached in the private debt market, where the share of holdings by retail money managers has gone from almost negligible in 2020 to 15.5 percent in 2025 (Hinds et al. 2026, 3). A similar pension fund reform is happening in the United Kingdom with explicit targets for retailization by 2030.

This regulatory push for retailization has been accompanied by a loosening of credit rating standards with a growing reliance on private letter ratings (PLRs) to assess the riskiness of private markets. By switching to a PLR, insurance companies obtained a better rating in 97 percent of the cases and “on average, designations were 2.74 notches higher, with designations 3.01 notches higher at small [credit rating agencies (CRAs)] and 1.9 notches higher at large [CRAs]” (Johnson, Wong, and Phelps 2024, 4). This has allowed insurance companies to avoid \$30 to \$35 billion in capital charges (Harris and Healy 2025), while also broadening the access to private-market-related portfolio positions to meet yield targets. While the National Association of Insurance Commissioners (NAIC) had to withdraw its critical report following pressure by the small CRAs, the Bank for International Settlements has expressed similar concerns, as did the Office of Credit Ratings of the SEC in its various releases of the *Staff Report on Nationally Recognized Statistical Rating Organizations*.

## **Pumping Up the Demand for Private Market Products: Engineering Liquidity, Embedding Leverage, and Marking to Myth**

Given that private funds want to attract a broader range of money managers, they must accommodate a broader set of preferences regarding credit risk, timing of yield distribution, and liquidity. This needs to be done on the basis of a financial industry grounded in taking long-term, illiquid positions in high-credit-risk businesses with limited collateral and a delayed expected ability to generate operational earnings. The growth of the secondary market in private credit instruments has been crucial in managing the conflict between the growing liquidity preference of money managers and the nature of private market business deals. The reliance on secondary funds—such as continuation vehicles (CVs), structured finance vehicles, and credit funds that specialize in the purchase of existing private claims—is expected to grow with retailization: “the ability to provide liquidity to [limited partners (LPs)] [...] continues to resonate with sponsors [of continuation vehicles] [...] There is also a continual need for LP liquidity in private markets, particularly as more retail capital enters [due to] the secular ‘democratization of alternatives’” (William Blair’s Private Capital Advisory Team 2026 3, 9). The heavy reliance on secondary transactions to maintain the liquidity of private markets creates an environment favorable to the growth of financial fragility, not only because there is a potential conflict of interest, given that secondary vehicles are created at the initiative of the sellers, but also because the maintenance of liquidity involves continuously sponsoring new vehicles to buy from other sponsored vehicles: “LPs express concern that continuation vehicles may be used to hide underperforming assets” (Edlich et al. 2026, 16), and the founder of a secondaries investment firm noted that it is not easy to decipher “lemons” from sound CVs (Heal and Gara 2025).

Structured finance vehicles such as issuers of collateralized funds obligations (CFOs) cause growing financial fragility by giving a false sense of safety and liquidity. They give a false sense of safety because the rating attached to them is not linked to the credit risk of the underlying assets. They give a false sense of liquidity because they require further financial engineering to maintain liquidity. Finally, while CFOs increase yield for a given credit rating, such a yield enhancement comes from increasing embedded leverage in private markets; the success of CFOs depends on the success of collateralized loan obligations that depends on the success on non-investment-grade business

debts. Each layer of leverage increases yield as well as the sensitivity of asset-backed securities to losses on private debts (Carlino et al. 2025). The embedded leverage induced by joint venture loan funds, securitization, and resecuritization has been compounded by the rapid rise of leverage among Business Development Companies (BDCs). Following a loosening of their maximum allowed leverage in 2013 and 2018 (S&P Global 2025), the median leverage of BDCs has almost doubled and is growing. Average leverage in private debt funds was 1.9 in 2025, reaching as far as 3.6 or higher for the top 5 percent most leveraged private debt funds (Berg and Lee 2026, 4).

Besides the rise of direct and embedded leverage, the growing reliance on level 3 valuation has increased financial fragility by linking the continuous availability of refinancing to untested asset-price valuations. The increasing preference of financial institutions for level 3 valuation is directly related to the rise of private markets. Level 3 valuation is also ripe for abuse, with financial firms using different pricing models to value financial assets, both internally and for their customers (Counterparty Risk Management Policy Group III 2008, 88). Arbitrariness in valuation creates potential conflicts of interest and market manipulations, e.g., general partners recording inflated asset value in order to attract lenders and sustain the refinancing process (Financial Conduct Authority 2025).

### ***On the Supply Side: Incentives to Loosen Underwriting and Hide Problems***

The ability of private borrowers to service interest is declining, with a growing share of businesses with negative interest coverage ratios and the rising share of interest paid in kind (PIK) in total interest service (International Monetary Fund 2024). If interest rates continue to rise, interest service will continue to increase, given that most private debts carry a floating rate. This will lead to further increases in interest PIK, and thus will increase the operational income necessary to make a business viable. At the same time, lenders may refuse to refinance interest service if the value of the underlying assets does not rise fast enough or certain triggers are reached in the debt contracts, leading to a credit crunch and the forced liquidation of positions. Taken together, asset-price direction comes to take a bigger role in the viability of private debt deals. Retailization will help expand the pool of potential buyers and sustain asset prices, but this can only go on for a time until forced liquidations rise and spread to public markets.

The data about the share of interest PIK in funds' interest income underestimate the presence of interest refinancing because of lending practices that hide such refinancing. There is a growing demand by businesses for private debts that contain interest PIK features (Mincemoyer et al. 2025). Private debt funds have an incentive to accommodate this demand because PIK debts generate a higher yield, and all interest service can be recorded as income under accrual accounting rules even if not all of it is serviced (in 2006, deferred interest service represented up to 67 percent of the pre-tax profit of some mortgage lenders). However, there is usually a covenant that limits interest-refinancing and CRAs may record a default when interest PIK occurs. To bypass these problems, private debt funds have innovated via "synthetic PIK" features in private debts. This allows a business to request a loan from a different financial institution to service the interest, and "synthetic PIK is not reported as PIK and may not be fully represented in loan valuations with respect to underlying credit issues" (Mincemoyer et al. 2025).

Market forces are incentivizing private market funds to increase financial fragility. First, the growth of the private debt market requires finding new potential borrowers. As the market saturates for a given set of credit standards, it is necessary to loosen those standards or to move beyond credit-constrained businesses. In the latter case, banks have an incentive to lower their credit standards, weaken covenants, and include PIK and other innovations in their credit practices in order to maintain market share; this is already occurring for private credit provided to large corporations (International Monetary Fund 2024, 71) as well as private credit provided to small and medium enterprises: "Competition between banks and direct lenders has fostered a trend toward loan terms favorable for borrowers, including the increased prevalence of covenant-lite structures, PIK toggles, and synthetic PIK facilities" (S&P Global 2026).

As Mr. Blankfein, former CEO of Goldman Sachs, noted in the case of the pre-2008 financial dynamics: "It should be clear that self-regulation has its limits. We rationalised and justified the downward pricing of risk on the grounds that it was different. We did so because our self-interest in preserving and expanding our market share, as competitors, sometimes blinds us—especially when exuberance is at its peak" (Blankfein 2009).

Second, the retailization of private markets will lead to a large inflow of funds looking for yield. This may further drive down credit standards as private market funds are pressured to

use their "dry powder" (i.e., liquid assets) to buy riskier assets in order to generate the rate of return expected by retail portfolio managers. Such riskier assets may include synthetic PIK debts, loans to companies previously deemed too risky, and structured finance products. Such financial products are dependent on proper asset price dynamics to allow continued refinancing. This also further reinforces a portfolio mindset in which LPs take positions in the primary market with the expectation that they be able to liquidate them quickly at low cost ahead of schedule because "secondaries are now recognized as a strategic portfolio management mechanism for both private fund managers and investors" (SS&C 2025, 2). Finally, general partners are also increasingly relying on the ability to sell and refinance their positions, which lowers their incentive to carefully judge the creditworthiness of the underlying businesses.

Third, "the lender-sponsor partnership involves a quid-pro-quo approach in times of stress, where both parties provide concessions to stabilize the issuer" (Margolis and Chin 2025). The flexibility of private debt contracts is touted as a benefit over bank credit. However, flexibility compounds the problems if too much discretion is used to loosen covenants and evaluate assets with the hope of reselling to someone else by hiding problems through overvaluation, synthetic PIK, credit rating inflation, and other measures. Too much flexibility may give an incentive to avoid fixing problems.

### **Rampant Free Market Ideology**

The credit rating, debt underwriting, and valuation practices that are increasing financial fragility, together with retailization, have been encouraged by a policy environment that promotes deregulation, desupervision and deenforcement. Such trends have accelerated under the second Trump administration, which sees government oversight as "regulatory adventurism" and, despite abundant evidence to the contrary, considers competition to be a cleansing mechanism that roots out dangerous financial practices by allowing "market forces—not the regulator—to drive the disclosure of any additional aspects that may be beneficial" (Atkins 2026). Long set aside are the mea culpas of Kohn, Greenspan, and others who conceded that they "placed too much confidence in the ability of the private market participants to police themselves" (Kohn in House of Commons 2011, Ev3), and that they "made a mistake in presuming that the self interest of organizations, specifically banks and others, were such is [*sic*] that they were best capable of protecting their own

shareholders and their equity in the firms” (Greenspan in US House of Representatives 2008, 34).

FDIC staffing has once again been on a downward trend since 2011 and is close to its pre-2008 levels, with 5,000 employees in 2025. The Consumer Financial Protection Bureau has been gutted by layoffs and refusal by Director of the US Office of Management and Budget Russell T. Vought to fund it properly. Since 2012, the SEC (a key regulator for private markets) has recorded a growing number of departures by experienced supervisors, while its staffing stagnated and then significantly declined in 2025 (US Government Accountability Office 2026). The SEC staff has found problems in the CRA’s rating practices and has reported the problems to its Division of Enforcement when appropriate (and has also recognized the needs for a better regulatory framework for CRAs), but SEC enforcement actions are significantly less frequent since 2024 (Huffman and Jindra (2025). SEC Commissioner Caroline A. Crenshaw pushed for more information to be provided to the SEC but was outvoted. She noted “my colleagues use lots of buzz words—freedom, diversification, democratization. Call it what you will, at bottom it’s risky and it’s reckless” (Crenshaw 2025). Abroad, the FCA has also pushed for improved reporting of information regarding private credit (Arnold 2026).

Prosecutions (as well as convictions) of white-collar crimes have declined significantly since 2011, from an average of 9,000 yearly prosecutions by the Department of Justice across administrations until the middle of the Obama administration, to 4,000 currently (Transactional Records Access Clearinghouse 2025). Such a criminogenic environment is prone to generate further growth of financial fragility in private markets and the overall financial industry. Such is the case to an even greater degree since Jay Clayton, US Attorney for the Southern District of New York (and SEC Chairman under the first Trump administration), has pushed for the self-reporting of fraudulent activities with a promise of declination (Southern District of New York US Attorney Office 2025).

### **What Next?**

Private markets commonly involve the use of Ponzi finance, i.e., credit-constrained businesses rely on the ability to refinance the principal and interest service on their private debts. This, in turn, relies on the continuous growth of asset prices to justify additional refinancing, given a loan-to-value ratio. Currently, there are signs that the reliance on Ponzi finance in private

markets is growing and spreading beyond private businesses. The underwriting of private debts increasingly incorporates the availability of interest refinancing, money managers’ portfolio strategies have become more dependent on liquidating assets in smoothly working financial markets, and the interdependence of private equity funds, private debt funds, banks, and money managers is rising. The push for the retailization of private markets creates a temporary solution to deal with refinancing and liquidation pressures but also feeds an asset-based Ponzi process by passing the buck for holding financial instruments tied to private markets to a broader segment of the financial sector. This is only sustainable temporarily, given that rising leverage, more securitization, more continuation, more resecuritization and recontinuation, a rising share of level 3 valuation, a rising share of interest PIK, the growing use of synthetic PIK, and the loosening of underwriting standards can only go so far in sustaining a net inflow of new participants. Unfortunately, all of this is currently encouraged by a regulatory environment that believes in the self-cleansing properties of markets through competition, shareholders’ pressures on management to get rid of fraud, market-driven disclosures of information, and self-reporting of fraud for a free pass.

As the process of fragilization continues, default rates may remain low because the recognition of payment difficulties is deferred by seemingly favorable market conditions that allow refinancing and liquidation at rising asset prices to proceed smoothly via PIK debts, continuation (CVs), recontinuation (CVs on CVs), securitization, and resecuritization. High yields are obtained by participants who entered early and, potentially, the next entrants if the Ponzi process continues. Ultimately, however, the accumulation of weak underwriting, mounting refinancing pressures, loose credit rating, inflated asset valuation, and embedded leverage generate such a fragile financial structure that a crisis produces losses that pierce through any capital and liquidity buffers. Equity buffers will crumble and liquidity will evaporate as refinancing channels close and real and financial assets tied to private markets need to be liquidated en masse to meet debt commitments. A significant markdown of level 3 valuations and a large downgrade of credit ratings will feed a debt-deflation process that may spread to other markets as interdependencies grow during the period of stability. As such, although BDCs and other financial vehicles are structured in such a way that they have large buffers of equity, these buffers provide a false sense of safety. This is all

the more so that liquidity and capital buffers are procyclical. Leverage is rising among BDCs, covenants are weakening and being bypassed (e.g., synthetic PIK), and participants in private markets are bypassing capital regulation via credit rating inflation, securitization (rated-note feeders, CLO, etc.), and off-balance-sheet innovations such as joint venture loan funds. Banks such as JPMorgan, Barclays, and Citigroup have started to implement financial strategies to profit from a fallout of private market funds via credit default swaps on Apollo, Ares, and Blackstone funds.

Private markets may not yet be a source of systemic risk, but given the previous trends, regulators should put a brake on current practices. Given the high short-term profitability of a Ponzi process (and the current frenzy about the AI sector—a key borrower in private markets), and the risk of losing market shares if one does not participate, market forces do not incentivize self-correction of financial practices that increase the risk of financial instability. Instead, herd behaviors and *fuite en avant* becomes the norm, and the goal of each participant is to prolong the process as much as possible, with the hope that one will come out unscathed when the process unravels. As Mr. Prince, former CEO of Citigroup put it: “When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing” (Prince, as quoted in Nakamoto and Wighton 2007).

Given the fundamental contradiction between the purpose of private markets and the desire to engineer liquidity in order to grow them, regulators need to intervene. Regulators should limit access to private markets to money managers with the ability to judge the risks involved, with a portfolio-management mindset geared toward patience and the operational success of the business enterprises, and with liquidity and financial buffers large enough to sustain expected and unexpected losses.

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