

Private Credit Placed on Sector Watch by SQM Research

20 March 2025

SQM Research today has placed the private credit sector on Watch* in response to increased instances of issues observed and to recent announcements made by financial regulators, ASIC and APRA.

A watch issued by SQM Research in this instance means that we are increasing our active monitoring of the sector on existing ratings, we have adjusted our ratings scoresheet to place a greater emphasis on governance; and that SQM's initial due diligence screening, which occurs prior to a formal review, will also be increased.

While SQM Research expects the bulk of its existing ratings to not be impacted by this watch, it cannot rule out some funds to being downgraded or discontinued over the next 12 months.

SQM Research has current ratings on approximately 70 private credit funds, covering both retail and wholesale funds, representing approximately thirty-three billion dollars of funds under management; making SQM the largest researcher of private credit funds in the Australian funds management sector.

In its various forms, SQM Research has been covering the private credit sector since 2007. Mortgage funds dominate its coverage with 37 products categorised as either open ended or contributory mortgage funds. Other major subcategories SQM Research rates within the private credit sector include unconstrained fixed income products, diversified credit and alternative private debt.

The issues SQM Research as observed include with increasing frequency have included:

- Lack of transparency on who borrowers actually are.
- Questionable categorisation of asset holdings (illiquid/liquid/fixed income/convertible equity/equity).
- Lack of transparency on sub fund holdings.
- Lack of transparency on group financials.
- Highly leveraged balance sheets.
- Overall inadequate disclosure within information memorandums
- Information memorandums that give too much latitude to the manager in terms of asset allocation weights.
- Elevated Loan to value ratios, calculated on end of completion developments.
- Vertical and horizontal related party structures (same Trustee, Responsible entity, Custodian, development/real estate agency divisions attached) that may give rise to a conflict of interest.
- Increased loan arrears and an increasing frequency of refinancing of existing loans that were scheduled to be exited.
- Sizeable interest rate margins not being passed onto investors.
- Lack of independence at board/ investment committee level.
- Dubious marketing strategies involving advisers.
- An increasing number of products being offered with a mismatch between stated liquidity and the underlying liquidity of the loan assets.



SQM Research stresses the above issues are not endemic within the sector but do appear with more frequency within wholesale funds and in particular, newer fund products offered to the market.

Some of these issues have been observed beyond the private credit sector.

Over the past 12 months SQM Research has screened out approximately 20 fund offerings within the private credit. The majority of these screened out products were in the wholesale sector. SQM Research conducts its due diligence using the same methodology, whether a fund is a retail or wholesale offering. As such SQM has an expectation that product issuers within wholesale funds offer the same level of transparency as retail funds.

Louis Christopher, Managing Director of SQM Research said:

"We are taking this precautionary measure in response to increased issues observed in the sector and in response to recent announcements by our financial sector regulators. This action doesn't necessarily mean that a fund rated by SQM will be automatically downgraded or placed on hold. However, it is viewed as a necessary step to ensure appropriate oversight of an asset class that has been growing in relevance and size over recent years."

We have an expectation that wholesale funds provide the same transparency as retail funds. On that front there is no question there has been a rapid increase on wholesale fund offerings which we think has been driven in part by a rapid increase in the number of Australians who now qualify as a sophisticated wholesale investor/high net worth individual; the threshold of which is still set at \$2.5 million dollars in net assets or a gross income of \$250,000 per annum.

As our financial regulators have stated in recent months, there is a clear link between weak governance and poor outcomes for investors. And so, while we have throughout our ratings research history, placed an emphasis on fund governance, we are determined more than ever to reduce the risks for investors by taking an increasing cautious approach to potential governance issues.

It must be stated there is no imminent event that SQM Research is aware of that may trigger a series of fund failures and that overall, SQM Research expects the sector to weather current challenges. The private markets sector has a positive future in front of it as there are genuine opportunities for investors.

What we are observing to date is nothing like what was experienced back in 2008 when a large number of mortgage trusts were forced into redemption suspensions. However, I think the risks within the sector have increased in recent times and so increased diligence is required."

*On watch means that SQM Research will increase its ongoing monitoring of the sector and has made adjustments to its ratings scoresheet to place a greater weighting towards governance factors. While the current ratings assigned to funds within the sector by SQM Research are still relevant, there may be possible downgrades over the medium term. Advisers are strongly encouraged to monitor SQM's daily ratings notifications.

For further information:

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About [SQM Research](#) SQM Research Pty Ltd is a respected Australian investment research house, specialising in providing research and data across all major asset classes. For further information contact 02-9220 4603.

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