



Private Credit ETFs for Retail Investors: Yield Potential, Liquidity Risks and Regulatory Scrutiny

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Exchange-traded funds (ETFs) are a popular investment tool for investors, providing market access to a diverse set of industries and asset classes through a liquid investment strategy. While private credit markets have exploded in popularity and become a favored investment class for many institutional investors over the past 20 years, their illiquid nature and sizable investment requirements make the private credit space generally inaccessible to retail investors. However, a new class of ETFs has recently been introduced to public markets that aims to provide retail investors with new access to the private credit market.

What Are Private Credit ETFs?

The core appeal of private credit ETFs lies in their potential to deliver attractive risk-adjusted yields, often in the range of six percent to 10 percent, while still enabling investors to enjoy daily liquidity and transparent pricing, key features of traditional ETFs that have contributed to the mass popularity of the product. For retail investors, these products present a novel opportunity to participate in a growing multi-trillion-dollar private credit market without meeting the high capital or accreditation thresholds typically required by private funds. These ETFs are designed to offer exposure to corporate loans and direct lending strategies by packaging both investment-grade public debt and private credit instruments into a single, tradable fund, enabling retail investors to participate in a market historically dominated by banks and large lending institutions. But questions remain as to whether these ETFs can provide retail investors with exposure to the private credit markets consistent with the underlying private credit space, while retaining the key characteristics retail investors expect in the broader ETF market.

Liquidity Mismatch in a Daily-Redemption ETF

An initial concern is the liquidity mismatch between the underlying private credit holdings and the daily redeemable ETF format. This mismatch raises questions about whether funds can meet large redemption requests during periods of market stress without resorting to forced sales or other actions

affecting the value of the fund's underlying assets. Compounding this issue is the challenge of valuation transparency: private credit debt does not trade frequently, making daily pricing less reliable and potentially subject to wide deviations from true market value. ETFs are also subject to Rule 22e-4 of the Investment Company Act of 1940, which (i) mandates the adoption and implementation by each ETF of a formal liquidity risk management program and (ii) generally requires that “illiquid investments” do not exceed 15 percent of the ETF's net assets. To the extent private credit assets comprise more than 15 percent of an ETF's net assets, the portfolio manager may need to ensure such assets will not be deemed “illiquid investments” by regulators.

Portfolio Strategies for Private Credit ETFs

To address these liquidity concerns, ETF portfolio managers often employ liquidity support agreements or utilize exposure to securitized private debt instruments such as collateralized loan obligations (CLOs) or business development companies (BDCs) and closed-end funds (CEFs) investing primarily in loan participations or CLOs. In certain cases, the same party may be involved in sourcing the underlying assets, and in providing the liquidity backstop. This creates a layered structure that raises questions about conflicts of interest and the durability of liquidity under stress. The mechanics of these arrangements typically cap redemptions at certain daily or weekly percentages, effectively serving as a pressure valve to manage outflows. While this helps the ETF meet daily liquidity requirements on paper, it does not eliminate the fundamental tension of putting illiquid assets into a liquid wrapper.

Retail Adoption and Regulatory Scrutiny So Far

Investor response so far has reflected a degree of retail skepticism. Although a handful of these ETFs have begun to attract modest inflows, adoption remains limited compared to traditional bond or equity ETFs. A contributing factor is the perception — often accurate — that true private credit exposure within these vehicles is relatively small. In some cases, allocations to private credit have amounted to only a mid-single-digit percentage of the portfolio, despite marketing efforts that emphasize exposure to private credit.

These dynamics have not gone unnoticed by regulators and market commentators. There is ongoing regulatory scrutiny around the alignment between marketing claims and actual portfolio holdings, the potential for conflicts of interest in liquidity support structures, and whether investors fully understand the downside risks. Policymakers have also raised concerns that yield-hungry retail investors could be drawn to these products without adequate appreciation of the lack of liquidity and the credit risks embedded in these ETFs.

Stress Testing the Market

A prudent investor should weigh not only the potential yield enhancement and diversification benefits, but also the structural integrity and operational risks inherent in these vehicles. The combination of modest private credit allocations, illiquidity and complex liquidity support mechanics may prove particularly challenging for retail investors unaccustomed to alternative credit strategies. As the market for these ETFs matures, the ultimate test will be how they perform under periods of excess credit stress and whether their promise of liquidity and yield can withstand the demands of a broader retail audience.

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