



**BOCCONI STUDENTS FOR
ALTERNATIVE INVESTMENTS**

Private Credit ETFs: Real Liquidity or Financial Illusion?

How the PRIV ETF Attempts to Engineer
Liquidity into a Structurally Illiquid Asset Class



Private Credit

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1. Private Credit ETFs: bridging the gap between yield and liquidity

Since the Global Financial Crisis, the world economy has experienced a prolonged period of low interest rates and increasing volatility in traditional bond markets. During this time, investors have actively sought alternative sources of yield. One standout beneficiary of this shift in asset allocation is private credit—a segment of the market that has grown significantly over the past decade.

Private credit broadly refers to non-bank lending to private companies, often in the form of direct loans. These instruments typically offer attractive yields, sometimes in the high single digits or more, in exchange for taking on risks related to illiquidity, credit, and, in some cases, complexity. They are generally held in closed-end vehicles, with long lock-up periods and minimal secondary market trading. For years, these characteristics made private credit appealing primarily to institutional players—such as pension funds, insurance companies, and endowments—that could tolerate illiquidity in exchange for yield enhancement.

However, with the recent development of private credit ETFs, the market is now witnessing an attempt to blend two fundamentally opposing financial concepts: illiquid underlying assets with the liquid, transparent, and tradeable structure of an ETF. Traditional ETFs are prized for their daily liquidity, intraday pricing, and ease of access for both retail and institutional investors. By design, they allow investors to enter and exit positions with minimal friction. In contrast, private credit operates with a completely different set of mechanics, including extended settlement cycles, limited transparency, and an inherent lack of liquidity.

This brings us to what many see as the core contradiction at the heart of private credit ETFs: Can a vehicle designed for daily liquidity reasonably hold assets that cannot be sold or valued on a daily basis?

In practice, this structural mismatch creates several potential problems:

- NAV dislocation: Since private credit assets are not priced daily in an active market, the Net Asset Value (NAV) of the ETF may not reflect real-time conditions. This can lead to a divergence between the ETF's market price and the actual value of its holdings, especially during periods of volatility.
- Liquidity strain during redemptions: If many investors decide to redeem at once, the fund manager may struggle to sell underlying assets—because private loans are difficult to liquidate quickly. Managers are often forced to sell the most liquid assets first, which can distort the portfolio and leave remaining investors with a less diversified, more illiquid fund.
- Risk of a “run”: Similar to a bank run, if investors lose confidence in the ETF's ability to provide liquidity, a wave of redemptions could follow. Early sellers may exit at favourable



prices, while those who remain could be trapped in a fund holding deeply illiquid or devalued assets.

- Systemic and reputational concerns: If large funds are unable to meet redemptions or must sell at fire-sale prices, it could affect other funds or markets, potentially triggering broader regulatory scrutiny.

Despite these concerns, investor appetite remains strong, partly due to recent performance trends. Over the past few years, private credit has outperformed traditional fixed income across several metrics, particularly in terms of yield and default-adjusted returns. As interest rates rose in 2022–2023 and traditional bond prices fell, floating-rate private loans—common in private credit portfolios—held up well, shielding investors from duration risk. In contrast, long-duration government and corporate bonds suffered steep losses, prompting investors to seek out less interest-rate-sensitive instruments.

Asset managers have responded by structuring ETFs that use a combination of liquid credit instruments (like broadly syndicated loans or short-duration high-yield bonds) and allocations to private credit via interval funds or business development companies (BDCs). These ETFs aim to deliver a blended exposure that captures some of the yield premium from private credit, while maintaining enough liquidity to meet daily redemption demands. While this approach addresses some liquidity concerns, it also dilutes the true exposure to private credit and raises questions about whether investors are truly getting what they believe they're buying.

In conclusion, private credit ETFs represent a compelling innovation in asset management, offering a bridge between yield-hungry investors and an asset class traditionally out of reach. Yet, the fundamental tension between daily liquidity and illiquid assets persists. As the market for these products matures, transparency, structure, and regulation will play a key role in determining their sustainability. For now, investors must weigh the trade-offs carefully: the allure of enhanced yield against the risks of liquidity mismatches—particularly in volatile or stressed market conditions.

2. A Study Case: SPDR SSGA IG Public & Private Credit ETF (PRIV)

PRIV, the SPDR SSGA IG Public & Private Credit ETF, sits at the intersection of two historically distinct investment domains: the transparent, liquid world of investment-grade public credit, and the dynamic, evolving domain of private debt. The ETF's structural innovation lies in its attempt to bridge these two worlds—delivering enhanced yield through private credit exposure, while maintaining the daily tradability that investors expect from ETFs.

At its core, PRIV maintains a portfolio mix that ranges between 65% and 90% in public investment-grade debt—typically Treasuries, agency MBS, and corporate bonds—and up to 35% in private



credit instruments. These privately originated investments include direct corporate loans, asset-backed deals, and non-bank lending opportunities, sourced primarily by Apollo Global Management.

However, it is Apollo's role that makes PRIV truly unique—and controversial. Not only does Apollo originate the private credit deals fed into the ETF, but it also acts as the liquidity backstop through its affiliate, Apollo Global Securities. In practice, this means Apollo commits to providing firm, executable bids on the private credit holdings—called Apollo Originated Securities (AOS)—within the ETF. It also agrees to buy them back in certain volumes if needed, up to 25% of total AOS holdings per day or 50% per week. This contractual mechanism is the linchpin of PRIV's liquidity promise: even if the underlying loans are not readily tradable on the open market, investors can redeem shares at NAV thanks to Apollo's standing bid.

This model is clever, but it's not without friction. The most obvious concern is the conflict of interest inherent in having a single firm act as both asset originator and price setter. During periods of market stress, Apollo might be incentivized to mark AOS holdings in ways that preserve performance optics, even if secondary market valuations suggest otherwise. This risk is amplified by the fact that the pricing mechanism depends on Apollo's own quotes, rather than observable market transactions. While State Street, the ETF's sponsor, and third-party valuation services are involved in overseeing pricing, the inherent complexity of private credit makes true mark-to-market valuation challenging.

PRIV is not alone in its attempt to engineer ETF-like liquidity into illiquid private assets. Other managers are experimenting with different formats. BondBloxx, for example, has launched a Private Credit CLO ETF that channels capital into tranches of CLOs backed by loans to non-investment-grade borrowers. While structurally liquid, CLOs are complex and thinly traded, and they introduce their own set of risks around pricing and volatility. Meanwhile, BlackRock has expanded its presence in private credit through separately managed accounts and model portfolios tailored for high-net-worth individuals, often structured as interval funds or European ELTIFs (European Long-Term Investment Funds), which offer periodic, rather than daily, redemptions.

What distinguishes PRIV is its ambition to bring institutional-style private credit exposure to a retail-accessible, daily-traded vehicle. Yet, in doing so, it raises fundamental questions about whether liquidity can truly be engineered—or whether it's merely being simulated. The ETF's structure relies on Apollo's willingness and capacity to act as a liquidity provider when markets are calm—but in a broader credit selloff, that capacity may be tested. The real stress test for PRIV will not be measured in basis points of outperformance during steady markets, but in how it behaves when credit markets seize up and investor redemptions spike. At that moment, Apollo's buyback commitments and the ETF's internal pricing discipline will face heightened scrutiny.



3. Engineered liquidity and valuation risks in PRIV

Despite the promise of liquidity in private credit being revolutionary, the SEC has responded with caution. The PRIV ETF offers daily liquidity in an inherently illiquid asset class, raising regulatory questions. Under SEC Rule 22e-4, open-ended funds like ETFs are restricted from investing more than 15% of their net assets in illiquid securities—defined as assets that cannot reasonably be sold within seven days at a price close to their fair value under normal market conditions. This rule is directly relevant to PRIV, since private credit is, by nature, illiquid. These are long-term, customized loans traded privately, not on public exchanges.

Yet, State Street classifies these Apollo-originated securities (AOS) not as illiquid, but as “less liquid.” This classification hinges on Apollo’s agreement to provide firm bid quotes and limited redemption guarantees. These engineered liquidity features allow the assets to meet SEC definitions of liquidity—at least on paper. In practice, however, this liquidity is conditional and could evaporate under market stress.

Apollo commits to buying back up to 25% of AOS holdings daily and 50% weekly, but this is far from the intraday liquidity that ETF investors typically expect. For example, unwinding even 20% of the ETF’s private credit exposure could take more than a week, assuming Apollo meets its maximum obligations. This creates a bottleneck, making PRIV appear liquid while functionally constrained by the limits of its sole liquidity provider.

Beyond liquidity mechanics, valuation poses additional risks. ETFs are required to calculate a daily Net Asset Value (NAV)—the per-share value of fund assets after deducting liabilities. For traditional ETFs, this is straightforward, as their holdings have real-time market prices. This becomes more complex for private credit, as these loans lack public pricing, may not trade for months, and are valued using internal models, assumptions, or third-party estimates. These valuations are not confirmed prices, so in normal times differences may be small, but in crisis, the gap between model value and what someone would pay could potentially grow. This means the fund’s NAV may not reflect real-time market reality, which could put investors at risk. This makes PRIV’s NAV less a market-cleared price and more an estimate – subject to distortion, particularly in volatile markets.

In PRIV’s case, Apollo’s bid prices serve as both the valuation basis and liquidity mechanism. However, this creates a potential conflict of interest: Apollo sources, prices, and buys the same loans, giving it influence over valuations that may not reflect true market dynamics. There's also no price discovery, as Apollo’s bids are not tested against a competitive market. If Apollo reduces its bids or stops buying, PRIV could quickly become illiquid, leaving investors vulnerable. In stressed conditions, this flawed pricing structure means the NAV could fail to reflect real-time market deterioration. Investors might be buying in at inflated values or selling at steep discounts, increasing the likelihood of the ETF trading below NAV and eroding investor confidence.



In short, while Apollo's bid prices enable PRIV to technically comply with liquidity rules, they are not true market-based prices. They introduce liquidity and valuation risks, especially in the event of market crises. The ETF's structure depends heavily on one counterparty's ability and willingness to support liquidity, raising fundamental questions about whether engineered liquidity can truly replace market liquidity.

4. Regulatory scrutiny around liquidity

In February 2024, the U.S. Securities and Exchange Commission sent a letter to the fund, raising critical questions about the PRIV ETF'S structure and made it public through a regulatory filing. The letter mainly raised concerns on the misleading use of Apollo's name in relation to its actual functions, the "less liquid" classification validity and the transparency in valuation mechanics and bid processes.

Although Apollo plays a central role in the fund, sourcing private credit assets and providing liquidity support through firm bid quotes, it is not technically the fund manager or sponsor. The SEC staff therefore expressed concerns that the use of "Apollo" in the fund name could be misleading for investors into thinking Apollo is more directly responsible for fund performance or oversight than it is and asked for the ETF to be renamed "to reflect the limited nature of Apollo's relationship with the fund". The main concern for investors is that Apollo plays the role of buyer, seller and pricing agent for the private credit in the ETF, which could result in conflicts of interest.

The SEC has also flagged a lack of clarity around how the portion of private assets that make up the ETF are valued. Since they do not trade on public markets and do not have a daily price, they are often valued using internal models or estimates. Valuations therefore heavily rely on prices suggested by the loan originator, pricing models based on assumption and bid quotes that are not tested by real market transactions. This opens the door to potential valuation biases, raising the question if investors can truly rely on NAV figures.

Private credit loans would normally count as "illiquid" under SEC rules, as they are not traded in public markets, they are hard to sell quickly and are often customized and complex. The classification of Apollo's loans as "less liquid" represents a middle ground category that acknowledges the illiquid nature of the assets but also argues they are not fully illiquid, because Apollo provides firm bid quotes, meaning it is willing to buy them back at a set price. This allows PRIV to remain compliant with the SEC's regulations which caps illiquid holdings at 15%, while instead in this case private credit holdings make up 10 to 35 per cent of the fund's portfolio. However, the SEC is questioning whether this label reflects economic reality, especially in stressed markets, where those same assets might become illiquid due to the increasing difficulty in selling them and the impossibility of them being all bought back from the originating fund.



For this reason, in September 2024, Moody's issued a note warning that liquidity imbalances could emerge in a crisis scenario. If investors rush to redeem their shares during market stress, the ETF may be forced to sell its most liquid assets first. This could leave behind a pool of hard to sell private credit, that Apollo cannot guarantee in its entirety due to its daily contractual limits on buybacks which is unknown, and which raises concerns with how the ETF would function during heavy redemptions. This scenario could undermine the ETF's ability to meet redemptions that can cause reputational damage, fund restructuring or regulatory intervention.

5. Conclusions

Despite these risks, PRIV may be paving the way for a new generation of "hybrid funds", that try to offer the best of both worlds: high yields from private credit and the liquidity of an ETF. If PRIV remains successful and avoids a major liquidity crisis, it could become a model for other asset managers to follow, potentially leading to a new class of funds, that blend public and private markets. Education, transparency and disclosure will be key in ensuring the long-term viability of this type of fund as many retail investors may not fully grasp the specific risks of private credit, especially the liquidity mismatch. There is a risk that investors associate "ETF" to its primarily liquid and low risk nature as a typical equity or bond fund, that can be solved with education and disclosure. The SEC is likely to increase control on these new structures. Future regulations may target stricter valuation rules, clearer disclosures, mandatory minimum buyback commitments for private assets and possibly even limits on the portion of private assets allowed in the portfolio.



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