



**Houlihan  
Lokey**

# Understanding Fair Value in Private Credit: Process, Judgment, and Limitations

A Collaborative View on the  
Complexities of Private Credit Valuation

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For private credit investors, two concerns have moved to the forefront: whether fair value marks on illiquid loans can be trusted, and whether the liquidity structures of the funds that own these loans will hold when redemption pressures mount.

These concerns have been amplified by a related and increasingly visible challenge: the liquidity mismatch embedded in many semi-liquid private credit vehicles. When redemption requests accelerate, as they did in late 2025 and into 2026, when several large nontraded BDCs and interval funds implemented gates or other withdrawal mechanisms, fair value marks became more than an accounting question. They directly impacted the price at which redeeming investors were due, creating real economic consequences for both those leaving and those remaining. Fair value marks can be more than an accounting exercise as they can directly determine the price at which redeeming investors exit, and new investors enter, creating real economic consequences for new, exiting, and remaining investors. The reliability of those marks is therefore central to investor confidence in the fund's ability to honor redemption obligations equitably. These are the right questions to ask, and the valuation community, together with asset managers, auditors, and regulators, should welcome the opportunity to address them openly.

Fair value determination in private credit is inherently a collaborative process. The asset manager, the independent valuation firm, the fund's board of directors (and/or valuation committee), and the auditor each play a distinct role in a governance framework that has been refined over decades and most recently codified under SEC Rule 2a-5.<sup>(1)</sup> When outcomes surprise the market, it is worth examining the process holistically rather than isolating any single participant. In that spirit, we offer perspective on four considerations that shape valuation outcomes, considerations that are often nuanced, sometimes misunderstood, and best addressed through continued partnership among all parties involved.





# Four Considerations in Private Credit Valuation

## 01

### The Challenge of Borrower-Level Fraud or Misrepresentation

Valuation firms and investment teams alike work from borrower-reported financial information. In most cases, that information is reliable. In rare cases, it is not—revenues are overstated, liabilities are obscured, or the picture presented to lenders diverges materially from underlying reality. When that occurs, neither the quarterly valuation process nor standard underwriting due diligence is designed to catch it; these processes are built for assessment, not forensic investigation.<sup>(2)</sup>

The more productive question is what can be done at the margins. Cross-referencing borrower-reported data against independent sources is not a guarantee, but it narrows the gap. When investment teams adopt this practice systematically, it also gives valuation firms more to work with. The limitation is real; the response to it need not be passive.

## 02

### The Role of Information Quality, Work-Flow Timing, and Investment Team Perspective

The valuation firm's conclusion is only as good as the information it receives. Under a typical engagement, the investment team provides borrower financials, management commentary, amendment history, and its own view of the borrower's trajectory. This input is essential—the investment team's proximity to the borrower, its ongoing dialogue with management, and its understanding of the loan's original thesis are contexts that no external party can fully replicate. But this dependence on the investment team also creates a structural vulnerability that is worth naming clearly.

Consider two asset managers holding the same loan as of the same measurement date. One received audited financials two weeks before quarter-end; the other is still working from a trailing management estimate. One has a board observer seat and recent visibility into a covenant waiver negotiation; the other does not. One has had direct management contact in the past 30 days; the other has not. These are not hypothetical differences; they describe routine variation in information rights and workflow timing across the market. The result can be materially different fair value marks on the same credit, neither of which is wrong, given the information each manager held.

For investors, the practical implication is straightforward: the quality of your manager's fair value marks is partly a function of the quality and timeliness of their borrower information. This is worth asking about directly—not just what valuation methodology is used, but what information underlies it, how current that information is as of the measurement date, and what the fund's information rights are relative to peers in the same credit.

The challenge becomes more acute in event-driven situations. When a borrower is undergoing a recapitalization, shifting from cash-pay to PIK, or working through a covenant amendment, the investment team's read on the most likely outcome is not merely useful context, it is central to the valuation. A credit in active negotiation may have a dramatically different fair value depending on whether the assumed outcome is a successful restructuring or a distressed transfer. Differences in the investment team's information and conviction about that outcome will directly drive differences in the resulting mark. Robust, timely, and candid information exchange between investment teams and valuation firms including explicit discussion of downside scenarios, not just the base case, materially strengthens the process for all stakeholders.<sup>(3)</sup>

## 03

### Engagement Scope: Positive Assurance and Range of Value

An important and frequently misunderstood dimension of private credit valuation is the scope of the independent firm's engagement. Two distinct approaches are common, and they are not equivalent.

Under a positive assurance engagement, the valuation firm reviews the asset manager's proposed mark and assesses whether it falls within a fair value range the firm considers reasonable. The firm is not independently deriving a value; it is rendering a judgment about whether the manager's value is defensible. For performing credits with stable cash flows and active comparable markets, this scope may be sufficient. For credits under stress, in active restructuring, or with limited market comparables, the range of "reasonable" values can be wide enough that positive assurance provides limited constraint on the manager's mark.

Under a range of value engagement, the valuation firm independently develops its own estimated fair value range, without anchoring to the manager's proposed mark. This is a more demanding scope and typically produces a tighter, more independently grounded conclusion.

Investors are not always aware which type of engagement applies to their fund's valuation process, and the distinction is rarely disclosed clearly in fund documents. Before drawing comfort from the fact that a fund uses an independent valuation firm, it is worth understanding what that firm was actually asked to do. The right question to ask is not "Do you use a third-party valuation firm?" but "What is the scope of that firm's engagement, and does it vary by credit quality or asset type?"<sup>(4)</sup>

## 04

### Mark Selection and Investment Team Conviction Within Governance Frameworks

Under SEC Rule 2a-5, a fund's board-designated Valuation Designee determines fair value in good faith, considering, among other things, the independent valuation firm's input and the investment team's views.<sup>(5)</sup> Valuation policies vary: some funds mark at or near the midpoint of the independent valuation firm's fair value range, while others may reflect the investment team's conviction by selecting a mark anywhere within this range. Both approaches can be reasonable and conducted in good faith. The independent valuation firm's role is to provide a well-supported range that informs the Valuation Designee's decision, not to dictate the final mark. This collaborative dynamic works well when all parties engage transparently, when the rationale for mark selection is documented, and when the board maintains active oversight of patterns over time. As the market evolves, investor confidence is best served by demonstrating that mark selection within independently derived fair value ranges is consistently documented, rationale-driven, and subject to active board oversight over time.



### A Shared Perspective

Valuation outcomes in private credit are rarely the result of process failure. More often, they reflect the genuine difficulty of the underlying problem: estimating the exit price of an illiquid loan in a market where comparable transactions are sparse, borrower information is incomplete, and reasonable professionals can disagree. Understanding why marks diverge from expectations, and which part of the process produced that divergence, is more useful than assigning fault. The four considerations discussed here are the places where that divergence most commonly originates.



# Strengthening the Framework Together

A well-developed regulatory framework centered on SEC Rule 2a-5 and encompassing the roles of the Valuation Designee, independent valuation firms, and board oversight governs private credit valuation. The market's rapid expansion and growing accessibility to retail investors require an enhanced focus on consistently adhering to this framework and evolving it to address remaining gaps. We suggest five areas where collaborative progress may benefit all stakeholders:



## 01 Understanding Engagement Scope

Investors benefit from understanding whether the independent valuations supporting their fund's NAV are conducted on a positive assurance basis or as ranges of value. Asset managers, valuation firms, and auditors should work together to ensure this information is clearly accessible to investors, consistent with applicable disclosure obligations and the fund's governance policies. This is an area where asset managers, valuation firms, and auditors can identify best practices.

## 02 Enhanced Information Exchange for Event-Driven Credits

For credits undergoing significant corporate events such as recapitalizations, shifts from cash-pay to PIK, mergers and/or material acquisitions, and covenant amendments, both asset managers and valuation firms benefit from more frequent and more granular information sharing. For credits in active transition, protocols should ensure that the investment team provides a consolidated, measurement-date-specific summary of the transaction's current status and most likely outcomes.

## 03 Guidance on Mark Selection

Aggregated information about how funds position marks within independent ranges (i.e., the percentage of marks set at the midpoint versus the upper or lower bound of the independent range), without revealing proprietary credit-level detail, may meaningfully enhance investor confidence. This is a conversation the industry should pursue collaboratively, recognizing that different valuation policies can each be reasonable.



## 04

### Constructive Regulatory Engagement

The SEC's 2026 Examination Priorities and ongoing regulatory attention to private credit valuation practices underscore the importance of robust governance frameworks.<sup>(6)</sup> Asset managers and valuation firms that can demonstrate the rigor and independence of their processes are better positioned to respond constructively to regulatory inquiries.

## 05

### Transparency in Valuation Methodology and Watchlist Disclosure

A meaningful step toward greater investor confidence would be clearer disclosure of the valuation methodologies applied across a portfolio, such as the proportion of assets valued on a performing (DCF) basis versus a recovery basis, without identifying individual credits. These two methodologies reflect fundamentally different assessments of credit quality and risk, and the distinction matters to investors seeking to understand portfolio composition and risk. As institutional and retail investors increasingly demand this level of transparency, managers who can demonstrate disciplined methodology disclosure may find it supports, rather than undermines, investor confidence over time.

Equally important is the establishment of a watchlist framework: structured processes whereby credits exhibiting early warning signs, such as covenant stress, PIK elections, amendment activity, or deteriorating coverage metrics, are identified for heightened monitoring and more rigorous valuation scrutiny are standard practice among institutional credit managers. While the rigor and scope of these frameworks vary, standardized aggregate disclosure of the scale of watchlist credits would give investors a consistent basis for comparing managers and assessing portfolio risk without compromising the confidentiality of individual borrower relationships. As investor expectations evolve, managers who proactively provide this level of aggregate transparency may find that it strengthens, rather than tests, investor confidence.

## Conclusion

Private credit valuation is a collaborative process built on trust, transparency, and professional judgment. The ongoing industry dialogue, prompted by investor scrutiny, regulatory attention, high-profile defaults in 2025 and 2026, and the heightened redemption requests by investors in private credit in 2026, is a valuable opportunity to improve information flows, clarify participant roles, and build the transparent governance that a growing investor base rightly expects. We look forward to continuing this work alongside our clients and the broader industry.

## Houlihan Lokey Contacts



**Rittik Chakrabarti**  
Managing Director  
Co-Head of U.S. Portfolio Valuation  
and Fund Advisory Services  
+1 212.497.4175  
[RChakrabarti@HL.com](mailto:RChakrabarti@HL.com)



**Michael Feron**  
Director  
Portfolio Valuation  
and Fund Advisory Services  
+1 312.456.4732  
[MFeron@HL.com](mailto:MFeron@HL.com)

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## Footnotes

(1) SEC Rule 2a-5 (17 CFR 270.2a-5), effective September 2022, establishes the framework for good faith fair value determination by a fund's board or its designated Valuation Designee, with consideration of all relevant factors including independent valuation firm input.

(2) The SEC has noted that valuation processes are not designed to detect fraud; see SEC Rule 2a-5 Adopting Release (Release No. IC-34616, November 2022) and related guidance on good faith valuation determinations.

(3) See CreditSights, *The Opaque Side of BDCs* (February 2025), noting that different lenders to the same borrower may have different access to information, contributing to mark differences across funds.

(4) Proskauer Partner John Mahon has noted the evolving practice toward more frequent third-party valuations, particularly among nontraded BDCs, though the scope of those engagements varies across the industry. See CreditSights (February 2025).

(5) Under Rule 2a-5, the Valuation Designee determines fair value considering all relevant factors. The independent valuation firm's input is one important element within a broader governance framework that includes the investment team, compliance, and Board oversight.

(6) See SEC Fiscal Year 2026 Examination Priorities, pp. 5-6; Bloomberg, *Private Credit's Sketchy Marks Get Warning Shot From Wall Street's Top Cop* (November 25, 2025).



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