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Asset-Backed Finance: Structural Resilience, Market Opportunity, and the Shift to Private Capital

Abstract

Asset-Backed Finance (ABF) has emerged as a key segment within the evolving private credit landscape. As traditional lenders retreat from asset-intensive sectors and institutional investors seek risk-adjusted income, ABF offers a structurally sound, cash-flow-driven alternative. This paper focuses on ABF strategies backed by diversified pools of financial or real world-linked assets, highlighting differences in underwriting, security, and scalability. We explore the core mechanics of ABF, including its market size, structural protections, and differences compared to traditional corporate direct lending, while examining the macroeconomic and regulatory shifts accelerating demand. Drawing on Monroe Capital's Alternative Credit Solutions Strategy, the paper offers a framework for evaluating ABF as both a defensive and opportunistic component of institutional portfolios.

Asset-Backed Finance Defined — and Why It's Gaining Prominence

Asset-Backed Finance (ABF) has emerged as a leading strategy within the broader Private Credit landscape, as investors diversify from traditional upper middle market direct lending into a strategy that offers both diversified protection and attractive yields. Economically, an ABF structure delivers compelling differences over that of direct lending. Loans are secured by a predictable, recurring cash flow generated by a diversified asset pool, while the underlying assets, typically housed in bankruptcy-remote special-purpose vehicles (SPVs), provide significant additional protection. Examples include equipment finance, aviation, litigation finance, fund finance, consumer loans, auto or powersport loans, student loans, commercial real estate, AI & infrastructure finance, residential and commercial mortgages, trade receivables, royalties, and media rights, among others.

ABF is a subsector of private credit, which encompasses the direct extension of credit by non-bank lenders. While traditional corporate credit underwrites cash flow at the enterprise level of a single operating borrower, ABF structures underwrite at the asset and structure level. These structures are typically privately originated and highly negotiated, with a greater focus on the quality, performance, and servicing of the underlying asset pool. In practice, principal and interest on ABF loans are serviced

directly from collections on the underlying asset pool, which are routed through controlled accounts. This allows investors to access the economics of real-world asset exposures while being insulated, via the bankruptcy-remote SPV.

Institutional interest in ABF has accelerated in recent years as several forces converge:

Substantial TAM: Estimates place the global ABF universe at around \$43.5 trillion today.*

Bank Retrenchment from Private Credit: More stringent regulation and capital requirements have reduced the willingness or capacity of traditional bank lenders to engage in ABF, opening room for private capital to fill funding gaps.

Higher Quality Data: Advances in data analytics and origination technology have improved transparency and risk modeling, allowing investors to more precisely assess underlying collateral risk, cash-flow volatility, and recovery potential.

As a result, ABF has evolved from a niche strategy to a distinct, systemically important component of the private credit ecosystem, with both protective and opportunistic characteristics, offering institutional investors scalable deployment, structural protection, and diversified return streams.



How Asset-Backed Finance Differs from Corporate Credit

Private credit is most commonly associated with direct lending to corporate borrowers, where loan repayment is based on the borrower's ability to generate cash flow and maintain enterprise value. In this traditional corporate credit model, underwriting is centered on company-specific fundamentals such as EBITDA, leverage ratios, and covenant compliance.

Rather than relying on a borrower's balance sheet or enterprise value, ABF structures are designed to finance portfolios of cash-flowing assets—often consumer or commercial receivables—through bankruptcy-remote vehicles that allow for risk-managed exposure at the asset level.

Crucially, ABF is not confined to asset-heavy industries such as real estate, equipment leasing, or automotive finance. It is also widely applied in sectors where the underlying collateral consists of receivables, including point-of-sale financing, litigation settlements, tax credits, insurance premiums, student loans, and merchant cash advances.

Two principal differences distinguish ABF from traditional corporate lending:

1 Underwriting Methodology
In corporate credit, underwriting is borrower-centric. Lenders assess a company's financial statements, business model, and management team. In contrast, ABF lenders focus on the characteristics, historical performance, and expected behavior of the asset pool, along with the capabilities of the originator and servicer.

This asset-level analysis involves extensive data evaluation, including trend analysis, delinquency patterns, seasoning curves, recovery history, and cash flow predictability. Additionally, structural enhancements, such as advance rate limits, concentration caps, reserve requirements, and third-party servicers, serve to insulate the lender from idiosyncratic risks (see Chart 1).

Chart 1

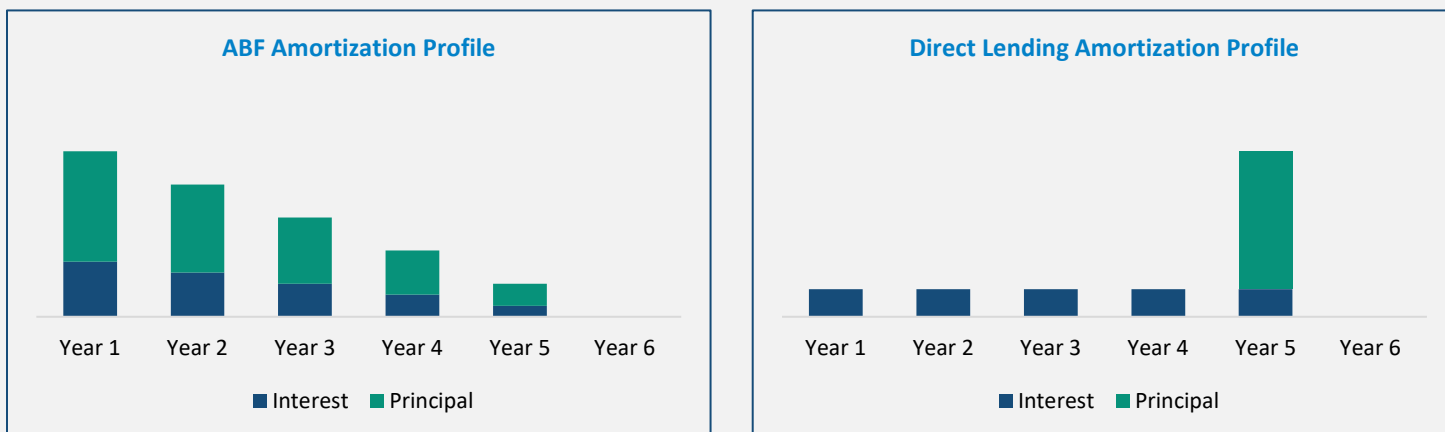
	Asset-Backed Finance	Direct Lending
Borrower Credit Risk	Diversified, Cash-Flowing Asset Pool	Corporate Entity
Underwriting	Specialized Asset-Specific	Traditional Corporate Credit
Covenants	Enhanced Structural Protection	Market-Standard
Market Players	Limited Participants	Banks & Financial Sponsors
Solution Offerings	Creative & Flexible	Market-Level Flexibility
Risk-Adjusted Returns	Greater Potential	Limited Potential
Amortization	Fully Self-Amortizing	Bullet Maturity
Market Maturity	Developing & Rapidly Growing	Established & Mature
Legal Structure	Assets Held in Bankruptcy-Remote Entity	Full Corporate Entity Liquidation
Market Correlation	Low	Moderate-High

The information presented herein is provided for illustrative purposes only to highlight the relative characteristics of noted investment strategies. The comparisons are conceptual in nature, based on Monroe Capital's general views of these strategies, and are not intended to represent actual or projected performance. The risk, return, and structural characteristics shown may vary significantly across investments and market conditions.

Repayment and Amortization

Traditional corporate loans, often have some reliance on a portion of the loan being refinanced at maturity, introducing balloon like risk and dependence on capital market conditions. ABF loans, by contrast, are typically structured to be self-liquidating, with repayment derived from the ongoing cash flows of the underlying asset pool rather than solely relying on amortization schedules or excess cash flow sweeps. This amortizing structure provides greater visibility into repayment and reduces refinancing risk (as illustrated in Chart 2).

Chart 2



Source: Monroe Capital Analysts. For illustrative purposes only.

Asset-Based Finance deals are typically self-amortizing with more front-loaded cash flows, thus reducing the tail risk associated with refinancing and exits

Together, these distinctions help explain why ABF has become an increasingly complementary component of private credit allocations; they offer investors secure collateral packages, reduced exposure to refinancing cycles, and access to specialized asset types across diverse end markets.

Examples of ABF Assets

Asset-Backed Finance touches a broad range of sectors and real-world activities, with collateral types spanning both commercial and consumer domains. At Monroe, ABF exposures are generally grouped into the following categories:

Commercial Finance

These portfolios are backed by obligations owed or supported by corporate entities. Credit facilities may support working capital needs, fund capital expenditures or provide liquidity through the financing of invoices and accounts receivable. Underlying asset types may include equipment, real estate, merchant cash advances, aircraft, commercial property, media rights, and music royalties. Repayment is generally linked to the borrowing company's operations or the income-generating potential of the financed assets.

Consumer Finance

These portfolios are composed of loans or receivables where repayment risk resides with individual borrowers. Common examples include credit cards, payroll deduction loans, charge-off receivables, auto or powersport loans, student loans, home improvement loans, insurance and warranty finance, solar installation loans, debt settlement, and rent-to-own. The collateral pools in this category tend to exhibit predictable cash flow patterns typically tied to recurring installment payments.

Litigation Finance

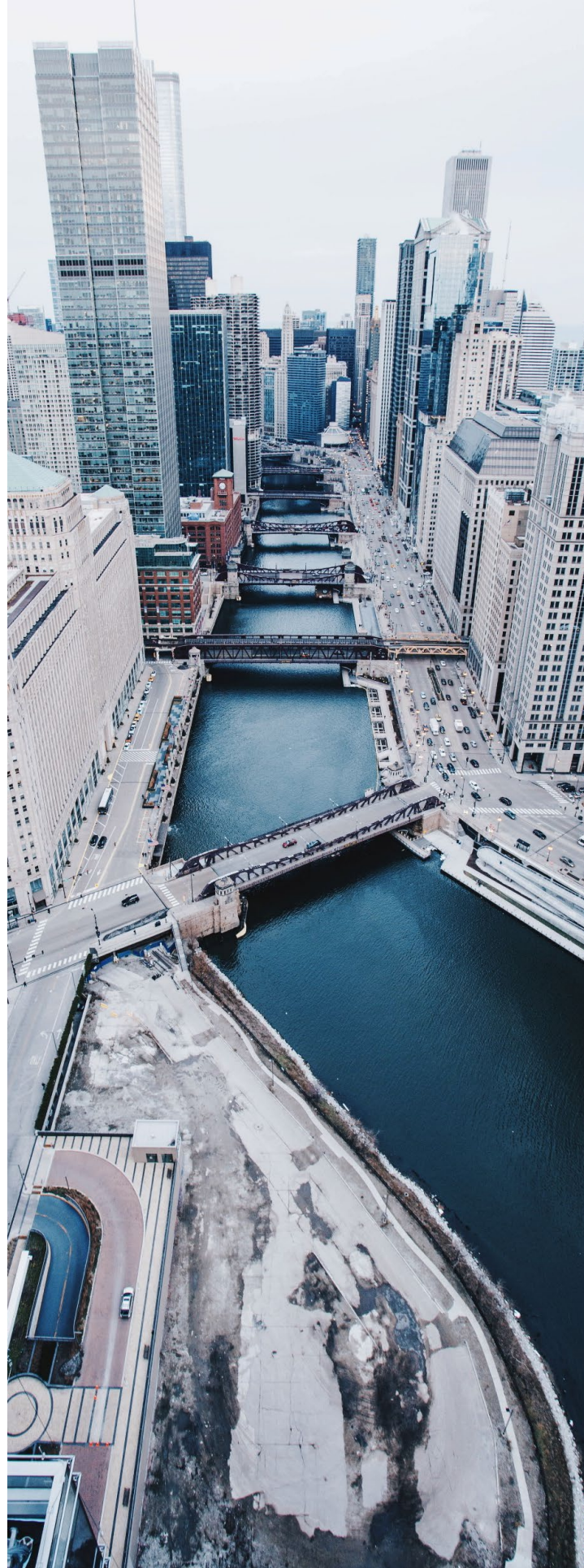
This segment can typically be broken out into consumer or commercial cases. In consumer litigation finance, asset pools consist of loans or advances whose repayment depends on the outcome of individual legal proceedings, typically personal injury claims. Financing may be extended directly to plaintiffs in anticipation of settlement proceeds, or to medical providers treating those plaintiffs, with reimbursement contingent upon a successful resolution of the case. In commercial litigation finance, credit facilities are extended to law firms, litigation funding vehicles, or portfolios of contingency fee receivables. Repayment is generally tied to the ultimate collection of legal fees or to returns from successful litigation outcomes—whether through trial judgment or negotiated settlement. Underlying legal matters often include business disputes, antitrust actions, securities class actions, and cross-border arbitration proceedings.

Fund Finance

The fund finance segment refers to the market for lending to private investment funds rather than directly to the underlying portfolio companies or assets. NAV-based facilities are a popular form of fund finance, being collateralized by the net asset value of the fund's portfolio. Other common facilities take the form of subscription or capital call lines, which are secured by uncalled capital commitments. Fund Finance facilities are used to smooth the private fund lifecycle, provide working capital, and, in some cases, add modest fund-level leverage.

AI & Infrastructure Finance

This category refers to the financing of capital-intensive assets across transportation, energy, utilities, and digital infrastructure. Increasingly, this universe includes digital and AI-related infrastructure, such as data centers, fiber networks, power and cooling systems, and more. Repayment is typically supported by contracted cash flows rather than corporate balance sheets, with further downside protection from the residual value of the physical assets. For private credit investors, AI-driven infrastructure finance offers a way to gain secured exposure to the growth of compute demand and their underlying assets, often with multi-year revenue visibility and highly negotiated structural protections.



Forward Flow Agreements: Structuring for Alignment and Scale

A forward flow agreement is a popular form of specialty finance transaction in which a fund or bank agrees in advance to buy future loans or receivables from originators, providing the lender with steady funding while the originators continue to service those receivables post-sale. These structures allow for scalable capital deployment while preserving operational continuity at the originator level.

When underwriting a forward flow arrangement, several considerations are paramount:

1 Evaluating the Originator/Servicer

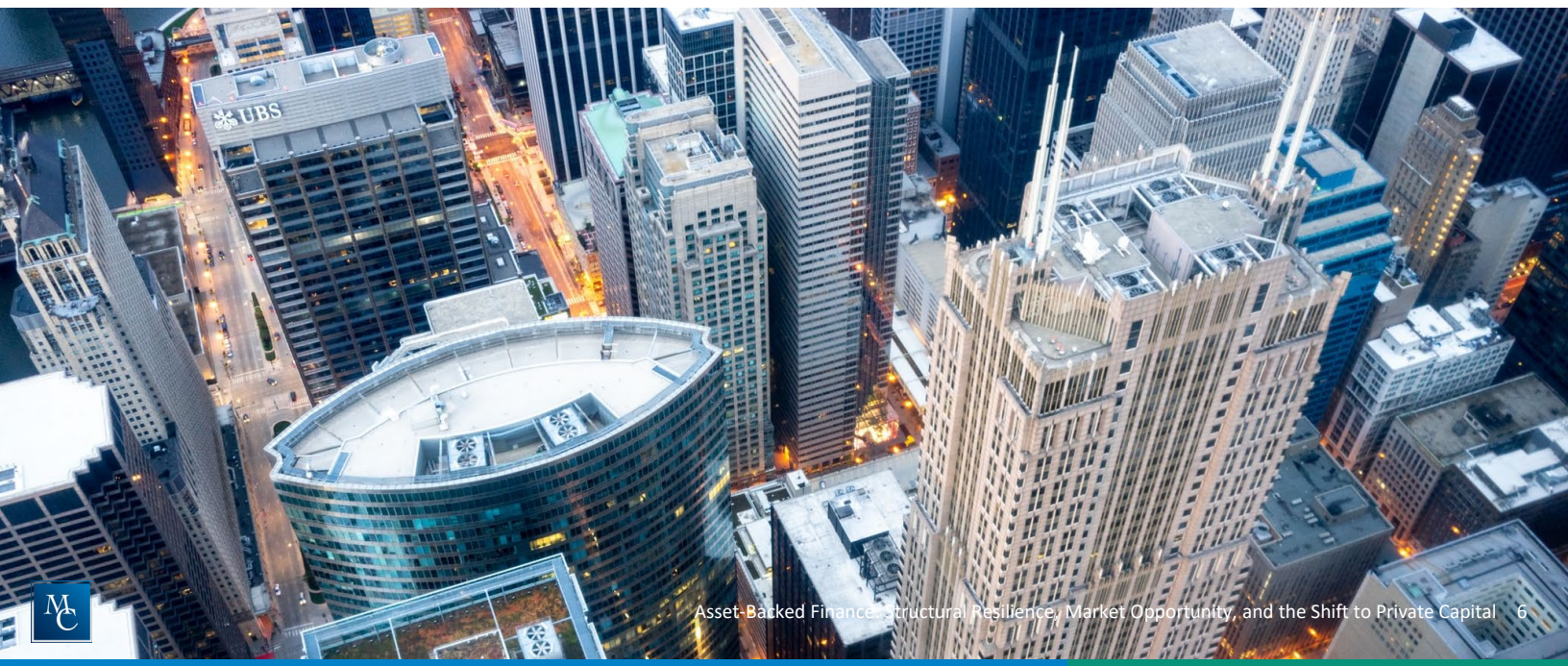
- Does the originator possess adequate servicing infrastructure and capitalization?
- What is their historical track record across vintages, and are there documented regulatory issues or compliance gaps?
- How do they monitor and adapt to changes in borrower behavior or legal frameworks?

2 Aligning Incentives Through Structural Enhancements

To reduce moral hazard and promote high-quality origination, alignment can be structured via:

- **Cumulative Loss Backstops** – Originators absorb losses beyond a negotiated threshold.
- **Purchase Price Claw-Backs** – A portion of the purchase price is escrowed and can be reclaimed if performance deteriorates.
- **Recourse Triggers** – Defaults above a specified level may require the originator to replace or repurchase assets.
- **Back-End Profit Shares** – Originators share in the upside if performance exceeds a hurdle, such as a target MOIC or IRR.
- **Cash Reserve Requirements** – Ensures the servicer can absorb unexpected losses without immediate disruption.

These features are often layered to create a credit box or a structured investment framework that governs eligibility, pricing, and servicing terms for assets that the lender will buy.

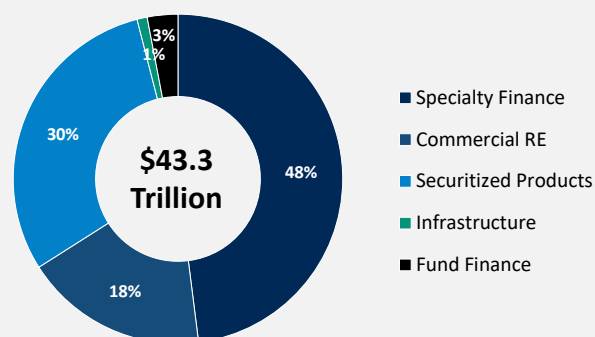


ABF Market Scope and Growth Outlook

The U.S. asset-backed finance market is vast, with total ABF-linked assets—including specialty finance, commercial real estate, securitized products, fund finance, and infrastructure—estimated at approximately \$43.3 trillion (see Chart 3). Roughly \$20.7 trillion is attributable to the specialty finance segment, which encompasses consumer and commercial finance asset classes. This opportunity set is expected to expand meaningfully in the coming years, fueled by structural shifts in capital markets and evolving investor preferences.

Chart 3

Asset Backed Finance Market



Source: Oxane Partners, Ares Management, AFME, Morgan Stanley Investment Management, Principal Asset Management, Federal Reserve Board Stability Report, EBA, ESMA, FCA, Estimates as of Q2 2025.

One key driver of ABF growth is the increasing demand for yield among institutional allocators—particularly pension funds, insurance companies, endowments, and sovereign wealth vehicles. With traditional public debt markets offering diminished real returns, these institutions are reallocating capital toward private credit strategies, including ABF, in search of consistent income and differentiated exposure. Data from Preqin shows a marked increase in the proportion of investors actively seeking to grow their allocations to private credit. This secular trend is expected to deepen as regulatory pressure on banks intensifies and capital formation continues to shift from public to private markets.

As the market matures, ABF is no longer viewed as a niche or esoteric strategy. Instead, it is increasingly recognized as a scalable, risk-controlled asset class that offers uncorrelated return potential and access to highly diversified pools of real-world collateral.

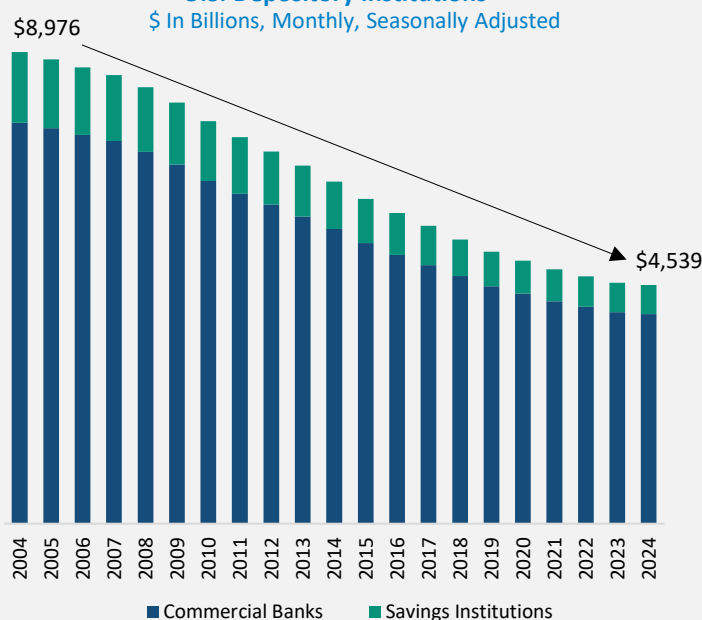
The Shift from Banks to Non-banks after the Great Financial Crisis

Over the past two decades, credit markets have shifted meaningfully away from regulated banks towards a broader ecosystem of non-bank lenders. Prior to the 2008 Global Financial Crisis (GFC), banks were the dominant force in credit markets, serving as primary lenders not only to corporate borrowers but also across a range of asset-backed structures. Non-bank lenders were largely relegated to the margins, often viewed as lenders of last resort.

By the mid-2000s, a wave of consolidation had reduced the number of banks in the U.S. financial system even as the largest institutions grew significantly in size and deposit base. This shift in market structure led many banks to prioritize large-scale corporate lending and capital markets activity over smaller, specialized financing opportunities (see Chart 4).

Chart 4

U.S. Depository Institutions \$ In Billions, Monthly, Seasonally Adjusted

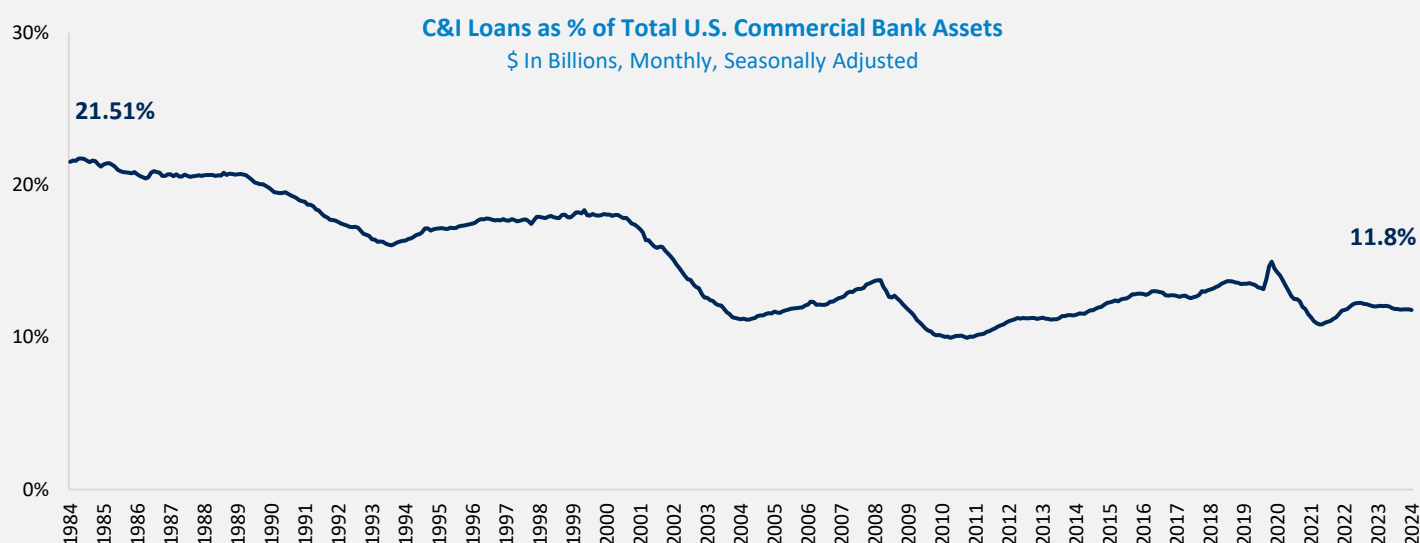


Source: FDIC Statistics at a Glance as of June 30, 2024.

The GFC catalyzed a new regulatory era. In the years that followed, legislation such as the Dodd-Frank Act and the Consumer Financial Protection Act imposed far-reaching reforms. Banks were required to hold higher levels of Tier 1 capital, maintain greater liquidity buffers, and adhere to tighter underwriting standards—particularly in risk-weighted asset calculations. As a result, the risk-adjusted return profile of many asset-backed or specialty finance exposures became less attractive under traditional bank capital regimes.

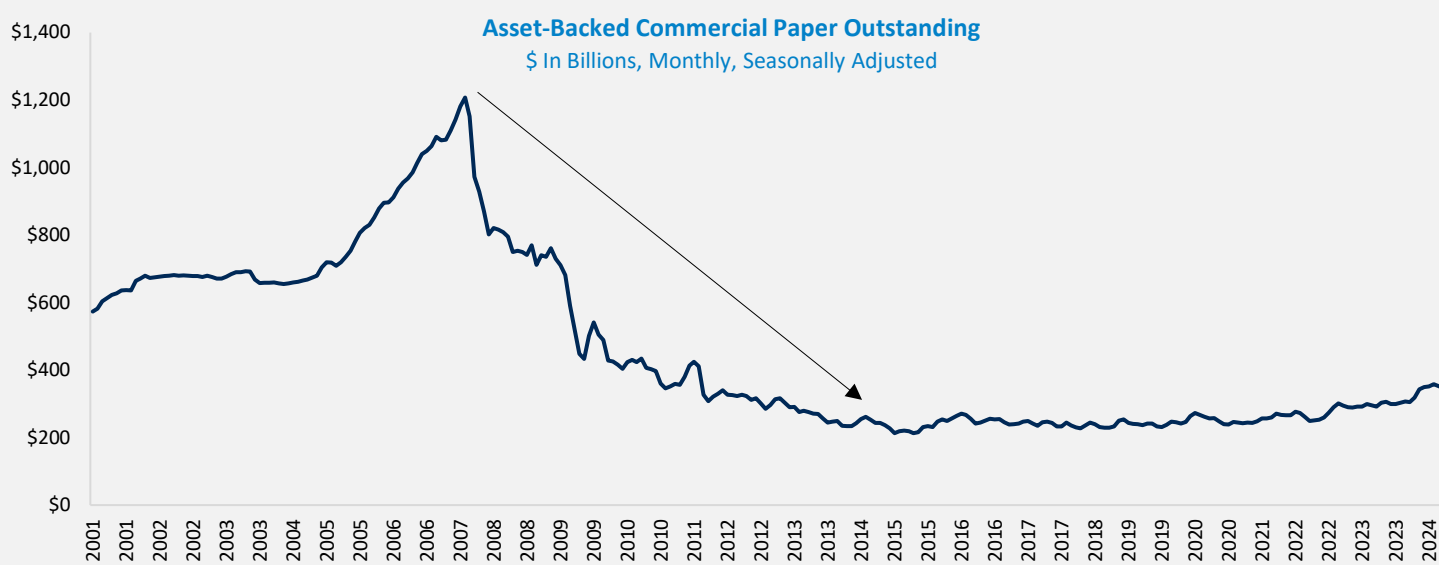
This shift had a profound impact on commercial and industrial (C&I) lending. As shown in Charts 5 and 6, banks curtailed activity in C&I lending relative to other balance sheet exposures, contributing to a funding shortfall that private credit managers and specialty finance platforms increasingly moved to fill.

Chart 5



Source: Federal Reserve Bank Economic Data Accessed August 2024.

Chart 6



Source: Federal Reserve Bank Economic Data Accessed August 2024.

In parallel, many banks adopted an originate-to-distribute model, offloading loans to securitization markets rather than holding them on their balance sheets. While this shift improved capital efficiency, it also opened the door for non-bank lenders to move upstream—taking on origination, servicing, and structuring roles once dominated by banks.

The result has been a fundamental reconfiguration of the asset-backed finance landscape. Today, non-bank institutions, including private credit funds, specialty finance companies, and credit-oriented asset managers, play a central role in originating and underwriting ABF transactions. With regulatory capital burdens set to rise under the forthcoming Basel III Endgame framework (originally slated to begin a three-year phasing period in July 2025, the full agreement has yet to be finalized), banks are expected to further reduce exposure to risk-weighted assets, particularly in less liquid or non-core lending verticals. As a result, the shift toward private capital in specialty finance appears not only durable, but likely to accelerate in the years ahead.

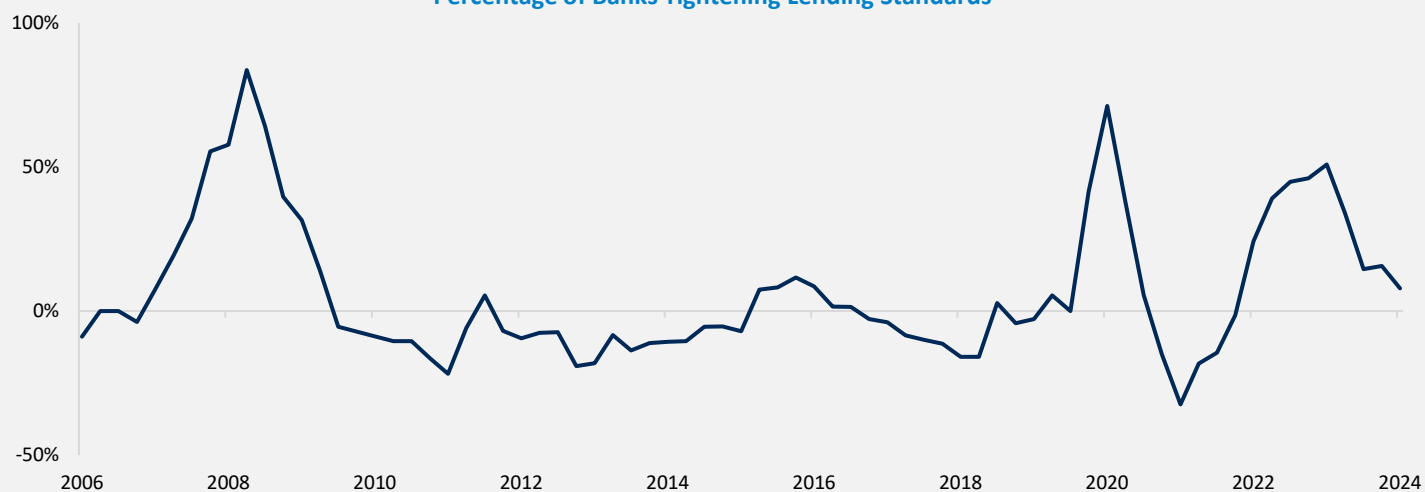
Regional Bank Contraction and Its Impact on ABF

The regional banking crisis of early 2023, triggered by severe asset-liability mismatches and rapid deposit flight, marked another turning point for the traditional credit ecosystem. Regulatory interventions and market instability forced many banks to reduce risk exposures, reprice liabilities, and reevaluate capital positions.

In the wake of the crisis, regional and community banks pulled back meaningfully from lending activity, contributing to a broad tightening in credit standards across the banking sector. While some of that tightening has moderated, many institutions remain in a prolonged deleveraging cycle, constrained by interest rate risk, rising capital requirements, and liquidity pressures (see Chart 7).

Chart 7

Percentage of Banks Tightening Lending Standards



Source: Federal Reserve Bank Economic Data Net Percentage of Domestic Banks Tightening Standards for Commercial and Industrial Loans to Large and Middle-Market Firms, Q3 2024.

In asset-backed finance, this environment presents both challenges and opportunities. As banks reduce their footprint in commercial and industrial lending, and increasingly allow facilities to roll off or seek to offload portfolios, private credit providers and specialty finance platforms are stepping in to absorb the demand. This retrenchment is driven not only by regulatory capital and liquidity constraints, but also by pressure to rationalize headcount and overhead as banks pivot toward more digital and AI-enabled operating models. This shrinks the resources devoted to specialized, relationship-intensive and structure-heavy lending businesses. The pullback from the regional banks in particular, continues to widen the opportunity set for non-bank lenders with the flexibility and capital to underwrite complex asset pools.

Structural Protections in ABF: Credit Risk Mitigation by Design

One of the defining features of asset-backed finance is the robust credit architecture embedded in transaction structures. Traditional corporate loans rely on borrower covenants and enterprise-level collateral such as the pledge of the stock of the underlying business. ABF structures are engineered to manage risk at the asset level through a layered combination of legal entities, cash flow controls, and third-party governance.

At the heart of most ABF transactions is a bankruptcy-remote SPV, which holds the underlying assets on behalf of the lender. This insulation from the originator's balance sheet limits the lender's exposure to corporate credit events and allows for more precise control of the cash flows backing the facility.

The credit performance of these structures is further reinforced by a suite of structural features:



Eligibility Criteria

Define which assets may be included in the borrowing base, excluding those with elevated risk profiles or non-conforming terms.

Concentration Limits

Reduce exposure to any single payor, geographic region, or asset class within the portfolio, thereby enhancing diversification.

Cash Reserves

Establish cushions for interest payments and loss absorption, which can be dynamically adjusted based on performance or market conditions.

Lockbox Accounts and Waterfalls

Route all borrower cash flows through lender-controlled accounts, ensuring priority of payments in accordance with a predefined distribution sequence.

Back-Up Servicers and Custodians

Provide operational continuity by appointing independent third parties who can step in to manage servicing or hold critical loan documentation if needed.

These mechanisms are not merely theoretical; they are tested, audited, and frequently modeled using historical cash flow and delinquency data. From a lender's perspective, they represent institutional-grade credit governance.

Pre-Closing Due Diligence

Since ABF transactions typically involve more individualized collateral and more structured transactions, many protections and mitigants are built into the underwriting and due diligence process. Many of these structures are very protective and are discussed below.

- 1. Document and Collateral Verification:** Collateral documents are reviewed to confirm that legal agreements, security interests, and underlying asset information are complete, accurate, and consistent with the provided data tapes and borrowing base. The deal team or qualified third parties may also visit and verify the collateral's existence, condition, and proper control.
- 2. Validity and “Bad Boy” Guarantees:** Sponsors and key principals may provide validity and “bad boy” guarantees, which create direct recourse for lenders in the event of intentional misconduct. This covers areas such as fraud, misappropriation of collateral, or voluntary bankruptcy filings, and reaffirms alignment while deterring fraudulent behavior.
- 3. Field Exam/Performance Review:** On a recurring basis, typically 1-2 times a year, field exams are conducted to analyze asset performance. In specialty finance, this often focuses on cash collections, delinquencies, charge-offs, recoveries, and other asset-specific metrics. These reviews include random testing of sample files and reconciliations to identify risks or changes to underwriting and servicing behavior.
- 4. Audit Confirmations:** Auditors will work to confirm outstanding balances, payment status, and key contractual terms for selected collateral. This independent confirmation process helps ensure that reported receivables and loans are depicted accurately.
- 5. Third-Party Servicer/Cash Controls/Waterfall:** Oftentimes, collections are managed by a qualified third-party servicer and/or funneled into a lender-controlled blocked account, such as a Deposit Account Control Agreement (DACA) account. From there, cash is applied according to a predefined payment waterfall, limiting the ability of originators or outside parties to divert or misapply funds.
- 6. UCC Filings and Lien Searches:** The UCC filing system is used to perfect security interests in many forms of ABF collateral and receivables, including aviation assets, consumer loans, real estate, and equipment or financial claims. Comprehensive lien searches and UCC filings help establish priority over specific collateral and enable other prospective lenders to see existing pledges, thereby reducing the risk of fraud, such as double pledging.
- 7. Background Checks:** Background checks are typically performed on the borrower, key sponsors, and senior officers. These reviews may encompass criminal records, civil litigation, regulatory actions, bankruptcies, and other reputational or compliance issues that could signal heightened fraud risk.
- 8. Third-Party Appraisals:** Independent third-party appraisers are often engaged to update asset values at appropriate intervals. These appraisals usually include a site visit, market comparable analysis, and verification of key attributes, providing an objective expert view on collateral coverage relative to outstanding exposure.

Post-Close Ongoing Monitoring and Early-Warning Indicators

Effective portfolio management in ABF is an ongoing, data-driven process that extends well beyond the initial underwriting pre-close. Managers continuously monitor collateral performance, servicer behavior, and structural tests across facilities to identify risks early. Tools, including borrowing base adjustments, concentration limits, covenant triggers, and amortization events, are used to adjust risk levels as conditions evolve. In combination, rigorous due diligence, thoughtful structural design, and disciplined monitoring enable ABF investors to differentiate between normal credit volatility and fraudulent activity. This supports active capital allocations across various asset types and structures, allowing investors to manage correlations, maintain targeted risk/return profiles, and preserve downside protection.

Additional Advantages of the ABF Asset Class

In addition to robust structural protections, ABF offers investors several portfolio-level benefits:

Attractive Yields – Enhanced spread relative to similarly rated corporate credit due to asset complexity and sourcing inefficiencies.

Inflation Resilience – Many collateral types (e.g., autos, equipment, real assets) appreciate or reprice with inflation.

Data-Driven Underwriting – Deep historical datasets enable precise modeling of default curves, prepayments, and recovery rates.

Diversification – Exposure to consumer and commercial credit risk outside the corporate capital structure.

Cyclical Protection – Many ABF asset classes have demonstrated lower loss severity than corporate debt during downturns.

Artificial Intelligence and Asset-Backed Finance: Technology as a Tailwind

In recent years, AI has emerged as an increasingly relevant player as both a user of ABF capital and a tool for managing capital effectively. On one hand, AI is driving a significant build-out of digital infrastructure and related real-world assets. On the other hand, AI is reshaping how lenders source, underwrite, and monitor asset pools, and complements many of the data-driven advantages that distinguish ABF from traditional corporate lending.

From an asset standpoint, AI is accelerating demand for the build out of capital-intensive digital infrastructure, including data centers, high-density power and cooling systems, fiber networks, and specialized campuses designed to house GPU clusters. These projects are typically supported by long-term contracts with cloud providers or large enterprises, creating contracted cash flows and tangible residual value, characteristics that fit well with ABF structures. As a result, AI and infrastructure finance have emerged as a distinct vertical within the broader ABF universe, allowing private credit investors to gain secured exposure to the growth of compute demand.

At the same time, AI is enhancing the process of underwriting and monitoring ABF portfolios. Advances in machine learning and related tools have allowed for the more effective monitoring of performance data, including vintage curves, recoveries, delinquency analysis, and prepayment behavior, including earlier detection and intervention. In practice, this AI-enabled analytics strengthens the portfolio management process and complements traditional field exams, file reviews, and effective structuring that remain central to ABF.

For investors, while AI introduces its own set of risks, including being an emerging technology, data privacy considerations, and potential concentration in technology related exposures, these risks can be managed through structural protections and ongoing monitoring. The thoughtful usage of AI functions more as a structural tailwind and reinforces ABF's role as a risk-managed way to finance real-world assets in an increasingly technology-driven economy.

Conclusion: A Scalable Strategy Built for This Market

Asset-Backed Finance is no longer a niche strategy. Amid structural shifts in the banking sector, regulatory headwinds, and rising institutional appetite for differentiated sources of yield, ABF has become a central and growing segment within the private credit landscape. Its self-liquidating structures, collateral-backed risk management, and access to real-world asset pools offer investors an increasingly compelling alternative to traditional corporate credit.

At Monroe Capital, ABF represents both a natural extension of our private credit platform and a growth area for the firm. As the industry continues to grow, Monroe focuses on lower middle market and middle market ABF transactions where bespoke structures and greater yields can be accomplished. With a track record spanning direct lending, structured credit, specialty finance, and real world-linked assets, Monroe has built the capabilities to originate, underwrite, and manage complex asset-backed transactions. We believe that the ability to deploy tailored capital—backed by institutional-grade infrastructure and rigorous underwriting—positions us to generate attractive, risk-adjusted returns while providing downside protection in a shifting credit environment.

In this market, certainty of execution matters. Borrowers increasingly value partners who are responsive, flexible, and capable of navigating complexity with creativity and speed. Across economic cycles, Monroe remains committed to being that kind of partner—one who brings insight, discipline, and reliability to every transaction.



Monroe's Alternative Credit Solutions

19

Average Years of Experience
Across Team

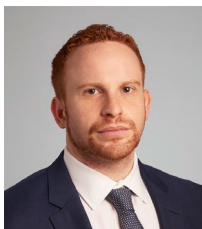
14

Dedicated Investment
Professionals

350

Alternative Credit Solutions
Transactions Reviewed
Annually

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