GOLUB CAPITAL

A Short History of Sponsor Finance

The Evolution of Bank and Non-Bank Participation in Middle Market Lending

A mix of regulatory, market and client-driven forces has pushed banks away from lending to private equity-backed middle market companies, opening the door for non-bank institutions to fill the gap. This paper explores the factors behind this historic shift and the coincident emergence of a deeply symbiotic relationship between private equity sponsors and private credit managers—one captured in the term "sponsor finance."

The Long Arc of Bank Disintermediation

The diminishing role of banks in financial markets is not a new phenomenon. Over the past several decades, banks have experienced repeated waves of disintermediation, often prompted by both industry regulation and financial innovation in capital markets (see Exhibit 1). Consider some familiar examples:

- The rise of money market funds redirected trillions of dollars from bank deposits into more flexible, higher-yielding instruments in open-end fund structures.
- Large corporate issuers began bypassing bank loans in favor of commercial paper and capital market solutions for their operating cash needs.
- Securitization allowed traditionally bank-held assets, such as mortgages and auto loans, to be pooled and sold in capital markets, offloading them from bank balance sheets.

This historical context is key to understanding the rise of private credit and sponsor finance. Importantly, the story is less one of revolution than evolution.

Exhibit 1

A History of Bank Disintermediation

Private Credit Is Just the Latest Example

Bank lending as a share of total borrowing has been falling for 50 years; increased regulation, financial innovation and advances in securitization have prompted more borrowers to bypass traditional banks.

CAPITAL MARKET INNOVATION AND TRADITIONAL BANK DISINTERMEDIATION

Money Market funds shift bank deposits to asset managers	**Commercial Paper** market replaces banks to support corporate operating cash needs	**Securitization** of traditional bank assets (mortgages, auto loans) pooled and sold in capital markets	**Non-bank lenders** offer more efficient "financialization" of middle market lending needs

Source: Private Credit's Next Act, April 2024, by Huw van Steenis, Oliver Wyman and Golub Capital analysis.

Factor 1: Three Waves of Regulation

While many factors have shaped the history of private credit, regulation has been a powerful and persistent force. Since the 1980s, three major waves of regulatory reform, typically following some idiosyncratic market crisis, have cumulatively reshaped how banks participate (or are hindered from participating) in lending (see Exhibit 2).

First Wave: Savings and Loan Crisis

Rising inflation and interest rates in the 1980s created a severe mismatch on bank balance sheets: The amount banks had to pay on short-term deposits climbed dramatically, while the income earned from long-term mortgage assets remained fixed. This set in motion a long period of bank consolidation: Nearly one-third of U.S. banks became insolvent from 1986-1995. Many local and regional lenders, a natural source of debt capital for middle market businesses across the U.S., were gradually replaced by a handful of national and global brands.

To stabilize the industry, regulators began instituting controls over bank balance sheets. The U.S. Federal Reserve and Office of the Comptroller of the Currency instituted a formal capital ratio for larger banks in 1981. Such regulatory-based capital requirements became the nexus of most future bank regulation.

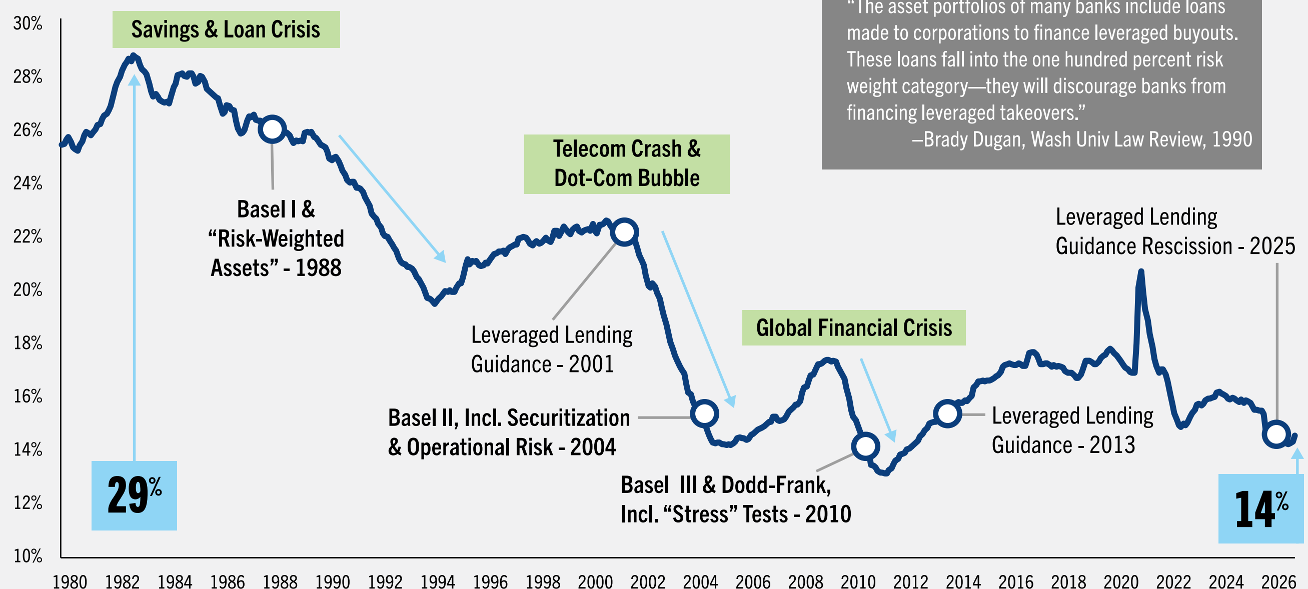
The global extension of this approach came in 1988 with the Basel I Accord, which introduced the concept of risk-weighted assets, imposing higher capital requirements for riskier credit exposures. Loans used for financing leveraged takeovers fell into a highly penalizing 100% risk weight category, making them less attractive from a return-on-equity standpoint.

Exhibit 2

Three Waves of Market Stress and Regulatory Action Drive Banks to the Periphery of Private Credit

Three market disruptions (the savings and loan crisis; the dot-com bubble; the global financial crisis [GFC]) and the increasingly nuanced regulatory capital requirements that followed (in Basel and Dodd-Frank regulations) helped progressively drive banks out of the business of lending to middle market leveraged buyouts.

Commercial & Industrial (C&I) Loans as a % of Total Bank Credit



Note: In 2013, U.S. banking regulators issued updated leveraged lending guidance (LLG), which replaced the 2001 version, and outlined supervisory expectations for banks underwriting and holding leveraged loans, especially those with debt/earnings before interest, taxes, depreciation and amortization (EBITDA) ratios above 6x. While this guidance did not impose hard limits or legally binding requirements, it signaled areas of heightened supervisory focus and encouraged banks to apply more conservative underwriting and risk-management practices, contributing to the post-GFC migration of leveraged lending activity to non-bank lenders. In December 2025, the OCC and FDIC formally rescinded this guidance, citing concerns about regulatory overreach and competitiveness. Although this move gives banks greater flexibility to an extent, the LLG was never viewed as a major binding constraint, and its rescission is unlikely to have a significant impact on market dynamics. Moreover, private credit managers have become a central part of the sponsor finance landscape, and any meaningful shift in market share could take time, as banks would need to rebuild the leveraged lending infrastructure that largely migrated away in the post-GFC era.

Source: The Federal Reserve database of Assets and Liabilities of Commercial Banks in the U.S. from H.8 filings and Golub Capital internal analysis. Data as of March 31, 2026.

Second Wave: Dot-Com Bubble (2000s)
The dot-com bubble and subsequent credit issues led banking agencies to issue new leveraged lending guidance (LLG) in 2001, highlighting the risks of leveraged financing, especially in the middle market. In 2004, Basel II expanded the regulatory screw-tightening to include operational and securitization risk, further raising the cost of capital for certain types of leveraged lending. Notably, these rules applied only to regulated banks, not non-bank lenders.

Third Wave: GFC (2008)
The 2008 GFC arguably brought the most transformative change, with the Dodd-Frank Act and Basel III significantly increasing bank capital requirements. These measures also introduced stress testing to ensure that banks could weather future downturns.

These regulatory decisions opened a wide path for non-bank lenders. Unencumbered by the regulatory capital rules, non-bank lenders would rise to meet the growing need for flexible debt capital among middle market companies and their financial sponsors.

Factor 2: Sponsor Preferences Reshape Lending Dynamics

While regulation caused banks to retreat, it was not the only force behind the rise of private credit. Equally important was the changing nature of borrower demand—specifically from private equity sponsors. As the private equity ecosystem continued to grow in scale, private equity general partners found themselves hamstrung by slow, unreliable, inflexible and often expensive financing processes. Arranging deals through multiple banks and insurers often meant juggling conflicting terms, multiple underwritings and a patchwork of documentation, each offering only a single fragment of a total solution for the capital stack (including senior, junior or mezzanine debt) and each with its own incentives. The friction and complexity inherent in such transactions clashed with the goals of private equity sponsors.

Recognizing this client need, non-bank lenders responded by building a more tailored solution (see Exhibit 3). They offered speed, confidentiality and certainty of execution. They were willing to provide additional financing to sponsors for add-on acquisitions and to structure and hold loans without syndication. They developed a unitranche option that offered a one-stop capital solution from a single lender, solving for the entire debt stack. This new financing model had a strong appeal for private equity sponsors who increasingly prioritized recurring bilateral lending relationships with their private debt partners over impersonal and fragmented bank syndications.

Non-bank lenders, with crisper decision-making, fewer regulatory constraints and long-duration capital that better matched the duration of their loan portfolio, were well positioned to deliver. Consequently, private credit became not just an asset class in its own right but a natural strategic partner to private equity itself. Beyond the regulatory shifts, this client-driven dynamic helped cement the dominance of non-banks as the lenders of first resort for private equity managers.

Exhibit 3

What Sponsors Want: The Industry Speaks

Non-Bank Lenders Become the Preferred Source of Capital

Non-bank lenders have replaced banks as the main source of debt capital for private equity-backed middle market companies for reasons that go well beyond bank regulatory capital constraints.

The Benefits of Direct Lending to Private Equity Sponsors

Speed of Decision-Making	Relationship Orientation	Certainty of Execution	Bilateral Negotiations/Confidentiality
Capacity to Lend in Scale	Ability to Structure Bespoke Solutions	Ease of Add-on Financings	No/Limited Syndication

Benefits of non-bank lenders drawn from the Proskauer Private Credit Survey 2024.

A Relationship Business: The Alignment of Private Equity and Private Credit

Not surprisingly, the rise of private credit has closely mirrored the growth of private equity (see Exhibit 4). Over the past two decades, global private equity assets under management have grown from $1.2 trillion to more than $12 trillion.

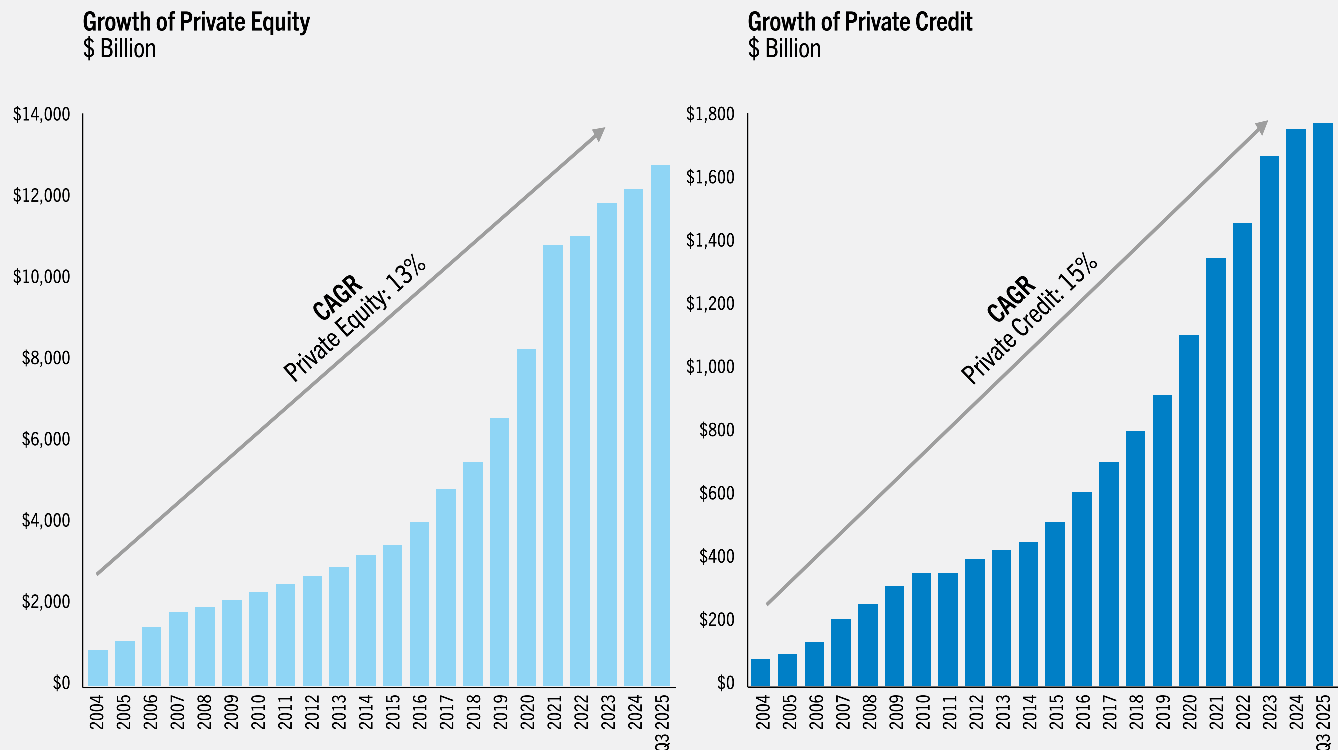
Less often acknowledged is how tightly private credit asset growth has tracked this expansion, climbing from about $80 billion in 2004 to over $1.7 trillion recently. The financing needs of private equity sponsors have created durable demand for private credit. As sponsors pursue more deals and larger transactions, they require lenders that can keep pace not only in dollars but in speed, confidentiality and structural flexibility. The parallel growth in private equity and private credit has been more than coincidental. It's symbiotic.

Exhibit 4

The Symbiosis of Private Equity and Private Credit

Private Equity Capital Demand Grows, Non-Bank Lenders Respond

As commercial banks face higher regulatory burdens for holding leveraged middle market debt on their balance sheets, private equity sponsors seek ever greater amounts of debt capital from non-bank lenders to finance their deals.



Source: Preqin. Data as of September 30, 2025.

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CAGR is defined as Compound Annual Growth Rate.

If You Can't Beat Them… Banks at the Margin of Private Credit

Faced with persistent risk-based capital pressures and shrinking returns, banks have had to rethink their relationship with the private credit ecosystem. No longer comfortable storing credit risk on their balance sheets, banks have shifted to origination and syndication. That is, rather than holding loans, they package and sell them to a broad array of investors, which allows them to earn fees while minimizing risk-based capital charges.

And while banks have largely ceded the core business of private leveraged lending to non-bank players, they continue to participate on the margins of the asset class. One example of this is the provision of credit facilities to private credit managers, including subscription lines, asset-based leverage facilities or warehouse lines that help the managers scale their operations and smooth their capital deployment.

This activity has become increasingly profitable. Since 2015, non-depository lending has grown far more rapidly than traditional C&I lending at banks, especially over the last few years (see Exhibit 5). While banks may no longer dominate sponsor finance, they remain important providers of structural support, extending liquidity to the private credit managers who do.

But for middle market borrowers, the center of gravity has shifted. The relationships, the talent pool and so much of the essential contours of what we know as sponsor finance have migrated to the non-bank lending community—and there is very little likelihood of a reversal of that new status quo. While banks still play a role in the world of middle market lending, their involvement today is largely supportive and secondary to that of private non-bank lenders.

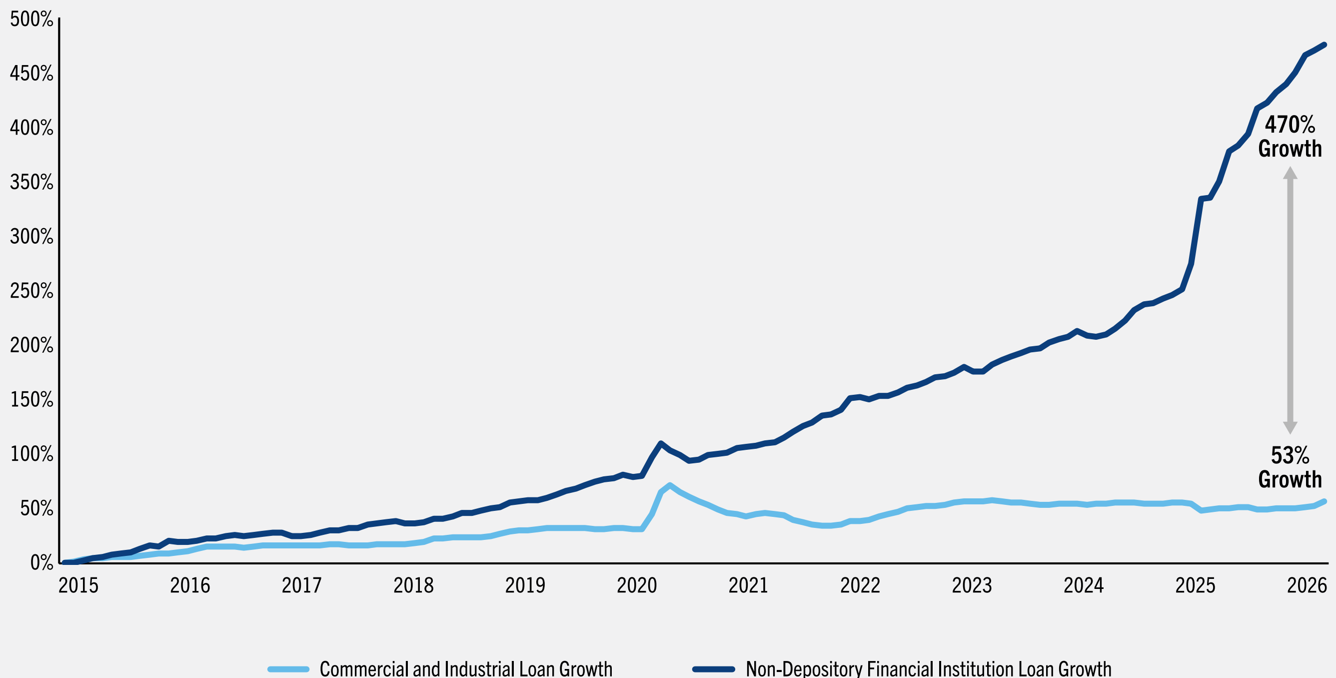
Exhibit 5

Banks Seek Supporting Role on the Margins of Private Credit

Loans to Non-Bank Lenders on the Rise

With talent having migrated to non-bank lenders, banks are effectively out of the core private credit space; they seek other ways to participate in the direct lending ecosystem (e.g., in credit facilities to non-bank lenders).

C&I vs. Non-Depository Loan Growth



Source: The Federal Reserve database of Assets and Liabilities of Commercial Banks in the United States from H.8 filings and Golub Capital internal analysis. Data as of March 31, 2026.

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