

Developed Market Banks

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On high alerts for “Credit Cockroaches”

Executive Summary

- The collapse of Market Financial Solutions (“MFS”) is both a significant standalone event and a symptom of broader fragility in the private credit ecosystem. This episode signals a potential turning point for a sector that has grown rapidly but may not yet have the infrastructure or transparency required to manage its expanding risks. Investors remain sensitive to signs of hidden leverage or valuation uncertainties within private credit portfolios, increasing the likelihood that even manageable credit events may trigger disproportionate market reactions.
- The potential write-downs tied to the collapse of MFS are financially manageable for these banks and could be absorbed within a single quarter’s earnings without a major drag on their capital ratios. However, the event exposes gaps on how banks monitor private credit exposures and collateral tracking; similar to the events of First Brand and Tricolor.
- Moving forward, we expect banks to adopt a more cautious stance on NDFIs, tightening the underwriting standards, which will translate into a tightening of overall liquidity. This raises the risk of spillovers into the public bond markets, raising the decompression in spreads especially at the lower end of the credit spectrum in High Yield (“B” and below).
- Over the near-term, sentiment towards the Financials is likely to remain vulnerable to negative news flow, prompting further spread widening. The recent cluster of headlines adds pressure at a time when spreads were already near cyclical tights.
- We believe there will be better entry points ahead to deploy risk. As a base case, we think US GSIBs and the national champions in Europe/UK/Switzerland are able to comfortably manage a late-cycle plateau; supported by strong capital and liquidity profile. We reiterate our preference for defensive positioning.

Risk Off: Amidst the ongoing noises surrounding private credits, spreads in Financials have been showing signs of stress, with the widening more pertinent in the subordinated structures. Despite that, we see scope of further credit spreads widening, potentially overshooting to the upside before eventually settling down. We believe the overall cautious stance towards private credit could risk spillover to broader public markets, which will lead to further decompression in spreads, in particular the lower credit rated segments.

Figure 1: AT1 Spread moved wider; but still near 1-year tight



Source: Bloomberg

Private credit headwinds: Over the near-term, sentiment towards the Financials is likely to remain vulnerable to negative news flow, prompting further spread widening. The recent cluster of headlines – including the MFS collapse, US Business Development Companies (“BDC”) markdowns, liquidity-management actions by major alternative managers and broader equity market volatility from the US-Iran conflict – adds pressure at a time when spreads were already near cyclical tight. Investors remain sensitive to signs of hidden leverage or valuation uncertainties within private credit portfolios, increasing the likelihood that even manageable credit events may trigger disproportionate market reactions.

Latest Credit Cockroach: The collapse of Market Financial Solutions (“MFS”) into administration on 26 February 2026 amid allegations of fraud and financial irregularities has become the latest flashpoint intensifying scrutiny across private credit. The collapse is a fresh reminder from late-2025 bankruptcies (First Brands Group, Tricolor); serving as both a significant standalone event and a symptom of broader fragility in the private credit ecosystem. Along with recent fears surrounding AI-driven disruption, investor anxiety is mounting and on high alert for more “credit cockroaches” or hidden risks in opaque credit portfolios.

MFS is a UK-based specialist mortgage provider that focused on high-value, complex property lending, often operating in the private credit sector. Its services were geared towards borrowers and property investors requiring specialized financing solutions that traditional banks may not typically provide. MFS has tapped banks for secured credit lines used to fund mortgage originations, while banks took comfort in tangible collateral (of underlying securitized mortgages). The collapse has been attributed to

allegations of fraud and double pledging of assets. Major banks that have significant exposure includes Barclays (GBP600mn), Jeffries (GBP100mn) and Santander.

Risks of spillover to public markets: The potential write-downs tied to the collapse of MFS are financially manageable for these banks and could be absorbed within a single quarter's earnings without a major drag on their capital ratios. However, the event exposes gaps on how banks monitor private credit exposures and collateral tracking; similar to the events of First Brand and Tricolor. Moving forward, we expect banks to adopt a more cautious stance on NDFIs, tightening the underwriting standards, which will translate into a tightening of overall liquidity. This raises the risk of spillovers into the public bond markets, raising the decompression in spreads especially at the lower end of the credit spectrum in High Yield ("B" and below).

Defensive positioning: Sticking with quality banks, we believe there will be better entry points ahead to deploy risk. As a base case, we think US GSIBs and the national champions in Europe/UK/Switzerland banks are able to comfortably manage a late-cycle plateau; supported by strong capital and liquidity profile. In this environment, we reiterate our preference for defensive positioning. We identify the following themes for the sector:

- Bank Seniors should outperform in this environment, as compared to the more subordinated structures.
- Banks should continue to outperform Insurance; given more concentrated NDFI exposures in the latter.
- Structures with near calls and a high likelihood of calls should be more defensive; offering a defensive way to generate yields.

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