



# A Cautionary Tale in Private Credit: Lessons Learned from First Brands

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# Private Credit in the News

- Lloyd Blankfein:
  - “We’re getting close to the end of the late stages of cycles on this, and **we’re due for a kind of a reckoning.**”
  - “I wonder where there’s **hidden secret leverage.**”
  - “It sort of **smells like that kind of a moment [the Financial Crisis] again.** I don’t feel the storm, but the horses are starting to whinny in the coral.”

PRO

## Private credit could be the next crisis on Wall Street. How worried should investors be?

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### Private credit has half the ingredients of a financial crisis

Worries arise that valuations shown on balance sheets don't match reality



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### An Exodus of Money Endangers Wall Street's Private-Credit Craze

Investors ask to cash out 14% of Cliffwater's \$33 billion fund while

# Private Credit—The Basics

- Since Financial Crisis, bank lending overall has declined and private credit become one of the fastest-growing segments
- Currently estimated to be approx. \$2T market
- Debt financing by non-bank lenders (such as private equity firms, asset managers, or hedge funds) to borrowers (typically middle-market companies)
- Not broadly syndicated to institutional investors
- Loans generally not securitized
- Direct loans (to company itself)
- Asset-backed loans (i.e., receivables, inventory, hard assets)
- Offer higher yields (but higher risk)
  - Borrowers have lower credit ratings, limited operating history, or high leverage
  - Opaque valuations (i.e., use internal models over varying times and not daily and public mark-to-market)
  - Less regulated—operate outside the regulated banking system
  - Looser underwriting/monitoring standards



# First Brands

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# First Brands Bankruptcy

- A global supplier of aftermarket automotive parts
  - Employed 26,000 people globally
  - For FY ended 2024, total net sales approx. \$5B
- Filed for Chapter 11 bankruptcy in SDTX in September 2025, citing market conditions caused by tariffs and certain allegedly fraudulent financing obligations, including:
  - \$2B+ in receivable factoring liabilities
  - \$800M in accounts payable (supply chain financing)
  - \$2B+ in SPV off-balance sheet obligations

# Factoring

- FBs' customers routinely negotiated extended payment terms
- Factoring allowed FB to get paid on the invoice quickly from a third party (typically in the private credit market), in exchange for near-term cash, after a haircut
  - The lender collects full payment when the invoice becomes due
- 2 Types of Factoring:
  - Customer-linked factoring
    - FB's customer arranged with a financing company to pay FB directly after the invoice was approved; when it came due, the customer would repay the lender directly
  - Third-party factoring
    - FB would sell the invoice to a third-party unaffiliated with the customer
    - The lender paid FB the value of the invoice, minus a haircut, and wait for the customer to pay back FB after the invoice was due
    - At this point, FB would pay the full value of the invoice to the lender
    - The lender (factor) had no relationship with the customer, and the invoices not subject to customer verification

# Alleged Factoring Fraud

- Inflated value of receivables
- Double-pledged receivables as collateral
- Sold non-existent receivables
- In total, alleged that FB sold **billions of dollars of receivables that did not exist**
- Concealed fraud:
  - For example, one lender sought information about certain invoices it bought; its auditor saw large discrepancies between the amounts in the actual invoices compared to the invoices it purchased
  - After this discovery, FB instructed that emails from certain third-party lenders be limited to an inner circle of FB executives involved in the scheme to prevent low-level employees from mistakenly providing accurate information to an inquiring lender

# Alleged Accounts Payable (Supply Chain) Financing Fraud

- **Either** FB partnered with lenders to pay its suppliers directly for invoices FB owed; FB would repay the lenders later, **or**
- A lender would pay FB directly at a discount; FB would remit to the supplier and repay the lender later
  - Alleged that FB provided false invoice information, and false information about its financial position, to induce lenders to increase the amounts of funds advanced
    - FB used online platforms supplied by the lenders themselves
      - ✓ Rather than upload the invoices, FB submitted spreadsheets containing data entries reflecting false invoice information (amounts and dates) that were transmitted to lender
      - ✓ When lenders began to ask for digital copies of the invoices themselves, FB created fake invoices
      - ✓ One lender asked to see a physical invoice. At that point FB discussed ending the relationship.
    - Also alleged that under FB's direction, lenders sent funds to a third-party bill-processing intermediary based on false invoices
      - ✓ The funds were not used to pay suppliers, but were routed directly to FB itself

## Off-Balance Sheet Fraud

- Alleged that FB also defrauded lenders by hiding off-balance sheet debt.
  - Certain inventory financing arrangements with entities nominally separate from FB, but:
    - Were owned and controlled by FB's founder;
    - Had no independent business operations; and
    - Were secured by FB inventory but were **not disclosed to lenders as FB debt**.
  - Also, FB pledged to the off-balance sheet lenders inventory as collateral that was already subject to liens or pledged to other FB senior lenders and remained on the balance sheet.
    - FB submitted false inventory schedules to the off-balance sheet lenders, and
    - Disguised the source of proceeds obtained from the off-balance sheet lenders and flowing into FB, and the repayment of obligations from FB to the off-balance sheet lenders.
      - ✓ Off-balance sheet lenders' funds were routed through a customer collections entity outside the FB corporate structure and then disbursed across FB subsidiaries before being swept back into the FB operating account – **an effort to make it look like the funds were ordinary customer receipts from retail subsidiaries rather than the loan proceeds from related party financing arrangements**.
      - ✓ Repayments to the off-sheet lenders were similarly disguised.

# Falsifying Financials

- FB also allegedly falsified the company's financials that were provided to lenders.
  - For example, directions from the CFO to the VP for Finance: "Want to: reduce factoring by 3. Reduce interest by 6. Reduce non cash by 14. Increase restructuring by 14."
- FB maintained internal "bridge" files that juxtaposed accurate corporate financials with false financial adjustments needed to meet the benchmarks set by company.
  - Were used to manually adjust entries in the corporate books of various FB subsidiaries and were reflected in the FB financial statements and presentations.
- FB also misled its outside auditors.
  - Repeatedly certified that FB had no related party transactions.
- FB also provided false information to the asset backed lenders regarding the collateral allegedly securing their loans.
  - Under the loan agreements, the lenders held priority liens on the inventory. Yet FB later encumbered the inventory, purporting to sell the inventory free and clear to the off-balance sheet lenders through the related parties.

# DOJ Indictment

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA  
v.  
PATRICK JAMES and  
EDWARD JAMES,  
Defendants.

**INDICTMENT**

26 Cr.

26 CRIM029

COUNT ONE  
(Continuing Financial Crimes Enterprise)

## Banks Involved in Private Credit Too

- FSOC reports that banks had [approximately \\$445B](#) in exposure to private credit industry as of second quarter 2025

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# The Blowup That Exposed How America's Banks Are Entangled in Private Credit

Western Alliance vs. Jefferies fight exposes risks to bank backing for private credit

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**SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK**

-----X  
WESTERN ALLIANCE TRUST COMPANY, N.A. and :  
WESTERN ALLIANCE BANK, :

Plaintiffs, :

- against - :

JEFFERIES FINANCIAL GROUP INC., LEUCADIA :  
ASSET MANAGEMENT LLC, POINT BONITA :  
CAPITAL MASTER FUND A LLC, LAM TFG I :  
SPV, LLC and LAM TRADE FINANCE GROUP LLC, :

Defendants. :

Index No. \_\_\_\_\_

**COMPLAINT**

-----X  
Western Alliance Trust Company, N.A., (“Western Alliance Trust”), acting in its capacity  
as “Collateral Agent,” and Western Alliance Bank (“Western Alliance Bank”) (collectively,  
“Plaintiffs”)<sup>1</sup> for their Complaint against Defendants Jefferies Financial Group Inc. (“Jefferies”)

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## Other Consequences From First Brands

- Other private credit and related non-bank financing lenders to FB include: Raistone, Inc. and Onset Financial.
  - Raistone filed for Chapter 7 liquidation in February 2026 due to massive losses from FB.
- Other banks (besides Western Alliance) also suffered losses. First Citizens BancShares booked an \$82M charge-off tied to exposure to First Brands financing. SouthState Bank reported a \$32M charge-off for similar reasons.

## Other Recent Cases

- **Tricolor Holdings LLC**
  - Sold and provided subprime financing for used cars, focusing specifically on Hispanic customers with limited or no credit history
  - Employed over 1,500 people and generated approximately \$1 billion in annual revenue in both 2023 and 2024
  - Securitized car loans receivables into classes of bonds that were sold to private credit investors
  - Orchestrated a fraud of approximately \$900 million through bogus pledging and double pledging of collateral
  - Falsified borrowing base reports by altering the characteristics of collateral to meet the lender requirements
  - Misappropriated funds for the personal benefit of co-founders
  - CEO and COO indicted December 17, 2025
- **777 Partners**
  - Alternative investment platform investing in structured settlements
  - Misrepresented financial position to private credit lenders, including providing false bank statements and double pledging the receivables as collateral
  - Violated the investment mandate by investing in airlines and international football clubs
  - Misappropriated funds for the personal benefit of co-founders
  - Co-founder indicted for \$500M fraud on October 16, 2025

# Private Credit Exposure Includes Many Others

- Pension funds
- Insurance companies
- 401(k)s\*
- Sovereign wealth funds
- University endowments
- ETFs
- BDCs



# How Mitigate Risk in Underwriting?

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# Independent Verification of Collateral

- Direct customer confirmation (no borrower intermediation)
  - Require information from borrower that would permit direct contact with customer (e.g., emails, correspondence, secondary identification information (SSN/EIN, driver's license))
- Reduce use of third-party factoring (payments go directly from customer to lender; not through borrower)
- Conduct third-party auditing
  - Randomized invoice sampling, together with shipment verification and proof-of-delivery checks
- Use centralized collateral registry/platform-based receivables tracking

## Eliminate Borrower-Controlled Information Environments

- Access to raw ERP/sub-ledger data (read-only APIs)
  - Remove borrower's management as the gatekeeper of information and let lenders pull transactional data directly from the borrower's source systems in a way that is:
    - unfiltered (no Excel manipulation)
    - granular (invoice-level/not summary)
    - continuous (not just periodic reports) and
    - non-intrusive (read-only).
  - Sub-ledger would allow lender to see invoice ID, customer, amount, date issued, due date, status (open, paid, disputed), which invoices were paid (when and how)
  - Of course, still depends on the integrity of the ERP, so should also confirm directly with customer and have audit procedures

# Application of Data Analytics

- In case of financing a company against its receivables, inventory, or other recurring cashflows from its customers, the use of data analytics is particularly useful to uncover anomalies such as:
  - Duplicate contact information for multiple borrowers
  - SSN information against fraud database
  - Loan origination dates/invoice issuance dates being very recent
  - Round-dollar amount of loan originated value/invoice value
  - Multiple financing arrangements with the same customer
  - Perfectly sequential loan numbers or invoice numbers
  - Analysis of sales and purchases data to calculate approximate inventory and receivables

# Centralized Collateral Registry

- In most private credit markets, collateral tracking is decentralized and fragmented
  - Liens are filed in UCC systems (state by state); details are generic (“all assets”), and no real-time visibility into specific collateral pools (e.g., individual invoices)
- A centralized registry improves this by having **one system** (or a tightly integrated system) where each asset (or pool) is identifiable and each lender’s claim is recorded.
  - It makes that information searchable, standardized, and time-stamped.
  - What gets registered are invoice IDs, customer names, and invoice amounts and dates.
  - Each receivable is linked to a specific lender. It is updated when collateral is added, removed, or repaid.

# Independent Financial Diligence Providers (not Management-Provided)

- Third-party firms engaged by lenders
  - Validate borrower's financial condition, earnings quality, and collateral integrity using primary data and forensic techniques
  - More investigative than traditional audits or internal credit underwriting
  - Less reliant on management representations
  - Conduct management interviews
  - Review bank statements and sub-ledger data
  - Deal-driven (not annual reports)
  - Lower threshold for materiality (greater focus on risk)
  - Conduct full “enterprise-level” underwriting (not facility level)
  - Conduct analysis of SPVs and related-party affiliates
  - Perform physical inspection (inventory/warehouses)

# When Collateral is Sub-Prime

- Lenders can consider requiring:
  - No first-payment defaults
    - Ensures loan is “real” and consumer is engaged
  - Limits on amount of “deep sub-prime” (e.g., max 10%)
    - Prevents pool from being overwhelmed by high-risk paper
  - Maximum loan age
    - Prevents seasoned (old) loans from being re-pledged after they should have been paid off
  - State concentration limits
    - In case of receivables pool containing car financing, mitigates the risk of a single state’s DMV backlog or legal change affecting the whole pool



# Non-ABL (Direct Lending) Fraud Risk

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## Manipulated EBITDA

- Borrower fakes/double-pledges invoices or manipulates financials
  - Recognized as revenue
  - Flows into EBITDA (overstated)
  - Leverage appears lower
  - Loan size increases
  - Lenders believe they are senior when they are not

# Defenses to Non-ABL Fraud

- Validate earnings
  - Determine if EBITDA turns into cash consistently
  - Have full visibility, such as monthly access to bank statements, or API access to bank data
  - Cap add-backs for adjusted EBITDA (so EBITDA inflation becomes constrained)
    - Flag repeated “one-time” items
  - Flag reliance on premature synergies
  - Require full transparency on debt (with ongoing certifications)
  - Monitor continuously (not periodically) from underwriting through performance using third-party diligence (QoE; forensic accounting)



# Litigation and Government Investigations

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# Early Preparation

- Assume any deal could later be scrutinized in lawsuits, bankruptcies, or by regulators
- Build the record early – maintain clear records of:
  - Investment committee memos
  - QoE reports
  - Third-party diligence
  - Internal analyses and stress tests
  - Financial reporting (e.g., all details of invoices used as collateral, EBITDA, etc.)
    - Be clear about how valuation was reported and understood
  - Communications with borrower
  - Risks disclosed and identified, requests for information, responses received, any escalation, how risks were mitigated, and rationale for final decisions made
- Good email hygiene
  - Assume internal emails/chats/DMs, etc. are discoverable
  - Avoid casual or speculative statements (“numbers look aggressive but fine”)

# When Problems Arise

- Engage advisors early
  - Legal counsel – preserve privilege
  - Financial advisors/experts
  - Forensic accountants
- Preserve evidence
  - Implement litigation hold
    - Avoid deleting emails, etc. (including stopping auto-deletion)
    - Identify key custodians (deal team, credit committee members, portfolio managers, forensic accountants)
    - Obtain relevant docs/records (secure shared drives and personal devices (if used for deal communications))
- Reconstruct story
  - What was underwritten?
  - What was known at closing/later?
  - How did what borrower stated/provided differ from reality?
  - When did red flags first appear and what did you do about it?

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# Questions?

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