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A reality check for private credit markets

Two corporate collapses expose hidden risks in the fast-growing and opaque world of private credit.

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By Christian Eufinger and Yuki Sakasai

Two little-known companies in the U.S. collapsed within weeks of each other in September 2025, amid allegations of fraudulent activity and unreported off-balance-sheet liabilities.

Their failure spooked the credit market, especially because both had borrowed heavily from non-bank lenders (like private credit funds, hedge funds and private equity firms). These may be the first warning cracks showing the deep fragility of the booming private credit market, where non-banks have lent trillions with minimal transparency and weak safeguards. This could have significant market and regulatory implications for the broader credit market, and possibly the overall economy.

The tip of the iceberg or an isolated incident?

The fall of Tricolor Holdings began on September 9, 2025, when Fifth Third Bancorp, an Ohio-based U.S. regional bank with about $213 billion in total assets, suddenly disclosed that it would write down a $200 million loan to one of its commercial borrowers, claiming fraudulent activity. The name of the borrower wasn't mentioned, but was soon understood to be the Texas-based Tricolor Holdings, a U.S. subprime auto loan lender.

On September 10, a day after the news of financial trouble broke, Tricolor Holdings filed a voluntary petition for liquidation under Chapter 7, listing its assets and liabilities in the range of $1 billion–$10 billion.

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Tricolor Holdings operated 35 retail dealerships in Texas and California, served over 70,000 customers and disbursed over $1 billion in affordable auto loans. LSEG Workspace data suggests the firm sold approximately $9.8 billion of asset-backed securities (ABS) over the past three years. One area of focus in the investigation by the U.S. Justice Department was whether Tricolor Holdings pledged the same collateral on multiple loans.

In any case, the market reaction to the news was swift, and the price of its ABS dropped sharply.

The second company to fail was First Brands Group, a Michigan-based auto parts manufacturer, which had been aggressively expanding its business through debt-driven acquisitions. Trouble started brewing in early August 2025, when a $6 billion refinancing deal was put on hold due to a lack of earnings clarity. Media reports suggest the firm may have been "factoring," selling customer IOUs for cash, on a massive scale.

First Brands Group's financing woes deepened on September 11, 2025, when Apollo Global Management was reported to be shorting its debt. It eventually filed for bankruptcy on September 24, 2025, and its loans are currently trading at around 11 cents on the dollar. Big Wall Street names like Jefferies and UBS were caught with large exposures.

Why this matters, and what banks are doing

Reactions to the twin failures have been muted so far, suggesting equity investors don't think this will lead to an economy-wide crisis. Nevertheless, there are signs of investor nerves in the lagging performance of U.S. bank stock, especially regional banks. These are likely weighed down by the information gap, which comes from the opaque nature of the largely unregulated private credit market and the low transparency in borrower monitoring and lending quality standards.

Investors are wondering if these are two isolated scams — or the first cracks of a much bigger structural problem.

Quality of lending standards and monitoring from a traditional bank perspective

Data from the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices sheds some light on what lending standards traditional banks are using. Lending

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standards for risky loans appear to have been easiest around 2019, zig-zagged in the COVID-19 period, and have tightened since. Only a fraction of large banks responded that lending standards were easy from a historical perspective.

At face value, the survey suggests that traditional banks are aware of the credit risk and haven't eased their lending standards to risky borrowers during the recent private credit boom. In other words, banks have been cautious. So what is happening?

The rise of non-banks and Cov-lite loans

Lending has historically been dominated by traditional banks, but that's changing. Non-banks now account for nearly 50% of corporate loans newly created or issued. That's up from just over 30% during the global financial crisis.

Also of concern is the popularity of so-called Covenant-lite ("Cov-lite") loans, which have fewer financial restrictions, making it harder for lenders to monitor borrowers' financial health. These loans, which replace strict maintenance covenants with looser "incurrence" ones, now dominate new lending by hedge funds and private equity firms. There is less oversight, and more risk, and given the opacity of the market, no one really knows how bad the loan quality is.

Tricolor Holdings and First Brands Group should be a wakeup call

The collapse of Tricolor Holdings and First Brands Group put the spotlight back on an unanswered question: Is the credit market fundamentally sound despite the rise of non-banks and Cov-lite loans? The truth is, it has never really been stress-tested since the global financial crisis — even during the pandemic, various government measures helped to mitigate negative credit shocks.

As for the two failed companies, it remains to be seen if they are just two bad apples, or the beginning of another systemic market failure that could spill over into the real economy. But one thing is clear: In the coming months, we should all keep an eye open for similar cases.

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Christian Eufinger

Professor in the Financial Management Department at IESE Business School, and co-director of the Center for International Finance (CIF).

Yuki Sakasai

Senior Research Associate at IESE Business School, and a member of the Center for International Finance (CIF).

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