

# PRIVATE LENDING: UNFOLDING LITIGATION DEVELOPMENTS AND MANAGING RISKS

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## US Litigation and Dispute Resolution Alert

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With increased uncertainty in the US economy around tariffs and other federal policies, the historically high levels of commercial and government debt in the United States and other major economies, and continued volatility in the US and global stock markets, financial institutions, private capital providers and asset management firms are currently facing a significant stress test. Reports in the financial press reflect a wave of investor withdrawals hitting major funds simultaneously, firms publicly announcing mark downs in the valuation of certain loans, and traditional banking institutions announcing restrictions on lending to private capital funds. At the same time, seemingly to protect capital and liquidity levels, various firms are capping redemptions to maintain adherence to pre-established limits. PIMCO has warned the sector may be entering a “reckoning” following years of ostensible aggressive lending and weaker underwriting standards. See Finbarr Flynn and Harry Suhartono, Pimco Sees Crisis of 'Bad Underwriting' in Private Credit, Bloomberg (11 March 2026). This possible dislocation will tend to ripple through the lending ecosystem, forcing traditional banks “to re-evaluate the commitments they have made to those funds.” Telis Demos, Why Bank Stocks Are Getting Beaten Up Over Private Credit, Wall Street Journal (13 March 2026). The convergence of these risks creates a particularly challenging environment, as legal probes may trigger parallel enforcement actions, lender and investor litigation, and bankruptcy proceedings.

Despite apparent declines in criminal and civil regulatory enforcement in financial markets, financial firms should expect continued focus on fraud, misleading statements, and improper valuation practices, particularly as private markets become more accessible to retail investors. In November 2025, US Attorney for the Southern District of New York (SDNY) and former Securities and Exchange Commission (SEC) Chair Jay Clayton signaled a renewed enforcement focus on valuation practices, especially as to whether private fund advisors “cherry-pick prices” that benefit themselves through higher fees at the expense of fund investors. Mr. Clayton specifically flagged inter-fund transfers—where assets with no observable market trading are moved from one affiliated vehicle to another—as a high-risk area for manipulation. This renewed emphasis is reflected in the SEC Division of Examinations' 2026 priorities, which listed among its “developing areas of interest” registered investment companies that use complex strategies or hold significant illiquid investments, including any associated issues regarding valuation and conflicts of interest.

The entry of retail participants into private capital markets cannot be overlooked. Retail participation has broadened portfolio diversification opportunities and flattened access to asset classes historically reserved for institutional investors. The proliferation of retail-oriented vehicles, however, has introduced an investor segment with materially different risk tolerances, time horizons, and disclosure expectations than traditional counterparts. Such a shift brings heightened litigation exposure with respect to expectations on investment returns, suitability, and fiduciary duties.

With private lending markets coming under scrutiny, we set forth below an overview of significant developments in the area, highlight potential risks from past financial crises, and offer proactive measures to manage any inquiries by government authorities.

## THE CONTINUING FINANCIAL CRIMES ENTERPRISE STATUTE

On 16 December 2025 the US Attorney's Office for the SDNY announced the unsealing of an indictment charging the founder and former CEO of Tricolor Holdings LLC with orchestrating a years-long financial crimes enterprise that defrauded multiple banks and other private credit providers. Tricolor's former CEO and COO also were charged with bank fraud and wire fraud offenses in connection with schemes to fraudulently double-pledge collateral to multiple lenders and manipulate the characteristics of collateral to make assets with questionable value appear to meet lender requirements. Unable to maintain its access to loans, and unable to sustain its business without substantial cash, Tricolor filed for Chapter 7 bankruptcy on 10 September 2025. In related proceedings, prosecutors unsealed the guilty pleas of Tricolor's former CFO and a former finance executive at Tricolor in connection with their participation in the conspiracy, both of whom pleaded guilty to fraud charges in December 2025.

Six weeks later, on 29 January 2026, the SDNY unsealed an indictment against the founder and former chief executive officer of First Brands Group and his brother for an alleged multi-year, multibillion dollar fraud scheme. The brothers are alleged to have falsified invoices and pledged the same collateral multiple times to lenders, causing the automotive supplier to collapse into bankruptcy with over US\$9 billion in debt.

Both sets of indictments are the first major federal prosecutions in nearly thirty years that clearly apply Section 225 of Title 18, the Continuing Financial Criminal Enterprise (CFCE) statute, to a large-scale financial fraud enterprise. The statute was created by the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act (Pub. Law 101 647) on 19 November 1990 and was enacted in response to the savings and loan crisis of the 1980s.

The statute allows prosecution of individuals who organize or supervise a continuing financial crimes enterprise that involves four or more people and generates US\$5 million or more within a 24-month period, with penalties of ten years to life imprisonment plus heavy fines. Designed to mirror the Continuing Criminal Enterprise statute (18 U.S.C. § 848), Section 225 specifically addresses white-collar enterprise-level financial crimes and is aimed at strengthening criminal enforcement against large-scale financial fraud. It targets individuals who organize, supervise, or manage a coordinated set of financial fraud offenses such as bank fraud, mail and wire fraud, false statements, and embezzlement.

There is an implied cautionary message in the renewed use of the CFCE. Criminal exposure might attach not only to executives and other senior officials who personally execute transactions, but to those who direct or approve those business activities.

## FAIR VALUE MEASUREMENT

In a notable 2026 civil enforcement action, the SEC settled claims against a formerly registered investment adviser and private fund manager, concerning the sufficiency of its fair valuation procedures for principal sales of loans to its private fund clients. See *In re Madison Capital Funding LLC, Advisers Act Release No. 6948* (28

February 2026). The loan sales at issue occurred during a narrow window—March through May 2020—when, despite extreme market dislocation at the start of the COVID-19 pandemic, the adviser continued to sell performing loans it had originated before the disruption at par value less the unamortized loan fee, without further assessing whether the market disruption had affected the loans' fair market value. Mitigating factors noted in the order included that all but one of the loans either continued to perform or were fully repaid by borrowers, and that in May 2021, in response to an examination deficiency letter, the adviser voluntarily reimbursed the funds over US\$5 million and enhanced its disclosures and policies. Without admitting or denying the allegations, the adviser agreed to settle negligence-based violations of the Investment Advisers Act and pay a US\$900,000 penalty.

This SEC case tracks the approach of prior enforcement actions by federal authorities in cases probing valuation methodologies. For example, in May 2018, a New-York based investment adviser agreed to pay more than US\$10 million to settle SEC charges that it falsely inflated the value of securities held by funds the company advised. See *In re Visium Asset Management LP*, Securities Act Release No. 10494 (8 May 2018). This caused the funds to overstate their net asset value (NAV) and the liquidity of the fund's holdings, which led to inflated fees to the adviser. In parallel proceedings, the portfolio managers were criminally charged with securities and wire fraud in connection with the scheme and related insider trading. They were convicted or pleaded guilty, and the adviser's CFO settled charges that he did not reasonably supervise the portfolio managers by appropriately responding to red flags of their mismarking.

Recent case filings by civil plaintiffs against private capital firms and their affiliates have adopted this theory of liability. See *Burnell v. BlackRock TCP Capital Corp.*, Case No. 2:26-cv-1102 (C.D. Cal.). Plaintiffs generally have alleged that private capital firms failed to disclose to investors that their investments were not being timely or appropriately valued; that their efforts at portfolio restructuring were not effectively resolving challenged credits or improving the quality of the portfolio; that resulting unrealized losses were understated; and that as a result the NAV was overstated.

The focus by federal authorities and private plaintiffs on valuation practices and methodologies brings into view the relevant standards for fair value measurement.

When a company places a dollar figure on an asset, auditors, regulators, and investors want to know how defensible is that number. Under Accounting Standards Codification Topic 820 (Fair Value Measurement), the Financial Accounting Standards Board devised a three-tier framework to answer precisely that question. The hierarchy classifies assets by the observability of the inputs used to determine their fair value, with each successive level demanding greater scrutiny, richer disclosure, and, often, more contentious judgment. The stakes are considerable. Misclassification, or manipulation of inputs within a level, can inflate balance sheets, distort earnings, and mislead creditors.

Level 1 assets carry the highest degree of reliability because their valuations rest on unadjusted quoted prices in active markets for identical assets or liabilities. When a portfolio manager checks the closing price of shares on a public exchange during trading hours, that figure is a Level 1 input. The valuation test is straight mark-to-market. It requires no modeling, no assumptions, and no professional judgment about what the asset might be worth. Typical assets in this category include exchange-listed equities, US Treasury securities, exchange-traded funds (ETFs), listed futures and options, and sovereign bonds trading in deep and liquid markets. Even at Level 1, nuance can surface. A fund holding a large block of stock may find that selling the entire position would move the market, yet ASC 820 explicitly prohibits applying a block discount to Level 1 instruments. Firms must also

determine whether a market is “active”—a judgment that proved highly contentious during the 2008 credit crisis, when trading volumes declined and bid-ask spreads widened materially. A market that appears liquid under normal conditions can rapidly lose that designation, forcing a reclassification to Level 2.

Level 2 encompasses assets which fair values cannot be read directly from a live exchange but are nonetheless grounded in observable market data. Valuations at this level are model-driven, yet the models are calibrated using inputs that other market participants can verify—such as yield curves, credit spreads, and foreign exchange rates. Level 2 assets generally include investment-grade corporate bonds and municipal securities trading over-the-counter, interest rate and currency swaps, non-exchange-traded equity securities for which comparable transaction prices exist, and certain mortgage-backed securities with sufficient market activity to observe spread data. Various complexities might arise about the correct price to be applied in any given circumstance, such as the mid-market price versus the exit price. ASC 820 prescribes exit price, but in thinly traded markets, the bid can diverge substantially from the mid price. Analysts must also navigate other factors, such as the selection of appropriate peer-group credit spreads and the treatment of instruments that sit on the border between Level 2 and Level 3. A minor deterioration in market liquidity can render a previously observable input unobservable.

Level 3 generally comprises illiquid and bespoke assets. Assets classified here cannot be valued by referencing observable market prices or spreads; their fair values are determined almost entirely by unobservable inputs the reporting entity itself generates. As a result, Level 3 valuations carry the greatest potential for error (and potential misconduct) and attract the most intense scrutiny from auditors, regulators, and investors. Common methodologies include the discounted cash flow analysis, the market approach using earnings multiples from comparable private transactions, and NAV methods for certain fund interests. For this category, typical assets include private equity and venture capital holdings, real estate held for investment, complex collateralized debt obligations, leveraged loans for which no secondary market exists, intangible assets acquired in business combinations, and certain derivative instruments with long-dated maturities.

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Input Type</b>	Quoted market prices in active markets	Observable inputs other than quoted prices	Unobservable, entity-developed inputs
<b>Typical Assets</b>	Exchange-traded equities, US Treasuries, exchange-traded funds	Corporate bonds, OTC derivatives, non-exchange-traded equities	Private equity, complex structured products, real estate, illiquid loans
<b>Valuation Method</b>	Mark-to-market (direct price)	Mark-to-model with market-corroborated inputs	Mark-to-model with proprietary assumptions
<b>Key Complexity</b>	Minimal—price is directly observable	Bid-ask spreads, interpolation of yield curves	Subjectivity in discount rates, exit assumptions, illiquidity premiums
<b>Disclosure</b>	Low	Moderate	High—full roll-forward

	Level 1	Level 2	Level 3
<b>Burden</b>			required

## LIQUIDITY AND CONCENTRATION RISKS

Additional risks bearing on financial condition that have materialized in past financial crises include liquidity risk and concentration risk.

Liquidity risk generally is defined as the risk of incurring losses resulting from the inability to meet payment obligations in a timely manner when they become due or from being unable to do so at a sustainable cost. The *Lehman Brothers Securities and ERISA Litigation* involved a set of consolidated civil actions following Lehman Brothers' filing for bankruptcy protection in September 2008. There, a putative class of bond and equity purchasers alleged that the statements that Lehman's liquidity pool was sufficient to meet its expected needs over the next twelve months and that its liquidity position was "strong" were misleading statements. But the district court held that those statements were non-actionable statements of opinion, for which there were insufficient facts alleged that the Lehman executives did not truly believe them when made. The statement about liquidity were based on models and assumptions, some of which were disclosed in Lehman's various securities offering materials, about what would happen in the future.

A different result was reached in *In re MF Global Holdings Limited Securities Litigation*, which involved a commodities futures broker that failed in October 2011. In that case, the operative complaint alleged misstatements about MF Global's capital and liquidity management based on representations by the company and its officers about its "strong" liquidity position. The district court ruled such statements were actionable under the federal securities laws, in light of allegations that MF Global faced substantial strain on its capital and liquidity and met its regulatory requirements only through "daily intra-company transfers" and collapsed when "RTM [repurchase-to-maturity] counterparties demanded additional margins."

A risk concentration is any exposure with the potential to produce losses large enough (relative to a bank's capital, total assets, or overall risk level) to threaten a bank's health or ability to maintain its core operations. The early 2008 financial crisis case *SEC v. Mozilo* examined the characterization of concentration risk exposures. There, the SEC alleged that three senior Countrywide executives made a series of misleading statements aimed at reassuring investors that the company was mainly an originator of prime quality mortgages, qualitatively different from competitors who engaged in less sound lending practices. As one of its core holdings, the district court concluded that the SEC had adequately pleaded that Countrywide's description of its loan categories "prime non-conforming" and "subprime" constituted misleading statements. The court observed that "[b]ecause the banking industry and regulators viewed 660 or 620 as the dividing line between prime and subprime loans, by using the word 'prime,' Countrywide affirmatively created the impression that it used the same dividing line, and only included loans with a credit score of 660 or above, or at the very least, 620 or above, within that category."

In another 2008 financial crisis case, *In re Citigroup Inc. Securities Litigation*, class plaintiffs alleged that Citigroup and its executives misled investors about, among other things, the bank's collateralized debt obligation (CDO) exposure. In particular, the plaintiffs had alleged that Citigroup's November 2007 disclosure that it held US\$43

billion of super senior CDO tranches and expected a writedown of US\$8 to \$11 billion was materially misleading. The district sustained the falsity of those allegations because Citigroup allegedly had omitted from its disclosure the existence of US\$10.5 billion in hedged CDOs (and thus US\$43 billion was not the full extent of exposure) and the announced writedown was inadequate because it overstated the value of the CDO positions.

## PROTECTIVE MEASURES

With the uncertain market conditions, it is difficult to predict whether more severe storm clouds are approaching or these are simply squalls as the market self-corrects. For lending businesses, credit counterparties, and their internal counsel, there are a number of meaningful practical steps that can be applied to avoid missteps in the future. Companies can create an internal working group with legal counsel to ensure issues are identified and privileged communications are protected as necessary. Companies can work to ensure that external statements and representations (regarding valuation, risk, diligence, and other items) are consistent with internal statements and established practices. As appropriate, marks can be reviewed so that they are uniform within the enterprise and reflect market conditions. Compliance officials can discuss best practices with respect to communication, documentation, and technology. Finally, senior officials can stress the important of collective decision making to ensure all efforts are taken in good faith and on the basis of professional guidance.

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