

Clients & Friends Alert

Colorblind?: Investors Allege Tricolor’s Lenders and Underwriters Ignored Persistent Red Flags

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The historic collapse of the now-bankrupt subprime auto dealer and auto finance company Tricolor Holdings LLC and its affiliates (“**Tricolor**”) has been unfolding since September 2025, after public reporting that Tricolor’s lenders had discovered allegedly fraudulent activity related to Tricolor’s collateralization practices. In the wake of Tricolor’s initial bankruptcy filing, we previously offered suggestions for enhanced practices and controls that industry participants should consider implementing in an effort to mitigate the risks inherent in third-party finance transactions, emphasizing four key areas to focus on: (i) deploying enhanced due diligence; (ii) updating credit agreement provisions related to pledged assets; (iii) revisiting who maintains custody of pledged assets and ensuring better control over cash flows; and (iv) evaluating the treatment of structured finance transactions under the UCC and in bankruptcy. ([Seeing Red Flags in Tricolor: A Colorful Lesson on Collateral Interests.](#)) Subsequently, in January 2026, after the unsealing of a federal indictment against former executives of Tricolor asserting a seven-year, nearly billion-dollar scheme to defraud lenders and investors, we detailed the government’s allegations and purported evidence in bringing federal bank fraud, wire fraud, conspiracy, and related charges against Tricolor’s former CEO, CFO, COO and a senior finance executive. ([Money For Nothing: Indictment Details Tricolor Executives’ Alleged Fraudulent Scheme in Black and White.](#)) Now, following the latest development in the Tricolor saga, we address the recently filed civil complaint (the “**Complaint**”) brought by a collection of investors against several of the banks who lent to Tricolor and underwrote its securitizations, which asserts claims for federal and state securities fraud, common law fraud, and fraudulent transfers.

Tricolor’s Business and Securitization Practices

Founded in 2007, Tricolor is a “buy here-pay here” subprime auto finance company, meaning it is both an auto dealer and an auto finance company, offering in-house, on-the-spot financing directly to its customers. Tricolor’s operations were funded by cash advances from lines of credit that were collateralized either by Tricolor’s inventory of used cars intended for sale or by the future receivables Tricolor was due under its auto finance loans, as well as through securitizing its car loan receivables into classes of bonds that were then sold to investors, including the current plaintiffs in the civil action (the “**Plaintiffs**”).

To facilitate its securitizations—which are the major focus of the subject litigation—Tricolor established a series of “warehouse” lending facilities,¹ two of which were funded by three of the six defendants in the civil action (the “**Lender Defendants**”). Once Tricolor had originated a sufficient volume of auto loans out of the funds borrowed from warehouse facilities, it would pool the auto loans together and offload them into the securitization market. As alleged in the Complaint, in substance Tricolor’s securitization process involved the following: (1) Tricolor set up special-purpose vehicles (“**Warehouse SPVs**”) that used funds borrowed from the warehouse lending facilities to purchase auto loans originated by Tricolor at its dealerships; (2) Tricolor established “Trust” entities that raised funds through the sale of various tranches of securities (“**Notes**”) to investors; (3) the Trusts used the funds raised from selling Notes to investors to purchase auto loan receivables from the Warehouse SPVs, which then served as collateral for the Notes; (4) borrower payments on the underlying auto loans would be distributed as cash flow to investors as Noteholders; and (5) the Warehouse SPVs used the proceeds generated from selling the auto loan receivables to pay down the amounts borrowed under the warehouse lending facilities, thus allowing them to purchase more Tricolor-originated loans to be subsequently securitized. The other three defendants in the civil action (the “**Underwriter Defendants**,” and together with the Lender Defendants, the “**Defendants**”)—each an affiliate of one of the Lender Defendants—acted as either a lead or co-lead underwriter for one or more of the securitizations at issue.

The Alleged Fraudulent Scheme

The Complaint alleges that at the direction and with the knowledge of Tricolor’s senior executives, Tricolor:

- “Double-pledged” the same loans or inventory as collateral to multiple lenders or securitizations at once;
- Manipulated loan data in documentation it provided to lenders and underwriters to make loans falsely appear to meet eligibility criteria to be pledged as collateral in the financing arrangements;
- Pledged fictitious loans (made to fictitious borrowers and backed by fictitious cars) to various warehouse lenders and securitizations; and
- Pledged inventory that it no longer owned.

¹ “Warehouse” lending facilities are short-term revolving credit facilities extended to loan originators so that they can finance the loans they make during the interim period between origination and the securitization and sale of interests in such loans to investors in the secondary markets.

The Complaint also alleges that, through these various schemes, Tricolor fraudulently secured an additional \$800 million in loans from its lenders and between 2022 and 2025 sold more than \$2 billion in asset-backed securities to investors. Further, to disguise the existence of these schemes, Tricolor allegedly created and disseminated falsified backup records to mislead auditors.

Beginning in August 2025, after being alerted to lender concerns regarding audit delays and data discrepancies, Tricolor executives allegedly discussed—and implemented—ways to conceal the fraud and placate their lenders. When these efforts proved unsuccessful, Tricolor’s lenders terminated funding on the various warehouse loan facilities. As it became clear that Tricolor would therefore be unable to sustain its operations, Tricolor was forced to declare bankruptcy in early September 2025. As a result of Tricolor’s bankruptcy filing, the Plaintiffs claim that the Tricolor securities they hold—which had been trading at or over 100% of their face value prior to the bankruptcy—now trade at less than 10% of their face value, and that the securitization Trusts have not made any payments to the Noteholders since Tricolor declared bankruptcy.

The Investors’ Claims

The Plaintiffs’ claims focus on seven securitizations of Tricolor-originated auto loans Tricolor sponsored between April 2022 and June 2025 pursuant to which Tricolor raised approximately \$1.8 billion from investors. As alleged in the Complaint, these securitizations occurred after one or both of two audits of Tricolor’s operations and financial reporting practices that were conducted in 2022 and 2024, respectively. Audit reports were allegedly available to Defendants and raised significant concerns about the accuracy of Tricolor’s loan reporting and the adequacy of its internal controls, to which the Defendants allegedly turned a willfully blind eye. In particular, Plaintiffs allege that the 2022 audit identified that Tricolor lacked the internal controls or systems necessary to ensure the integrity of its loan data tape, including internal control weaknesses related to collateral, servicing, and collections, as well as insufficient inventory controls. Tricolor also allegedly obstructed the 2024 audit, causing delays and preventing the auditor from completing certain aspects of the audit process, including testing to identify any possible double pledging of loan collateral. Moreover, the auditing that was completed allegedly revealed that:

- Tricolor was deficient in properly reporting information regarding the aging of delinquent loan assets and in accurately reporting recoveries on charged-off loans;
- Tricolor was improperly listing excessively delinquent accounts as eligible collateral;
- A material portion of the customer loan repayments were posted to the bank accounts for the wrong loan facilities;

- For certain accounts, recorded loan repayments were unable to be reconciled with Tricolor's bank records;
- Reported collections on repossessed vehicles were based on index values, not actual recoveries; and
- On certain loan accounts Tricolor reported collections based on factors other than actual principal collections.

The Plaintiffs also contend that the Lender Defendants failed to heed a recommendation from Tricolor's auditor that they further investigate the issues raised by the 2024 audit.

The Plaintiffs additionally allege that the Defendants, in their roles as underwriters for the securitizations or administrative agents for the warehouse lending facilities, possessed access to non-public information about Tricolor's operations that was not available to investors. In particular, Plaintiffs allege that the Lender Defendants received a continuous stream of detailed data from Tricolor regarding the loans that Tricolor originated and ultimately securitized through "borrowing base reports" provided multiple times per month as well as each time that Tricolor wanted to draw upon additional warehouse credit funding, and also received monthly servicer reports summarizing the collateral Tricolor had transferred to the Warehouse SPVs.² As alleged in the Complaint, Tricolor was also obligated to provide the Lender Defendants with various data analytics, including analysis regarding the delinquencies and losses suffered on their respective loan pools. Similarly, the Complaint alleges that the Underwriter Defendants received substantial loan level data and analysis concerning the performance and characteristics of Tricolor's loan pools, as well as Tricolor's loan origination and underwriting practices. According to the allegations in the Complaint, a diligent review of this information would have revealed Tricolor's double pledging of assets, pledging of fictitious assets, and misrepresentations regarding the delinquency status—and thus ineligibility—of the pledged assets.

The Plaintiffs further allege that the Defendants were willing to overlook and did not further investigate these concerns, and continued lending to Tricolor and underwriting its securitizations, for two primary reasons. First, the Plaintiffs contend that the Defendants were unwilling to forfeit the allegedly substantial fees, interest income, and other revenue generated through their relationship with Tricolor. Second, according to the Plaintiffs, if Tricolor were unable to monetize its loan assets through securitization, it would have jeopardized the Lender Defendants' ability to recover the hundreds of

² The data allegedly provided in these reports included loan-level information such as account numbers, outstanding principal balance, vehicle identification numbers associated with each loan, payment activity, loan balance, and delinquency status.

millions of dollars in loans they had extended to Tricolor through the warehouse credit facilities, which were repaid from the proceeds of the securitizations underwritten by the Underwriter Defendants.

Claims against Underwriter Defendants

Against this backdrop, the crux of the fraud claims asserted against the Underwriter Defendants is that the offering memoranda they allegedly prepared and circulated in connection with each of the securitizations at issue, which were also not updated in response to the findings made by the 2024 audit, contained allegedly knowing or reckless material misrepresentations and omissions, based on what the Underwriter Defendants knew or should have known as a result of the concerns raised by the 2022 and 2024 audits of Tricolor's operations and financial reporting practices. Among the alleged misrepresentations and/or omissions asserted by the Plaintiffs are:

- The Underwriter Defendants misrepresented that they were sufficiently knowledgeable about Tricolor, its receivables, collateral, and the securitizations;
- The Underwriter Defendants failed to disclose the concerns raised by the 2022 and 2024 audits about the accuracy of Tricolor's loan delinquency, performance, and loss information as reported on the loan tapes and in the offering memoranda;
- The Underwriter Defendants failed to disclose that statistical information contained in the offering memoranda regarding the attributes of the loan receivables pledged as collateral was compromised as a result of the concerns raised by the 2022 and 2024 audits;
- The offering memoranda misrepresented that the Notes were supported by overcollateralization and excess spread because the reported principal balance and anticipated cash flow generated by the receivables for the collateralized assets were false, misleading, and could not be relied upon; and
- The offering memoranda misrepresented the experience and track record of Tricolor's management team.

The Plaintiffs further assert that they relied on the integrity of the statements made by the Underwriter Defendants in the offering memoranda and would not have purchased their Notes at the prices they did, if at all, if the Underwriter Defendants had disclosed what they allegedly knew about the deficiencies in Tricolor's processes and controls, and the concerns about the accuracy of its loan data.

In connection with these claims against the Underwriter Defendants, the Plaintiffs seek rescission of their Notes purchase agreements and money damages, including return of the consideration paid for

the Notes (or in the limited case of one Plaintiff that had subsequently sold a portion of its Notes at a loss, the value of the consideration paid for the Notes less the value of the Notes when sold), as well as costs and expenses, including attorneys' fees.

Claims against Lender Defendants

The Plaintiffs have asserted claims against the Lender Defendants for actual and constructive fraudulent transfer. In particular, Plaintiffs assert that the transfers of investor funds from the Trusts to the Warehouse SPVs in exchange for the pledged collateral were actually fraudulent because, as an essential part of the allegedly fraudulent scheme perpetrated by Tricolor, these transfers were made with the actual intent to defraud them as creditors. Plaintiffs further assert these transfers were also constructively fraudulent because, as a result of Tricolor's alleged misconduct, the Trusts did not receive reasonably equivalent value, and were left insolvent or with unreasonably small capital because the unimpaired portion of the loan portfolios cannot generate the cash flows necessary to meet the Trusts' obligations.³ Moreover, as alleged in the Complaint, because the funds transferred to the Warehouse SPVs were then used to pay down the warehouse lending facilities, the Lender Defendants are subsequent transferees. And because the Lender Defendants had knowledge of, or were reckless with respect to, Tricolor's fraudulent scheme, they did not receive the allegedly fraudulent transfers in good faith.

In connection with these claims against the Lender Defendants, the Plaintiffs seek to recover the value of the allegedly fraudulent transfers, as well as costs and expenses, including attorneys' fees.

Conclusion

As the case proceeds and additional details emerge, we will continue to monitor the matter and provide further analysis as appropriate on material developments.

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³ According to the Complaint, a forensic analysis conducted by the Trustee in the bankruptcy action revealed that the auto loan receivables that the Warehouse SPVs sold to the Trusts included 31,408 double-pledged loans representing \$547,928,874 in falsely reported value, and 6,960 entirely fictitious loans representing \$135,488,888 of non-existent value. Together, these fraudulent loans represent approximately \$683 million in overstated collateral—roughly 31% of the asserted \$2.2 billion in auto loan receivables that the Trusts should have received in exchange for its funds transfers to the Warehouse SPVs.

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Cheryl Barnes	+1 (202) 862-2340	cheryl.barnes@cwt.com
Kathryn Borgeson	+1 (202) 862-2384	kathryn.borgeson@cwt.com
Gina Castellano	+1 (212) 504-6234	gina.castellano@cwt.com
Sophie Cuthbertson	+1 (202) 862-2341	sophie.cuthbertson@cwt.com
Christopher Dickson	+1 (704) 348-5159	christopher.dickson@cwt.com
Michael Gambro	+1 (212) 504-6825	michael.gambro@cwt.com
Stuart Goldstein	+1 (704) 348-5258	stuart.goldstein@cwt.com
Christopher Horn	+1 (212) 504-6961	chris.horn@cwt.com
Christopher McDermott	+1 (704) 348-5184	chris.mcdermott@cwt.com
Douglas Mintz	+1 (202) 862-2420	douglas.mintz@cwt.com
Andrea Nixon	+1 (212) 504-6223	andrea.nixon@cwt.com
Casey Servais	+1 (212) 504-6193	casey.servais@cwt.com
Jared Stanisci	+1 (212) 504-6075	jared.stanisci@cwt.com
Mercedes Tunstall	+1 (202) 862-2266	mercedes.tunstall@cwt.com
Hunter White	+1 (202) 862-2269	hunter.white@cwt.com
Thomas Curtin	+1 (212) 504-6063	thomas.curtin@cwt.com
James McDonnell	+1 (212) 504-5590	james.mcdonnell@cwt.com
Andrew Thompson	+1 (212) 993-3165	andrew.thompson@cwt.com