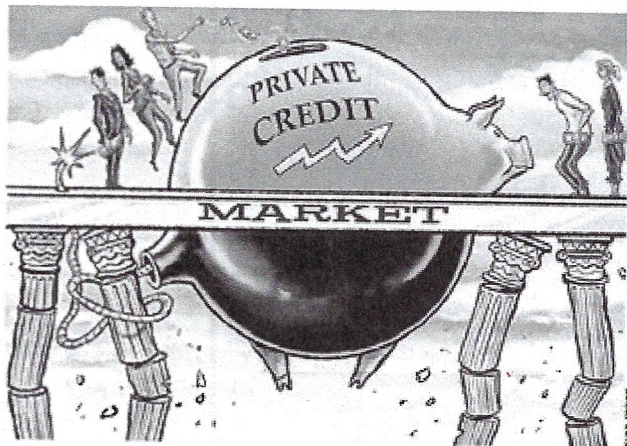


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Lenders quietly rewrite their collateral rules, which suggests a crisis waiting to happen.



CHAD CROWE

A Private-Credit Winter Is Coming

By Dan Wertman

Wall Street insists credit quality remains strong. At first glance, the numbers back it up: Deal value rose more than 200% in the third quarter, major banks beat earnings expectations, and credit spreads remain tight. Yet beneath the surface, a quiet but dramatic shift is taking place inside credit deals that suggests creditors are bracing for distress, not recovery.

Two recent bankruptcies, TriColor Holdings and First Brands Group, have exposed alleged collateral fraud across multiple major institutions. But they're a symptom of a broader problem: of a deep private credit system with the potential to unravel faster than anyone can track. Note

First the facts. First Brands Group, an automotive parts manufacturer, collapsed on Sept. 28 with more than \$10 billion in liabilities. Raistone, a trade finance creditor, alleges that \$2.3 billion in collateral effectively vanished. Swiss bank UBS faces more than \$500 million in exposure; Jefferies disclosed \$715 million in receivables exposure and has publicly stated it believes it was defrauded.

Weeks earlier TriColor Holdings, a subprime auto lender and used-car retailer, filed for Chapter 7 liquidation. Court filings show liabilities between \$1 billion and \$10 billion. JPMorgan reportedly wrote off \$170 million, and Fifth Third Bank disclosed \$200 million in potential losses. Both were tied to alleged double-pledging of auto-loan portfolios across multiple warehouse credit lines.

In each case, sophisticated creditors armed with advanced systems and compliance frameworks were blindsided by opaque privately structured financing arrangements. And not from obscure fintechs or speculative lenders. They involved JPMorgan, Fifth Third, UBS and Jefferies—all banks with the deepest benches in credit structuring and compliance. But the structures involved were nontraditional loans built within the sprawling \$1.7 trillion private credit ecosystem: trade finance funds, supply-chain financing vehicles, and warehouse lines linked to securitizations. Note

The increasing opacity of these financing structures has led to a corollary collapse in collateral verification. The result is a game of musical chairs in which lenders discover (often much too late) that the same assets were promised to multiple creditors.

Herein lies the real story, and it isn't about fraud allegations: Private credit has grown so fast that verification and audit frameworks haven't kept up, leading to structural weaknesses across modern credit markets. Lenders are discovering that their control mechanisms, designed for more-transparent syndicated markets, don't function in opaque financing ecosystems.

There's no better leading indicator of market psychology than real-time covenant changes, which show where the smart money is quietly hedging. Right now, the smart money is fortifying against a downturn.

Since 2023, lenders have started to close off liability management loopholes that made pandemic-era financing so risky. Terms like "J. Crew blockers" and "anti-PetSmart," which prevent issuers from shifting valuable assets beyond creditors' reach, have become more prevalent in recent years.

But in the last quarter, something changed. Lenders shifted their focus from simply closing liability-management escape routes to securing high levels of lien-subordination protection—the term that governs who gets paid first when everything falls apart.

Terms requiring unanimous lender consent before any lien subordination jumped 23 percentage points in the third quarter and now appear in 84% of all credit deals. That's one of the sharpest quarterly increases ever recorded for a protective covenant.

The market signal is that lenders are no longer only trying to prevent borrowers from exploiting loopholes to stay out of bankruptcy; they're actively preparing for what happens when bankruptcy is inevitable. That's why lien protections are surging. When sophisticated creditors start demanding unanimous consent on subordination, it's a signal that confidence in collateral integrity is faltering.

The temptation in every credit cycle is to dismiss protective trends as overreaction. But these shifts often precede major market repricing. In 2007, loan documents loosened months before defaults surged. In 2020, pandemic-era covenant suspensions created the conditions for distressed companies to scrutinize their loan documents, uncovering the "liability management loopholes" that have defined the years that followed. Artificial intelligence can help the market better quantify precise spikes than was ever possible in prior cycles—and it's showing us these anxieties are spiking now.

Executives who want to stay ahead of the next phase of the credit cycle should take three lessons from this moment. First, don't confuse deal volume with market health. Rising issuance can mask deteriorating standards. The same institutions driving new credit deals are often the ones quietly inserting stronger protections behind the scenes.

Second, re-evaluate collateral verification frameworks. The Tri Color and First Brands cases prove that data integrity is the Achilles' heel of modern lending. If lenders don't have a unified view of pledged assets across structures, risk models are blind by design.

Third, treat term trends as early-warning signals. Term-level shifts in credit deals are a leading indicator of fear, often surfacing before defaults appear in public data. Leaders who monitor these changes proactively can anticipate risk rather than react to it.

Wall Street's public narrative is that the economy is resilient, inflation is cooling, and consumer credit remains stable. That may all be true on the surface. But the legal architecture of the credit markets tells a different story. When lenders quietly rewrite the rules of engagement, or demand all-for-one consent before lien subordination, it signals a system steeling itself for impact.

We may not yet see distress in earnings reports, but the foundations of credit protection are shifting fast. When that happens, it's never an accident. It's the market whispering what headlines haven't caught up to: The next phase of this credit cycle may have already begun.

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