

WSJ Print Edition

Did a political blessing from the feds encourage a lack of due diligence?

Tricolor and Treasury's Seal of Approval

Subprime auto lender Tricolor Holdings' bankruptcy is hitting big banks and asset managers. JPMorgan Chase on Tuesday reported a \$170 million charge. One question: Did the federal government's seal of approval for Tricolor cause investors to ignore hazard lights?

Tricolor caught creditors off guard when it filed for Chapter 7 bankruptcy last month. The Justice Department is reportedly investigating the lender for doublepledging collateral. But lapses in due diligence may also be to blame.

JPMorgan CEO Jamie Dimon admitted Tuesday that Tricolor was "not our finest moment." He also warned the failure could portend more problems lurking in credit markets. "When you see one cockroach, there are probably more," Mr. Dimon said. "Everyone should be forewarned on this one." Sage advice.

In hindsight some of Tricolor's problems appear obvious. A Tricolor bond offering this year showed that more than two-thirds of its borrowers lacked a credit score. For those with credit scores, the average was 614. More than half also didn't have a driver's license. Barron's reported in 2022 on other problems.

For example, Texas regulators had cited Tricolor more than 130 times between 2019 and 2022, including for selling cars for which it didn't hold title. The dealer also sold cars at prices on average 46% more than Kelley Blue Book's "fair purchase price" value. Many customers defaulted in short order, resulting in cars being repossessed, which Tricolor then resold.

Yet the Treasury Department in 2019 designated Tricolor as a Community Development Financial Institution (CDFI). Congress established the program in 1994 with the goal of expanding credit for minority and lower-income folks. The CDFI designation makes businesses eligible for special grants. It can also lower their borrowing costs. Banks can meet their Community Reinvestment Act obligations to invest in low-income communities by lending to CDFIs. Banks that don't meet their requirements under the law can face restrictions on their growth. So it's no surprise Tricolor leveraged the CDFI label to attract investors.

BlackRock cited Tricolor's CDFI designation in a 2022 press release for its \$90 million investment. Tricolor is "a fintech company with a majority-diverse employee base that leverages proprietary AI-powered technology to sell and provide financing for high-quality, affordable used vehicles to underserved Latinx customer," a BlackRock press release said.

Much of Tricolor's marketing was hype, but investors didn't notice or care. Tricolor borrowed billions of dollars from banks to make loans to customers, which were then packaged and sold as part of asset-backed securities to investors such as Pacific Investment Management Co. and AllianceBernstein.

Tricolor said last year that a bond offering "was oversubscribed by nearly 6.5 times." The Treasury imprimatur and financing by sophisticated institutions may have given investors a false sense of security and caused them to relax underwriting standards. An eternal lesson relearned the hard way.

As for Washington, Tricolor illustrates how the CDFI program can contribute to reckless investing. The Trump Administration's efforts to shrink the program have run into opposition in Congress from both parties. How many more CDFI program loan losses are waiting to be discovered?

The following is a digital replica of content from the print newspaper and is intended for the personal use of our members. For commercial reproduction or distribution of Dow Jones printed content, contact: Dow Jones Reprints & Licensing at (800) 843-0008 or visit [djreprints.com](#).

For personal, non-commercial
use only.