STRUCTURED FINANCE ASSOCIATION

SFA Research Corner

Trust but Verify: Lessons from Tricolor

September 18, 2025

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The sudden collapse of Tricolor Holdings — once hailed as a mission-driven lender and CDFI-certified issuer serving Hispanic and underserved borrowers — has left up to $10 billion in liabilities and sparked fraud investigations into allegations of double-pledged collateral and corrupted financials. For many in auto finance, the shock lies not only in the scale of the downfall, but in how little the credit performance data signaled it was coming.

It is important to stress that securitization itself was not the culprit, nor is Tricolor's downfall a canary in the coal mine for subprime auto lending. Properly structured, ABS is an efficient and proven tool for raising capital, providing liquidity, and diversifying funding sources. In Tricolor's case, the structures performed as designed: senior notes were building credit enhancement and recent deals were progressing normally. As Kayvan Darouian from Deutsche Bank Research observed, "When other subprime auto ABS sponsors shut down in recent years, the writing was on the wall well ahead of the bankruptcy filing… This was not the case with Tricolor, as collateral performance for the outstanding deals was generally solid." The machine worked; the inputs did not.

Markets quickly adjusted to the news. According to the Financial Times, "A slice of debt issued in June, which was given a triple A rating by KBRA, is trading at a distressed level of 78 cents on the dollar, down from par just last month. A more lowly rated tranche in the same debt issuance is trading as low as 12 cents on the dollar after trading above par in July." This rapid repricing underscored a broader issue: performance data alone cannot insulate investors if fraud is present.

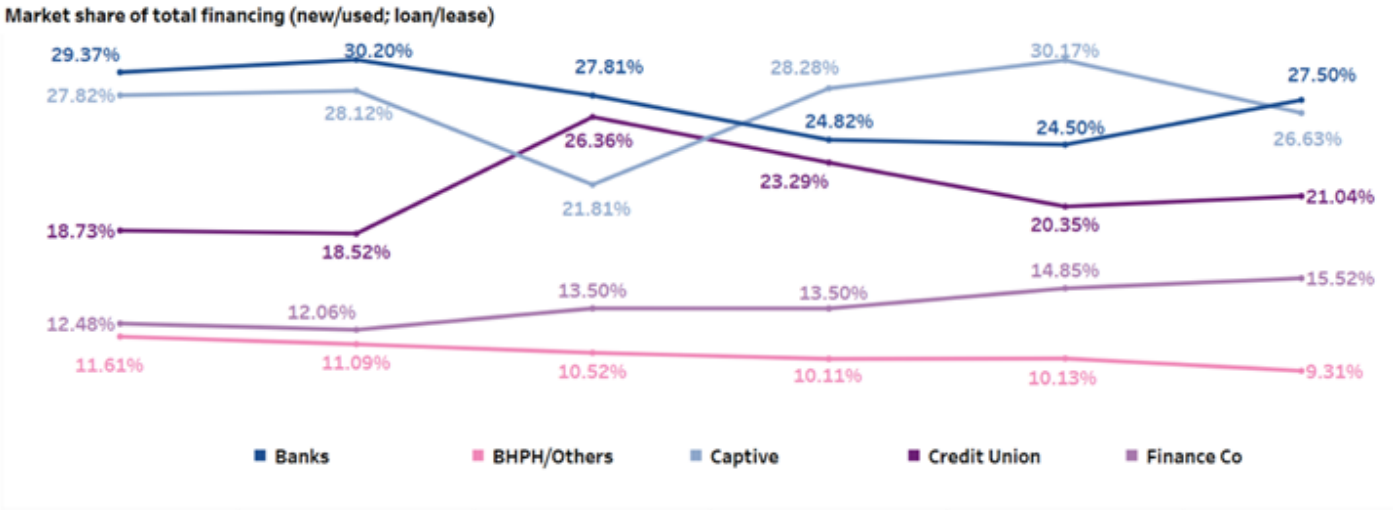
That is the deeper lesson: fraud can bypass traditional safeguards. As Will Black put it in his LinkedIn Newsletter Consumer Credit Matters, "Fraud is not the same as poor credit performance. You cannot underwrite against it." When inputs themselves are corrupted, servicer reports, trustee oversight, or backup servicing cannot provide meaningful defense.

Lessons Learned

The collapse of Tricolor highlights challenges long observed in Buy Here, Pay Here (BHPH) lending, where dealers both sell and finance vehicles. BHPH loans remain the smallest segment of the auto finance market — about 9% of auto originations as of Q2 2025, according to Experian — but they expand access to credit and allow dealers to manage customer relationships directly. The same integration, however, concentrates control of collateral, collections, and reporting in one place.

Tricolor intensified this risk by also acting as primary servicer, keeping billing, collections, and recordkeeping entirely in-house. This structure left warehouse lenders and ABS investors heavily reliant on Tricolor for both sourcing and monitoring data. While many BHPH operators responsibly serve underserved markets and provide vital access to credit, the Tricolor case underscores how vulnerabilities in the model can surface. Going forward, addressing these weak points will be critical in sustaining confidence in the market.

Market Share of Total Financing (New/Used; Loan/Lease)



Source: Experian, Sate of the Automotive Finance Market Q2 2025

The Oversight Gap

Regulation of BHPH lenders is fragmented. At the federal level, the FTC oversees all auto dealers on advertising, disclosures, and unfair or deceptive practices. States add another layer through licensing requirements, rate caps, repossession laws, and attorney general enforcement. Currently the CFPB, in its mission to protect consumers, supervises only the largest lenders under its Larger Participant Rule — currently those with 10,000 or more contracts annually — while still retaining authority to enforce consumer protection laws against smaller firms. This patchwork provides a foundation, but it also highlights where complementary measures — such as stronger verification tools and industry-led best practices — can reinforce trust and resilience in the system.

That context makes the CFPB's current review significant. In an advance notice of proposed rulemaking published in the Federal Register on Aug. 8, 2025, the Bureau stated that it is evaluating "increasing the threshold aggregate annual originations number" for auto lenders under the Larger Participant Rule. Scenarios under review would raise the threshold from the current 10,000 contracts annually to as high as 1.05 million. The Bureau noted that, depending on the final level, "the number of larger participants identified could be reduced by more than 90 percent, from approximately 63 entities to as few as five." The Bureau emphasized that even if a firm is not designated a larger participant, and thus not subject to examination, it would "remain subject to the Bureau's enforcement authority" under federal consumer financial laws.

If the threshold is raised, and fewer entities are examined, private stakeholders — warehouse lenders, investors, and rating agencies — will bear a greater burden for oversight. Placing oversight in the hands of those closest to the collateral and with the most at stake positions the market to develop tailored monitoring that can adapt more effectively to evolving risks.

The Way Forward

As Will Black noted, "Securitization is an elegant machine for transforming loan pools into capital-markets products." Yet even the most elegant machine cannot function when its inputs are fraudulent. Tricolor shows that the structures themselves worked — it may have been dishonesty at the source that broke the chain of trust.

One lesson is the vulnerability of the servicer-lender model, where the same institution originates loans, services them, and reports performance. This model has real efficiencies, but it also concentrates control in ways that heighten reliance on internal reporting. Rather than abandon it, the market can strengthen counterbalances.

The good news is that the toolkit already exists — including custodianship of files, UCC lien searches to prevent double pledging, lockbox structures that channel payments directly to custodial accounts, hybrid or backup servicing to reduce sole reliance on originators, and independent audits or Agreed-Upon Procedures (AUPs) that add external verification. While one measure is not sufficient on its own, together, and when applied consistently, they can provide meaningful layers of assurance.

The constructive path forward is to reinforce these safeguards, apply them more consistently, and encourage best-practice standards across the industry. By doing so, the market can restore confidence, better protect against blind spots, and show that securitization remains a resilient and indispensable tool for raising capital.