

WHITE PAPER

Systemic Resilience in Secured Finance

**THE 2026 SFNET BLUE RIBBON
FRAUD TASK FORCE REPORT**



Systemic Resilience in Secured Finance: The 2026 SFNet Blue Ribbon Fraud Task Force Report

Prepared by: The Secured Finance Network (SFNet) Fraud Task Force

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Disclaimer: The non-public case studies included in this report have been anonymized and refer to instances where fraud may have been suspected or alleged, but not proven, and their inclusion herein should not be read as indicating the definitive presence of fraud or that they occurred at any current or past employer or client of any member of the task force. In addition, the below recommendations represent a collection of “best practices” relating to mitigation of potential frauds and not necessarily a guarantee that compliance will eliminate all instances of fraud.

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SFNet Overview

Founded in 1944, the Secured Finance Network is an international trade association connecting the interests of companies and professionals who deliver and enable secured financing to businesses. With more than 1,000 member organizations throughout the US, Europe, Canada and around the world, SFNet brings together the people, data, knowledge, tools, and insights that put capital to work.

Spanning seven major financing categories (asset-based lending, factoring, supply chain finance, equipment finance and leasing, leveraged lending, cash-flow lending, and asset-backed securitization), secured finance provides critical liquidity to businesses across industries and economic cycles.

The primary focus of this report is on the asset-based lending, factoring, and supply chain finance segments, which together represent nearly half the annual originations of this \$6.5T ecosystem.

Executive Summary

In late 2025, the Secured Finance Network (SFNet) convened a task force to provide guidance and resources to the industry following a series of actual or alleged fraud-market events in 2025. The Task Force’s objective was to assess the scope of actual or perceived fraud risk and develop actionable strategies to enhance portfolio resilience considering that assessment.

A comprehensive survey of SFNet member leadership revealed a divergence in perspective; while 45% of respondents perceive an increase in industry-wide fraud, 67% reported that fraud activity within their own portfolios has remained stable. This suggests that while fraud is a persistent challenge, most lenders are managing risk effectively, and the “contagion” effect is limited.

However, the findings indicate that the industry has an opportunity to address a growing control deficit. Over time, as technology and deal structures have evolved, monitoring practices have not kept pace. Modern fraud often leverages new tools or transactional complexity—such as Generative AI or special purpose vehicles (SPVs) to reduce the efficacy of historical controls.

This white paper synthesizes data from 29 member organizations and 26 real-world cases. It offers a road-map for lenders to modernize their verification mechanisms, ensuring they effectively address emerging threats without succumbing to alarmism. By learning from recent cases like First Brands, lenders can adapt their controls to “verify, then fund,” ensuring continued stability and growth.

I. The 2026 Mandate – Navigating a Changing Environment

The year 2025 served as a valuable learning opportunity for the secured finance ecosystem. The Task Force’s analysis suggests the industry is navigating a period of modernization.

Industry Perspectives: Perception vs. Reality

The Task Force surveyed 29 SFNet member organizations to gauge the market’s temperature. The results highlight that while there is heightened awareness of risk, most portfolios remain healthy.

- **Awareness is High:** Nearly half of respondents (44.83%) believe fraud is increasing globally, reflecting prudent attention to market headlines.
- **Portfolios are Stable:** A significant majority (66.67%) reported that fraud incidents in their own books have remained the same.

This data is encouraging. While a small minority of respondents (17%) reported an upward trend in fraud cases in their own portfolios, the reality is significantly less than the perception of elevated risk. Asset-based lenders and supply chain finance providers were more likely to report an increase, while community banks, factors, and small non-banks mostly indicated that fraud levels remained the same.

Moreover, over the past 3 decades, losses in the event of default in the subject asset classes have averaged less than 50 basis points annually, with fraud representing only a small fraction of these losses. This negligible experience suggests that the implementation of rigorous standards leads to a higher level of portfolio performance. The goal of this report is to share those practices with the broader market.

Despite the recent disclosures of large-scale frauds, most borrowers, whether because of moral inclinations, fear of consequences or the deterrents afforded by ABL structures, are honest counterparties. Otherwise, capital would not be available in the credit markets.

The “Monitoring Challenge”

As borrowers adopt new ERPs and digital payment methods and AI implementation becomes more pervasive; lenders must update their monitoring infrastructure. The survey identified key areas for improvement:

- 76% of respondents identified “Less stringent monitoring and controls” as a primary vulnerability.
- 62% cited a need for better “training to spot warning signs”.
- 55% pointed to “Complex deal structures” as a potential blind spot.

By addressing these areas proactively, lenders can close the gap between modern risks and legacy controls.

Current Trends and Environments Conducive to Fraud

- Frauds are more likely to occur in companies without effective and independent corporate governance and strong internal controls (i.e., the alleged frauds at First Brands, Carriox (Brahmbhatt), Liberty Steel (Greensill), and Tricolor).
- There is a high correlation between instances of fraud and borrowers with liquidity issues and/or poor financial performance.
 - Fraud risk is heightened with borrowers that have material fiduciary obligations that could attach personal liability to ownership and corporate officers.
- There appears to be a growing use of undisclosed affiliate transactions to facilitate fraud, especially with foreign affiliates.
 - Cross-border diversion of funds is both harder to track and then to ultimately recover.

II. Case Study Learning – The First Brands Experience

The bankruptcy of First Brands Group serves as a potent case study for the importance of transparency in capital structures. The indictment of its principals highlights specific red flags that lenders should be aware of and protect their organizations against through proactive diligence. For more information on the First Brands case, please see Appendix D.

Understanding Your Borrower and Their Capital Structure

First Brands utilized a complex web of entities to obscure its true financial leverage. The indictment alleges the use of SPVs to double-pledge assets and obtain multiple financings of those assets where the assets in question remained on the books of the original obligor in addition to being transferred to the SPV.

The Importance of Independent Diligence

The case reinforces the need for independent verification.

- **Avoiding the “Halo Effect”:** Lenders should not rely solely on the diligence of the agent or other syndicate members. Every institution must understand the borrower’s structure independently.
- **Vendor and Account Debtor Validation:** The fraud relied on the fabrication of invoices and purchase orders. Direct verification with vendors and customers—bypassing the borrower’s provided contacts—is a critical control.

III. Anatomy of Modern Fraud – Task Force Analysis

The Task Force analyzed 26 real-world cases to identify common patterns. These are not just cautionary tales; they are instruction manuals for better monitoring.

Mechanism A: Accounts Receivable & Billing Integrity

Prevalence: ~58% of cases

Billing schemes remain the most common form of collateral inflation.

- **The Tactic:** Creating “fresh air” invoices to shell companies that mimic legitimate customers or borrowers who create a large volume of credits and re-bills creating excessive dilution or chargebacks.
- **The Fix:** Triangulating cash receipts with shipping documents and third-party verified PODs (proof of delivery).

Mechanism B: Inventory Management & “Re-Aging”

Prevalence: ~35% of cases

In an environment of supply chain variability, inventory data can be manipulated to maintain borrowing availability.

- **The Tactic:** Borrowers may manually edit the “date received” field in their ERP system. This makes “stale” inventory (older than 12 months) appear as “fresh” eligible collateral.
- **The Fix:** Lenders can implement inventory protocols to track serial numbers over time.

Mechanism C: Cash Dominion & “Harvesting”

Prevalence: ~12% of cases

This typically occurs when a business faces liquidity stress.

- **The Tactic:** Owners may prioritize personal distributions or “harvesting” equity over paying critical vendors or taxes. A key warning sign is when “silent” vendors—landlords, utilities, logistics—are stretched while trade vendors are kept current to maintain inventory flow or held checks or book overdrafts masking true accounts payable balances owed.
- **The Fix:** Monitoring the AP aging specifically for key service providers and strictly enforcing distribution covenants.

Mechanism D: Cyber Fraud & AI

Prevalence: Emerging

- **The Tactic:** Criminals are using Generative AI to impersonate executives. One case involved a \$25-million wire fraud facilitated by a deep-fake video call from a CFO.
- **The Fix:** “Proof of life” is no longer sufficient. Out-of-Band (OOB) authentication via a pre-verified phone number is essential for all wire changes.

IV. The “Red Flag” Framework

To assist lenders in identifying these risks early, the Task Force has compiled a comprehensive checklist of warning signs.

Comprehensive Red Flag Table

Red Flag Indicator	Potential Issue
Financial Reporting	
☒ Late or inconsistent reporting	Masking performance decline
☒ Manual adjustments to agings	
☒ Delays in issuance of finalized FYE audited or reviewed financial statements	Fabrication of data
☒ Incomplete or untimely interim financial information, including A/R and A/P agings	
☒ Unsatisfactory caliber of financial information	
☒ Delayed or postponed field audit	Hidden liabilities or cash diversion
☒ “Round number” invoices	
☒ Small, same dollar-sized invoices to the same debtor	
☒ Unexplained inventory adjustments	Disagreement over accounting practices
☒ Growing unreconciled or “suspense” accounts	
☒ Increase in trade inquiries	Lack of accountancy independence and qualifications
☒ Sudden change in accounting firm or CFO	
☒ Accounting firm is small in relationship to the complexities and size of the borrower’s operation	Hiding physical reality
☒ Accounting firm has no or limited expertise in the borrower’s industry	
☒ Accounting firm derives a substantial portion of its revenue from the borrower and its affiliates	Cash diversion / Harvesting
☒ Accounting firm has no or unsatisfactory peer reviews	
☒ Accounting firm cannot issue audited financial statements or a “management letter” in connection with audited financial statements	Cash diversion / Harvesting
☒ Accounting firm subject to litigation by other lenders and/or third parties.	
Behavioral	
☒ Resistance to site visits or field exams	Hiding physical reality
☒ Funding other businesses or lifestyle of the owner	
☒ Significant changes in the salary draw, loans or other flows of cash between the company and the principals	Cash diversion / Harvesting
☒ Owners and/or senior management have low personal credit scores (need written consent to obtain)	

Red Flag Indicator	Potential Issue
<ul style="list-style-type: none"> ❑ The borrower restricts communications to ownership or limited subset of management ❑ Lack of responsiveness to calls or emails ❑ Inconsistencies in responses to questions from the borrower's management team ❑ Borrower ownership signs all governing loan documents, including the borrowing base 	Borrower control of the narrative to the lender
<ul style="list-style-type: none"> ❑ Borrower use of MCA funding ❑ Borrower is a defendant in commercial litigation 	Desperation for funds and/or avoidance of obligations
Fictitious Customers - Suppliers	
<ul style="list-style-type: none"> ❑ Unexplained increase or changes suppliers and customers 	Diversion of cash and creation of fictitious collateral
<ul style="list-style-type: none"> ❑ Supplier's physical location does not support activity ❑ Suppliers provide unexplained extended terms ❑ Suppliers lack lending facilities 	
<ul style="list-style-type: none"> ❑ Inventory weight/volume disproportionate to sales ❑ Slowing inventory turnover ❑ "Round table trading" among distributors in the same markets ❑ Lack of current inventory return authorization logs ❑ Frequent new or undeclared inventory locations 	Borrower inventory inflation
<ul style="list-style-type: none"> ❑ A/R aging inconsistent with liquidity condition 	Re-aging or fabrication of receivables
<ul style="list-style-type: none"> ❑ Transactions not supported by purchase orders ❑ Customers are newly formed entities ❑ Unsatisfactory verifications, including verification calls referred to mobile numbers ❑ Customers lack a corporate website or a corporate domain name associated with e-mails ❑ Disproportionate number of customers use the same bank as the borrower ❑ Customers have "trust me" billing or handshake agreements 	
Structural	
<ul style="list-style-type: none"> ❑ Complex SPV structures without clear purpose 	Obscuring leverage
<ul style="list-style-type: none"> ❑ Suspicions raised in periodic visits and meetings with borrower management 	Lack of direct verification
<ul style="list-style-type: none"> ❑ Overreliance on information provided by advisor, platform provide, and/or the syndication agent ❑ Lack of independent confirmatory due diligence 	
<ul style="list-style-type: none"> ❑ Failure to maintain an objective viewpoint of the borrower's performance, trends, and requests. 	Lack of objectivity

Phase 1: Pre-Funding Checklist (Underwriting)

Use this to evaluate deal structure and borrower transparency.

- ✓ **Structure Review:** Does the borrower use multiple SPVs? If so, do we have visibility into the intercompany flows? Conduct extensive "checks" on all unknown vendors and customers. Why the opportunity? Review history with prior lenders
- ✓ **Background Check Depth and Credit Checks:** Have we conducted checks on principals going back at least 10 years? (First Brands principals had prior history). Require personal credit checks on ownership and senior management
- ✓ **Revenue Recognition:** Are billing terms GAAP standard? Be mindful of "bill and hold" or "convoluted varying terms." Are third parties such as the accounting firm used by the prospect independent and capable.
- ✓ **Documentation:** Can the borrower produce historical bank reconciliations and A/R agings? Be wary of "system transitions" as an explanation for missing data.
- ✓ **Operational Logic:** Does the business plan make sense given the reported financials?

Phase 2: Post-Funding Checklist (Monitoring)

Use this for monthly reporting and field exam reviews.

- ✓ **The "Round Number" Scan:** Scan ledgers for invoices/adjustments in increments of \$5,000 or \$10,000.
- ✓ **"Life Support" Vendor Check:** Are utilities, rent, and logistics vendors paid current?
- ✓ **Access Test:** Is the borrower delaying the field exam or restricting scope?
- ✓ **Inventory "Zombie" Check:** Comparing current inventory age to previous exams to spot re-aging.
- ✓ **Cash Flow Triangulation:** Does the cash hitting the bank match the reported collections?

V. Strategic Recommendations & Implementation

The Task Force recommends a tiered approach to modernization, allowing lenders to scale these practices according to their portfolio needs.

Tier 1: Operational Enhancements (Immediate)

- **Triangulate:** Validate Borrowing Base Certificates and Invoices against Cash Receipts and Physical Counts.
- **Authenticate:** Implement Out-of-Band (OOB) protocols for all wire transfers to defeat AI impersonation.
- **Verify:** Mandate physical verification for inventory-heavy deals; do not rely solely on documentation.

Tier 2: Governance & Culture (Policy)

- **Relationship Discipline:** Maintain independent diligence regardless of syndicate partners.
- **Examiner Rotation:** Rotate field examiners periodically to maintain a "fresh set of eyes."
- **Training:** Invest in training for teams to spot the "Red Flags" listed in Section IV. For more training resources provided by SFNet, please see Appendix D.
- **Independent analysis:** Trust, but verify – do not get too close.

Appendices

Appendix A: SFNet Fraud Task Force Members

Michael Albanese (Cost Reduction Solutions)

Michael Albanese serves as the Vice President of Operations for Cost Reduction Solutions (CRS), where he manages international due diligence and collateral field examination projects. Since joining CRS in 2010, he has overseen hundreds of active projects for over 90 lending institutions. Michael is active in the SFNet New Jersey Chapter and emphasizes transparency and truth-driven reporting as the foundation for successful collateral management and risk prevention.

Don Clarke (Asset Based Lending Consultants)

Don Clarke is the President of Asset Based Lending Consultants (ABLC) and a world-renowned expert in ABL disciplines. With nearly 40 years of experience, he authored the industry's first textbook on the subject and has trained over 5,000 students globally. As a senior instructor for SFNet and a former Education Committee chair, Don is a 2019 recipient of the Harry H. Chen Memorial Award of Excellence and is recognized for his skill in identifying fraud during field examinations.

Daniel Ennis (Parker, Hudson, Rainer & Dobbs LLP)

Daniel Ennis is a partner in the Commercial Finance practice group of Parker, Hudson, Rainer & Dobbs LLP in Atlanta. He primarily represents banks, finance companies, and other lenders in all aspects of lending transactions with a wide range of size and complexity, and is experienced in cross-border, lender, retail, and distribution finance, and credit facilities secured by specialized collateral. Dan has spoken for the State Bar of Georgia, SFNet and the Turnaround Management Association, is an active member of SFNet and TMA and was one of SFNet's 40 Under 40 Award recipients in 2021.

Bob Grbic (Bearbrook Advisors)

Robert Grbic is the Founder and President of Bearbrook Corporate Advisors and a 2024 SFNet Hall of Fame inductee. With over 40 years in the industry, including a tenure as CEO of White Oak Commercial Finance, he is a former chairman of SFNet's Factoring Committee. Bob is a recognized leader in credit education and has spent his career building best-practices credit cultures that prioritize rigorous due diligence to prevent loan losses.

Joy Hanawa (Mountain Ridge Capital)

Joy Hanawa is the Chief Technology Officer (CTO) for Mountain Ridge Capital and a distinguished expert in digital transformation within the secured finance sector. With over 18 years of industry-specific experience and a Master of Science in Technology Management, she specializes in building robust IT infrastructures for ABL and Factoring firms. A recognized thought leader in emerging tech, Joy led SFNet's critical training program on leveraging AI to integrate loan servicing software with CRM systems, providing the Task Force with essential expertise on using automation to detect irregularities and combat modern fraud.

Betty Hernandez (SLR Business Credit)

Betty Hernandez is an Executive Vice President, Chief Credit Officer, and a founding member of SLR Business Credit. With over 35 years of experience in asset-based lending, she oversees the credit quality of SLR's portfolio and ensures adherence to rigorous credit policies. Betty is deeply involved in SFNet leadership, serving as its President.

Katy Jordan (PNC Business Credit)

Katy Jordan is a Senior Vice President and Head of Channel Finance at PNC Business Credit. She specializes in creating innovative financing solutions for technology vendors and their partners, focusing on credit capacity and working capital optimization. Katy's background in asset-based lending, supply chain finance, and structuring—previously with Wells Fargo Capital Finance—gives her a unique lens on the specific fraud risks associated with vendor programs and tech-sector lending.

Joseph Marchese (PKF O'Connor Davies)

A Partner at PKF O'Connor Davies Advisory, Joe has over 25 years of experience in accounting and financial operations. He specializes in business planning, cash management, and both in and out-of-court restructuring for distressed companies. Joe often serves in interim leadership roles such as CRO or CFO, bringing a hands-on operational perspective to identifying financial irregularities and managing 13-week cash flow forecasts to maintain liquidity during crises.

Steven Sanicola (Siena Lending Group)

As the former Chief Risk Officer at Siena Lending Group, Steve was responsible for the firm's risk management strategy and day-to-day credit activities. He has played a key role in positioning Siena as a leading as-

set-based lender for upper and middle-market companies. Steve's focus on addressing risk as a priority that underpins Siena's culture, ensuring that Siena remains resilient in uncertain lending environments, particularly when dealing with complex, high-exposure transactions.

Baker Smith (BDO)

Baker Smith is a Managing Director at BDO Advisory with more than 30 years of experience in crisis management and turnaround planning. He has led over 300 teams for distressed companies, serving in roles such as CEO and CRO for high-profile assignments in the automotive and transportation sectors. A member of the SFNet Board, Baker's background in forensic advisory and strategic restructuring allows him to identify systemic vulnerabilities that are often exploited in fraud cases.

Appendix B: SFNet Fraud Survey Synthesis

I. Perception of Industry-Wide Fraud Trends

- **Summary:** Secured finance professionals are divided on whether the industry is seeing a genuine surge in fraud or simply a continuation of existing trends. While exactly half of respondents believe incidence levels are stable, nearly 45% report a noticeable increase, indicating a heightened state of alert across the sector.
- **Response Breakdown:**
 - **Remained the Same:** 52% (15 responses)
 - **Increased:** 45% (13 responses)
 - **Decreased:** 3% (1 response)

II. Portfolio-Specific Fraud Incidence

- **Summary:** When looking at their own books, lenders report a much more stable environment than the broader industry perception might suggest. Two-thirds of respondents have seen no change in the number of frauds within their specific portfolios, suggesting that current risk selection and monitoring may be successfully insulating many firms from the broader "market" trend.
- **Response Breakdown:**
 - **Remained the Same:** 67% (20 responses)
 - **Increased:** 17% (5 responses)
 - **Decreased:** 17% (5 responses)

III. Primary Areas of Vulnerability

- **Summary:** The survey identifies "Less stringent monitoring and controls" as the most significant systemic risk, followed closely by a critical "Lack of training" for staff to spot early warning signs. This data underscores a concern that operational speed and competitive pressures are eroding the fundamental diligence required to prevent sophisticated asset-based fraud.
- **Top Risk Factors Identified:**
 1. Monitoring Gaps: Less stringent monitoring and controls (22 selections)
 2. Training Deficit: Lack of training to spot warning signs (18 selections)
 3. Structural Risk: Complex deal structures that obscure underlying collateral (16 selections)
 4. Market Pressure: Competitive pressures and relaxed documentation (13 selections each)

IV. Institutional Mitigants & Strategic Actions

- **Summary:** In response to high-profile cases, organizations are shifting their focus toward more aggressive "in-life" monitoring and deeper underwriting scrutiny. While a third of respondents remain confident in their legacy practices, the majority are actively expanding audit scopes and reassessing their internal fraud protection policies.
- **Key Actions Implemented:**
 1. **Monitoring:** Enhanced monitoring routines (15 selections)
 2. **Underwriting:** Enhanced diligence during the onboarding phase (14 selections)
 3. **Auditing:** Increased audit scope and frequency (11 selections)
 4. **Policy:** Reassessing current fraud protection policies (11 selections)

V. Qualitative Insights & Expert Feedback

- **Summary:** Open-ended feedback from industry veterans emphasizes that fraud detection must be a "top-down" priority that refuses to yield to competitive deal-making pressures. Professionals noted that as payments move further into digital channels, maintaining strict cash dominion and "knowing what lies behind the big numbers" is more difficult—and more necessary—than ever.
- **Recurring Themes:**
 - **Vigilance:** "Never let your guard down; the key is to catch it early."
 - **Diligence vs. Speed:** A warning against "complacency" and cutting corners to win deals.
 - **Cash Mastery:** The importance of understanding granular AR and redirecting payment flows.

VI. Respondent Demographics

- **Summary:** The survey reflects a diverse cross-section of the market, though it is primarily driven by the perspectives of Asset-Based Lenders and Service Providers. This ensures the data is grounded in the reality of those who are most frequently exposed to inventory and accounts receivable collateral.
- **Top Participant Categories:**
 - **Asset-Based Lenders:** 13
 - **Service Providers:** 6
 - **Factors / Supply Chain Finance:** 6
 - **Community & Mid-sized Banks:** 5

Synthesis Checklist for Management

- **Internal vs. External Gap:** Why do 43% see fraud increasing in the market, but only 17% see it in their own portfolios? (Are we catching it, or are we not looking closely enough?)
- **Training Priority:** With “Lack of Training” ranking as a top-two vulnerability, should we cross-reference our staff certification with the SFNet “Field Exam Level 2” case studies?
- **Monitoring Shift:** Are our current “enhanced monitoring routines” focused on the red flags identified in the 26-case corpus (e.g., re-dating and in-transit anomalies)?

Appendix C: SFNet Fraud Task Force Case Studies

I. Inventory Inflation & Existence Risk

Focus: Falsified warehouse documentation, ownership misrepresentation, and value manipulation.

- **Case 1: Jewelry Retailer (\$5mm Fraud)**
 - **Description:** A high-end retail jeweler manipulated their inventory stock records to project a much stronger asset base than they actually possessed. The company struggled with slow-moving luxury goods and sought to bridge liquidity gaps by artificially bloating their inventory valuation during reporting periods.
 - **Mechanism:** Included consignment inventory in physical counts as owned inventory and falsified diamond certificates to inflate values.
 - **Red Flags:** Inventory turns were drastically out of alignment with industry standards and increased despite sales decreases.
 - **Outcome:** Discovered shortly after bank foreclosure and an Assignment for the Benefit of Creditors (ABC).
- **Case 2: Retailer (Chapter 11 Inventory Fraud)**
 - **Description:** This case involves a distressed retailer that misled both its senior lender and the judicial system during a formal reorganization. By presenting a healthy inventory position, the borrower hoped to secure more favorable Debtor-in-Possession (DIP) financing terms.
 - **Mechanism:** Provided falsified inventory reports to both the bank and the bankruptcy court.
 - **Red Flags:** Significant variances discovered between reported inventory and actual liquidation values.
 - **Outcome:** Discovered during the Chapter 11 liquidation process; required a restatement of SOFA and SOAL reports.
- **Case 3: Frozen Food Processor**
 - **Description:** A mid-market food processor utilized the complexity of international logistics to hide a massive shortfall in physical product. The borrower relied on the time delay inherent in overseas shipping to keep the lender from noticing the missing collateral.
 - **Mechanism:** Falsified warehouse receipts for inventory that either did not exist or had already been sold to end customers.
 - **Red Flags:** Excessive reliance on in-transit inventory relative to historical averages and industry norms.
- **Case 4: Metals Distributor**
 - **Description:** This distributor attempted to pass off industrial waste as premium raw material to satisfy borrowing base requirements. Because the lender’s field examiners were not metallurgical experts, the borrower gambled that a visual inspection would not reveal the quality discrepancy.
 - **Mechanism:** Reporting “scrap” metal as prime inventory on the borrowing base to maintain line availability.
 - **Red Flags:** Sudden, drastic changes in inventory valuation without corresponding shifts in market prices.
- **Case 5: Wholesale Chemical Distributor**
 - **Description:** A chemical wholesaler used deceptive storage practices to mask a massive sell-off of pledged collateral. The facility was arranged in a way that restricted movement, making it difficult for auditors to perform a comprehensive wall-to-wall count.
 - **Mechanism:** Use of empty or water-filled drums to simulate high-value chemical inventory and falsified labeling to mislead examiners.
 - **Red Flags:** Refusal to allow examiners to move specific “unstable” drums for closer inspection.

- **Case 6: Consumer Electronics Wholesaler**
 - **Description:** Faced with a warehouse full of obsolete technology, this wholesaler engaged in a data-manipulation scheme to keep the assets “eligible.” By refreshing the data in their system, they avoided the automatic aging out of products that would have reduced their credit line.
 - **Mechanism:** Creation of “Zombie Inventory” by manually updating Serial Number ages in the perpetual inventory system to make items appear current.
 - **Red Flags:** Inventory aging reports that showed no items over 90 days despite slow sales cycles.

II. Accounts Receivable (AR) Manipulation & Borrowing Base Gaming

Focus: Duplicate/fabricated invoices, pre-billing, and hiding collections.

- **Case 7: Utilities Construction Subcontractor (\$10mm Fraud)**
 - **Description:** A subcontractor for a large utility project engaged in a sophisticated “double-billing” scheme to fund their business venture. They leveraged the lengthy payment cycles of large utility companies to keep the fraud hidden from regular field exams.
 - **Mechanism:** Set up a shell company to receive customer payments while keeping duplicate “open” invoices on the borrower’s books to support ABL draws.
 - **Red Flags:** Aging receivables and difficulty reconciling invoices; zero availability on the ABL despite reported “profitable” contracts.
 - **Outcome:** Discovered during bankruptcy; case converted to Chapter 7 and lawsuits were filed.
- **Case 8: Wholesale Apparel Provider**
 - **Description:** An apparel company attempted to fix its cash flow issues by borrowing against sales that hadn’t happened yet. They treated their manufacturing pipeline as finished goods, essentially spending money that they hadn’t yet earned from their retail partners.
 - **Mechanism:** Generated invoices and included them in the borrowing base before the underlying goods existed or were shipped.
 - **Red Flags:** High volume of credit memos and shipping documents that post-dated invoice dates.
- **Case 9: Staffing Agency**
 - **Description:** A service-based business fabricated labor hours to meet its payroll obligations and debt covenants. The lack of a physical product made it easier for the borrower to create “paper” assets that looked legitimate on a digital ledger.
 - **Mechanism:** Falsification of time-tracking data to create ineligible “unbilled AR” through fake timecards for temporary workers.
 - **Red Flags:** Unbilled AR aging significantly beyond normal payroll cycles.
- **Case 10: Logistics & Freight Forwarder**
 - **Description:** A logistics company exploited a lack of communication between different financial institutions to pledge the same assets twice. This allowed them to receive double the funding for a single set of business activities.
 - **Mechanism:** Submitted the same set of receivables to both a bank ABL and a secondary factor.
 - **Red Flags:** Sudden influx of “confirmation” requests from unknown third-party financial institutions.
- **Case 11: Commercial Printing Company**
 - **Description:** A printing firm attempted to maintain its credit line by hiding the fact that its customers had already paid. By diverting the cash, they could use the funds for unapproved expenses while still showing a large (but fake) AR balance to the lender.
 - **Mechanism:** Retention of payments in a secret account while leaving invoices “open” on the aging report.
 - **Red Flags:** Rapidly increasing DSO (Days Sales Outstanding) despite claims of high collection rates.
- **Case 12: Medical Equipment Manufacturer**
 - **Description:** This manufacturer created a “synthetic” sales history by shipping goods to friendly third parties who had no intention of paying. This gave the appearance of a booming business, allowing the company to draw down its entire credit facility.
 - **Mechanism:** Issued large invoices for sales that were actually on consignment, then borrowed against them as firm AR.
 - **Red Flags:** Lack of proof of delivery (POD) for high-value shipments.
- **Case 13: Software Development Firm**
 - **Description:** A software company attempted to monetize its “pipeline” as if it were actual revenue. They bypassed GAAP standards by converting non-binding interest from potential clients into legally binding assets on their balance sheet.
 - **Mechanism:** Manually entered potential future contracts from Letters of Intent into the accounting system as current AR.
 - **Red Flags:** Significant variances between the AR aging and the general ledger revenue accounts.

- **Case 14: Food Service Distributor**
 - **Description:** This distributor relied on a collusive relationship with a key customer to defeat the lender’s audit controls. Because the customer vouched for the fake invoices, the lender believed the collateral was secure for several months.
 - **Mechanism:** Customer contact was a relative of the borrower who provided false confirmation of receipt of goods during bank verifications.
 - **Red Flags:** Over-concentration of AR in a single customer with suspicious contact information like personal email addresses.

III. Cash Diversion & Collections Rerouting

Focus: Steering payments away from controlled accounts or paying unapproved parties.

- **Case 15: Regional Medical Transportation Company**
 - **Description:** Faced with unprofitable service contracts and mounting debt, the owner of this company began “skimming” the cash meant for the lender. The owner prioritized paying off immediate threats to the business over the long-term debt obligations.
 - **Mechanism:** Directed customers to pay third-party contractors directly, bypassing the lender’s dominion account.
 - **Red Flags:** Sharp drop in collections over a two-week period and delinquent payroll.
 - **Outcome:** Resulted in a multi-million-dollar overadvance.
- **Case 16: Tech Services Firm**
 - **Description:** The management of this firm used a secret account to fund a lifestyle for executives that the company’s actual profits could not support. They hid these funds by intercepting electronic payments before they reached the bank’s lockbox.
 - **Mechanism:** Leveraged unauthorized accounts to store collections used for executive bonuses and distributions.
 - **Red Flags:** Discrepancies between customer payment portals and actual bank deposit records.
- **Case 17: Manufacturing Facility**
 - **Description:** A manufacturer treated customer deposits as a revolving credit line for their daily operations. This created a significant “hidden” liability, as the company lacked the funds to actually produce the items the customers had paid for.
 - **Mechanism:** Collected large deposits for future orders, but spent the cash on current overhead instead of raw materials.
 - **Red Flags:** Total unrestricted cash was consistently lower than the “Customer Deposits” liability account.
- **Case 18: Construction Supply Company**
 - **Description:** This company committed insurance fraud to cover a liquidity gap. Instead of using the insurance payout to replace a vital piece of machinery, the owner pocketed the cash, leaving the company’s production capacity severely diminished.
 - **Mechanism:** Deposited a large insurance check into a personal account rather than the corporate account.
 - **Red Flags:** Equipment remained non-functional for months despite the claim being “resolved.”
- **Case 19: E-commerce Aggregator**
 - **Description:** This digital business bypassed the bank’s controls by changing the digital banking settings on its sales platforms. They rerouted daily settlements into a new account that the lender had no visibility or access to.
 - **Mechanism:** Changed the deposit settings on Amazon and Shopify storefronts to bypass the lender’s blocked account.
 - **Red Flags:** Platform settlement reports did not match the cash hitting the lockbox.

IV. Financial Statement Misrepresentation & Reporting Fraud

Focus: Falsified tax records, manual adjustments, and covenant manipulation.

- **Case 20: Retailer of Farming & Agriculture Supplies (\$10mm Fraud)**
 - **Description:** A large regional retailer withheld funds from state governments to fund its own operations. They chose to stop paying sales tax while lying to their lender about their true debt load.
 - **Mechanism:** Failed to remit state sales taxes for six months while providing falsified financial statements.
 - **Red Flags:** Financial reports were consistently late and contained heavy manual adjustments.
 - **Outcome:** Required a total restatement of financial position during Chapter 11.
- **Case 21: Heavy Equipment Manufacturing Group**
 - **Description:** This manufacturer used “creative accounting” to hide a drop in operational efficiency. By mislabeling operational costs, they were able to present a much higher profitability margin to their lenders than was actually true.
 - **Mechanism:** Overstated EBITDA by capitalizing ordinary operating expenses rather than expensing them.
 - **Red Flags:** CapEx levels were significantly higher than industry averages despite no new equipment.
- **Case 22: Textile Importer**
 - **Description:** The importer maintained a dual-accounting system specifically designed to deceive external auditors. The “public” version of their books was scrubbed of any indicators of financial distress or unrecorded liabilities.
 - **Mechanism:** Used a separate ERP module to generate “Lender-Ready” reports that excluded operational liabilities.
 - **Red Flags:** Audit trail in the primary system showed numerous “balancing” entries to a suspense account.

- **Case 23: Industrial Services Provider**
 - **Description:** An industrial firm hid its true operational health by failing to record bills from its most critical suppliers. This made the company appear more liquid than it was, even as it was on the verge of being evicted or losing power.
 - **Mechanism:** Manually removed utility and rent invoices from the AP aging provided to the lender.
 - **Red Flags:** Physical inspection revealed “Final Notice” stickers on the facility.
- **Case 24: Furniture Manufacturer**
 - **Description:** To avoid a write-down of their equipment, this manufacturer forged a professional valuation. They used outdated data and digital editing tools to create a document that supported their inflated balance sheet figures.
 - **Mechanism:** Altered the dates and values on a two-year-old appraisal to make it appear as if a fresh valuation had been completed.
 - **Red Flags:** The appraisal report contained typos and font inconsistencies.
- **Case 25: Auto Parts Distributor**
 - **Description:** The owner of this distributor used the company as a personal ATM, hiding the withdrawals through a series of “round-trip” loans. These loans were temporary fixes designed only to make the quarter-end statements look correct.
 - **Mechanism:** Borrowed cash for personal use and “repaid” it at quarter-end with a short-term loan from a relative.
 - **Red Flags:** Large, round-dollar deposits and withdrawals precisely on the last day of each quarter.
- **Case 26: Renewable Energy Startup**
 - **Description:** A startup misrepresented its progress on government-subsidized projects to unlock more funding. They claimed project completion milestones were met when, in reality, the physical construction had not even begun.
 - **Mechanism:** Submitted falsified milestone completion certificates to the lender to trigger draws on a project-finance line.
 - **Red Flags:** Project timelines remained stagnant in news reports while the borrower claimed 90% completion.

Appendix D: Additional Resources

- 1) First Brands:
 - <https://restructuring.ra.kroll.com/firstbrands/Home-DownloadPDF?id1=MzkyODI4Mg==&id2=-1>
 - <https://restructuring.ra.kroll.com/firstbrands/Home-DownloadPDF?id1=MzkyOTc2Nw==&id2=-1>
 - <https://www.sfnet.com/home/industry-data-publications/the-secured-lender/magazine/tsl-article-detail/the-first-brands-collapse-a-cautionary-tale>
 - <https://www.gtreview.com/news/americas/first-brands-lenders-clash-over-inventory-finance-claims/>
 - <https://www.justice.gov/usao-sdny/pr/first-brands-executives-charged-multibillion-dollar-fraud>
 - <https://www.law360.com/bankruptcy-authority/articles/2435427/first-brands-can-tap-48m-from-ford-gm-in-bid-for-survival>
 - <https://www.sfnet.com/home/industry-data-publications/the-secured-lender/magazine/tsl-article-detail/receivables-purchase-and-asset-based-lending-insights-from-first-brands>
 - <https://www.sfnet.com/home/industry-data-publications/the-secured-lender/magazine/tsl-article-detail/the-first-brands-collapse-a-cautionary-tale>
- 2) Other resources
 - <https://www.sfnet.com/home/industry-data-publications/the-secured-lender/magazine/tsl-article-detail/part-1-al-lou-a-firsthand-account-of-a-massive-abl-fraud>
 - <https://www.sfnet.com/docs/default-source/tsl-tslexpress/alloupart2.pdf>
 - <https://www.sfnet.com/home/industry-data-publications/the-secured-lender/magazine/tsl-article-detail/top-5-in-voice-finance-frauds>
 - <https://www.sfnet.com/home/industry-data-publications/the-secured-lender/magazine/tsl-article-detail/ai-fraud-in-lending-the-cannon-at-your-gates>
- 3) Upcoming SFNet Webinars (visit www.sfnet.com)
 - The Phantom Invoice (A/R)
 - The Ghost in the Warehouse (Inventory)
 - The Digital Frontier (Cyber/AI)

WHITE PAPER

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