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Private Credit Under the Microscope: How to Prepare for Regulatory Scrutiny

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William is a Partner, Co-Chair of the firm's White-Collar Defense Practice Group, and Chair of the Investigations & Enforcement Practice Group, leading one of the premier compliance, investigations, and enforcement defense practices in the United States. He is a distinguished former federal prosecutor and regulator, and previously served as head of the Fraud Section of the U.S. Department of Justice's Criminal Division as well as in the Division of Enforcement at the Securities and Exchange Commission. Drawing on a unique range of experience, he regularly represents a broad range of companies, financial institutions and their executives in matters involving securities fraud, foreign bribery, sanctions, antitrust, cybersecurity, insider trading and money laundering.



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Viktor Okasmaa is a partner and Global Chair of the firm's Finance Department. He represents private equity sponsors, public and private companies, direct lenders and investment banks in connection with a wide variety of financing transactions. He has significant experience in acquisition financings and leveraged buyouts.



Sonali D. Patel
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Sonali is a partner in the White-Collar Defense Group. Her practice focuses on representing multinational corporations and individuals in high-stakes cross-border investigations and enforcement matters involving foreign corruption, fraud, insider trading, money laundering, tax evasion, and national security issues. She is a trusted advisor on compliance and risk mitigation in the context of mergers and acquisitions, international operations, and emerging technologies. Sonali served at the Department of Justice for 10 years, most recently holding the title of Assistant Chief of the Foreign Corrupt Practices Act (FCPA) Unit, and prior to that as a trial attorney in the division. While there, she led more than 50 FCPA-related investigations, working on some of the unit's most significant individual prosecutions. She also served as an Assistant U.S. Attorney for the U.S. Attorney's Office for the District of Columbia, focusing on fraud, public corruption, cybercrime and violent crime investigations.



Andrew English
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Andrew is a Partner in the Investigations & Enforcement Group representing corporations and individuals in a variety of criminal and civil enforcement actions. Andrew has represented companies and individuals under investigation for alleged FCPA, money laundering, False Claims Act, Anti-Kickback Statute, Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), and Securities Exchange Act violations. He has significant experience conducting worldwide investigations, including global cross-border matters in China, Russia, Eastern Europe, Latin America, and the Middle East. He also regularly counsels clients on the development of compliance programs, policies, and trainings.



Agenda

- Overview of Private Credit Landscape
- Public Concerns of Regulators
- How to Prepare for Regulatory Scrutiny—Likely Areas of Enforcement Focus
 - Diligence
 - Disclosures
 - Valuation



Overview of Private Credit Landscape

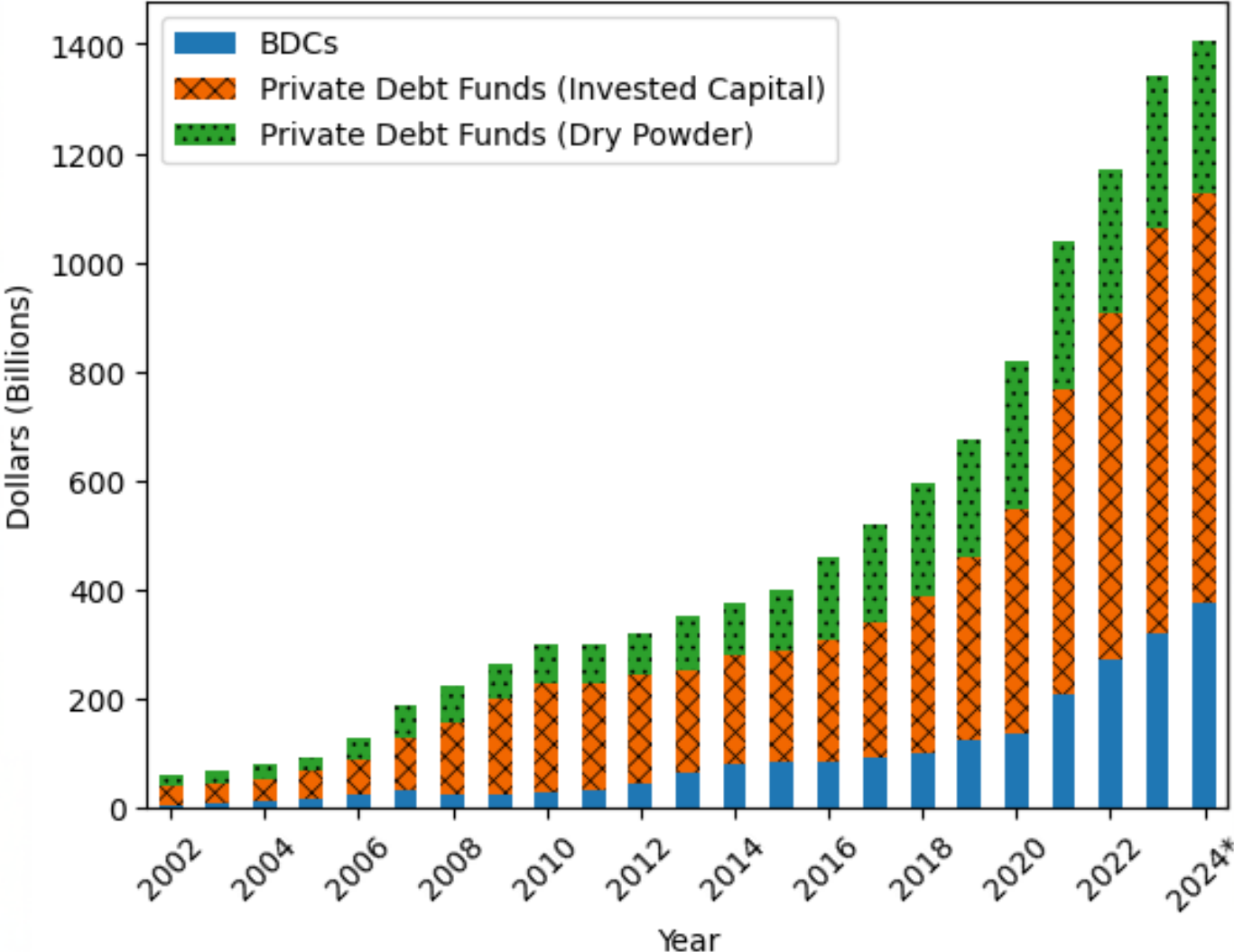
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What is Private Credit?

- Loans by non-bank lenders, typically private investment funds or specialty finance firms
 - Investors pool their money in a fund managed by a professional investment firm who identifies target borrowers
- Unlike traditional bonds or other similar arrangements, the loans are not traded but are private investments

	Public Bonds	Bank Loans	Private Credit
Source of Funding	Mutual funds, institutional investors (pension funds, endowments), retail investors	Bank	Institutional investors, wealthy individuals
Typical borrowers	Large, well-established companies	Businesses of all sizes, although generally with good credit profiles	Mid-sized to smaller companies or those with riskier credit profiles
Structure	Investment bank(s) underwrite the bonds, which are issued to the public market	Direct contract with banks tending to follow standardized terms	Direct contract but can be more tailored
Regulations	Strict set of requirements and detailed disclosures	Heavily regulated via statute and regulation	Less regulation

Growth of Private Credit



Source: Federal Reserve, FEDS Notes (May 23, 2025)

Factors Leading to Growth

- Following the 2008 financial crisis, reforms such as Basel III led traditional banks to reduce lending to mid-size and smaller companies and to riskier borrowers
- Private credit funds stepped in to fill this financing gap
- Persistently low interest rates drove investors to seek higher returns
 - Traditional fixed income not attractive given interest rates
 - Private credit an attractive alternative to traditional fixed income
- While once primarily funded by institutional investors, retail investors have a growing stake in private credit through structured investment vehicles that pool capital, such as publicly traded Business Development Companies (BDCs) and specialized ETFs



Regulator Concerns



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Regulators are Publicly Voicing Concerns

THE WALL STREET JOURNAL. **U.S. Officials Try to Get a Grip on Risks Bubbling Inside Private Credit**

In widespread requests, SEC is seeking information about valuations, loan selection and other practices by firms

Wall Street's watchdogs are ramping up their inquiries into how much risk has built up in the \$3 trillion private-credit industry, just as investor angst has sparked some backers to head to the exits.

The Securities and Exchange Commission in recent months has opened several enforcement investigations of large private-credit managers, according to people familiar with the matter. The Treasury Department has requested information from private fund managers and insurance firms about their business models. Bank regulators, too, have stepped up their focus on the risks posed by the industry, with the Federal Reserve querying banks about their lending and exposure to private credit.



There are definitely some areas of concern for me in private markets. People should know that the financial regulators and the Department are looking at those.

— Jay Clayton, US Attorney for the Southern District of New York, in a November 2025 interview with *Bloomberg*

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Regulators are Publicly Voicing Concerns – Statements by Jay Clayton

- Jay Clayton, US Attorney for SDNY, has questioned whether prevailing valuation practices for private funds are accurate.
- He flagged that the Department has noticed that there are significant differences in how competing firms value private assets in their portfolios.
- He also stated that firms cannot cherry-pick prices that result in higher fees and higher expenses for clients.
 - A particular area called out was internal asset transfers where a position is moved from Fund A to Fund B, where both funds are managed by the same fund.
 - Such transfers raise significant concerns that the valuation will be based on what is best for the fund manager rather than the fair market value of the assets.
- His concerns seem driven by what is seen as limited transparency and the bespoke nature of loans, which can complicate comparability across managers and strategies, and thus allow for fraud.
- Given that private credit growth has exploded in recent years, enforcement authorities worry that compliance controls, policies, procedures, and training have not kept pace with such growth.





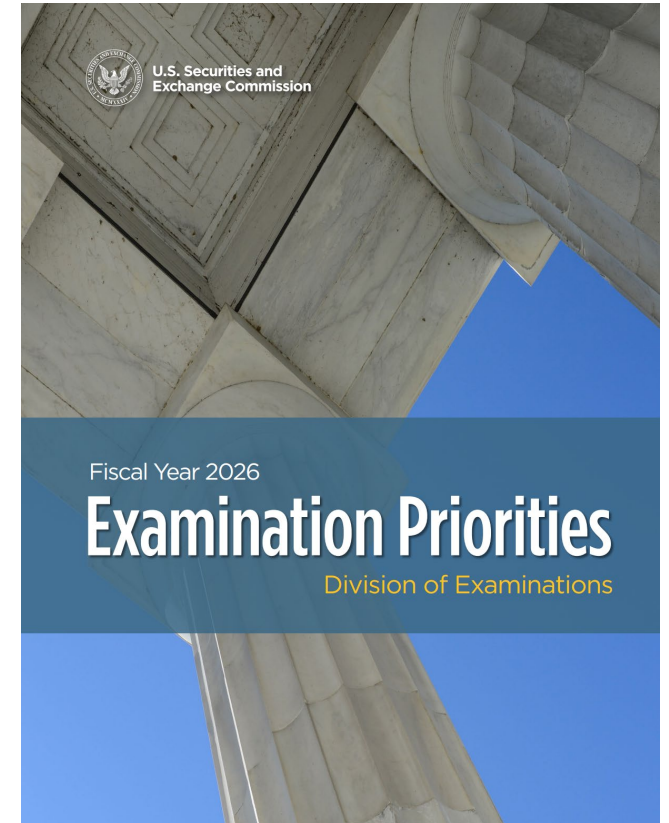
The SEC is closely monitoring both the lending gap that private credit has filled and the emerging pressures that it has experienced. . . . Let me be clear that opacity in this space can be an issue. That valuation, transparency, and credit quality are key.

— Paul Atkins, SEC Chairman, Keynote Remarks at the Economic Club of Washington, April 21, 2026

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Regulators are Publicly Voicing Concerns – SEC 2026 Examination Priorities

- “[T]he Division will focus on: Investment products with the following strategies or characteristics:
 - (1) alternative investments (e.g., private credit and private funds with investment lock-up for extended periods);
 - (2) complex investments (e.g., exchange-traded funds (ETF) wrappers on less liquid underlying strategies, option-based ETFs, and leveraged and/or inverse ETFs); and
 - (3) products that have higher costs associated with investing (e.g., high commissions and higher investment expenses than similar products/investments).”





How to Prepare for Potential Regulatory Scrutiny

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Areas of Enforcement Risk

- Enforcement authorities are clearly examining private credit.
- If a significant issue arises, regulators will operate with the benefit of hindsight.
 - In many instances, enforcement authorities view statements of “I didn’t know” as “You should have known.”
- Valuation of illiquid assets is challenging. Therefore, enforcement authorities will likely focus on deviations from policy, discrepancies, and control failures.
- Review your controls around diligence, disclosures, and valuations.
- Next slides walk through litigation/enforcement actions and lessons learned.

Diligence: Tricolor Holdings LLC

- Tricolor Holdings LLC – Subprime Auto Lending: Bank Deal Gone Wrong
 - CEO, CFO, COO were indicted for fraud. They allegedly double-pledged collateral and misrepresented the characteristics of collateral.
 - Tricolor’s financing was characterized by some as private credit deals, but most funding was traditional lending.
 - Investors in Tricolor have sued the banks that lent to Tricolor.
 - ❑ Tricolor funded its auto lending through revolving lines of credit from banks, and these loan receivables were then packaged into securities that affiliates of the banks underwrote and sold.
 - ❑ Plaintiffs have alleged that because the banks and their affiliates profited from the securitization of these loans, they ignored red flags and concerns being raised about Tricolor’s double pledging of collateral, control failures, and other irregularities.
 - ❑ The plaintiffs have alleged this constituted fraud under federal and certain state laws.

Diligence: First Brands Group



- First Brands Group – Major Auto Parts Supplier
 - First Brands' financing has also been characterized by some as private credit deals, but most funding was traditional lending.
 - CEO and other senior executives were indicted for fraud for lying about the strength of their businesses through fake documents and false financials.
 - Public reporting indicates that the Company's bankruptcy was triggered in part by the Company's failure to secure refinancing after investors demanded more thorough due diligence, including requesting a quality of earnings report.

Recommended Due Diligence Practices

- Ensure diligence is targeted to relevant risks of investment
 - Financial
 - Business and commercial
 - Management and ownership
 - Credit and recovery
- Document, document, document
 - No one can be 100% successful with their investments
 - If a borrower implodes, accusations of fraud often follow
 - Conducting thorough due diligence and then documenting that process and its findings helps rebut any accusation that the firm turned a blind eye or, worse, helped facilitate fraud
- Do not overrepresent what diligence is done
- Disclose risks related to investments and limits of diligence

Disclosures: SEC Enforcement Actions & Interpretations

- Omissions of information and misrepresentations.
 - Disclosed investment strategy did not match the strategy carried out in practice.
 - Inaccurate representations about the process of diligence.
 - Failure to execute sales at fair value not only a violation of fiduciary duty but also of disclosures stating entity would execute such sales at fair market value.
 - Inaccurate disclosures of conflicts of interest.
 - Inaccurate fee and compensation disclosures.
- Statements about hypothetical performance receive significant scrutiny.



Disclosures: SEC Enforcement Actions & Interpretations (cont'd)

- Must also adapt valuation triggers and assess impact on disclosures to significant world events that impact investments.
 - COVID-19
 - Russian sanctions
 - Iran conflict
- Conflicts between PPMs/governing documents and practice.
- Need to clearly state conflicts that exist and not hedge as “may” exist.



Recommendations Regarding Disclosure Practices

- Are they accurate?
- Sufficiently complete?
- Do they disclose all potential, material risks and issues?
 - Credit
 - Interest rate
 - Leverage
 - Conflicts of interest
 - Prepayment
 - Liquidity
 - Legal and regulatory
 - Dependence on key personnel
 - Macroeconomic
 - Investment management
 - Investment product
 - Governance risk
- Other potential areas of disclosure:
 - Fees
 - Valuation practices
 - Assets under management

Valuation Practices: Infinity Q



- *SEC v. Infinity Q Capital Management LLC*
 - The SEC alleged that Infinity Q, a registered investment adviser, represented to investors and others that certain assets were valued by an independent third-party valuation expert.
 - However, the SEC claimed that Infinity Q inflated the valuations in four ways:
 - Manipulated computer code so that the valuation models disregarded certain relevant information;
 - Entered inputs that were incorrect;
 - Selected valuation models that were inappropriate and could not accurately value the assets; and
 - Selected inputs that were inconsistent for similarly situated positions with the intent of inflating the value of the assets.

Securities and Exchange Commission v. Infinity Q Capital Management, LLC, No. 23-civ-05081 (S.D.N.Y. filed June 16, 2023)

Recommendations Regarding Valuation Practices

- Are there valuation policies in place?
 - Are they followed?
 - How often are these policies updated?
 - Who decides how and when they are updated, and does that present any conflicts of interest?
- What methodology/methodologies are used?
 - What documentation exists explaining the use of these methodologies?
 - Is the reasoning behind individual valuation decisions documented?

FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2022-03
June 2022

Fair Value Measurement (Topic 820)

Fair Value Measurement of Equity Securities Subject to
Contractual Sale Restrictions

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

Recommendations Regarding Valuation Practices (cont'd)

- Is there a valuation committee? Is it independent?
- Are there any indications that the valuation policies and procedures aren't being followed?
- Are there any indications that individuals within the organization disagree with the valuations or do not think they are accurate?
- Does the firm use a third-party valuation expert?
 - If not, why not? How does the firm avoid conflicts of interest affecting valuations?
 - If yes, does the third-party valuation firm receive sufficient information? Is any information withheld?

Recommendations Regarding Valuation Practices (cont'd)

- Regulators build their cases off of evidence that:
 - (1) valuation decisions were made based on what earns firms the most money not the true value of the assets, and
 - (2) representations that certain processes and procedures would be followed and then were not followed.
- Make sure valuation decisions are independent, that there are policies and structures to enforce independence, and that there aren't deviations from policies and procedures

The Time to Act is Now

- Well-designed controls only work if they are effectively implemented
- Regular testing of controls ensures they are followed
- Ongoing monitoring of investments to identify any red flags
 - Whistleblowing mechanisms for internal reporting allow firms to identify, investigate, and remediate quickly and appropriately.
 - Early identification of issues prevents them from growing.
 - To work effectively, complaints must be investigated.
 - Zero tolerance for retaliation.

The Time to Act is Now (cont'd)

- Conduct a risk assessment and develop a plan:
 - What enforcement authorities have jurisdiction? What claims could they and investors bring?
 - Refine disclosures appropriately based on these risks
 - Plan legal defenses
 - What to do if a borrower defaults or becomes insolvent?
 - What claims can be brought?
 - Where can claims be brought?
 - Where does the borrower have assets against which claims can be enforced?

Questions?

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