

Questions To Ask Your Client When Fraud Taints Financing

By **Mark Kirsons** (November 6, 2025, 5:45 PM EST)

Fraud is not a fad. Publilius Syrus, in the first century B.C., noted that "[i]t is a fraud to borrow what we are unable to pay." Nevertheless, fraud lurks in the shadows of financing transactions.

In an era when capital exceeds opportunity, profits are elusive, negotiations often are unbalanced, cost-cutting is emphasized and many don't know why certain protections historically appeared in loan documentation, fraud finds fertile ground.

In addition, a growing number of economists, bankers and advisers have noted the increased likelihood of an economic downturn, when fraud is far more likely to be discovered.



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Recently, an analysis from Moody's Analytics warned that the U.S. economy was "on the brink of a recession" due to factors such as tariffs and high national debt. It further warned that the winter of 2025 and early 2026 could be a time of significant vulnerability.[1]

Citing data from May through July 2025, UBS also recently noted elevated risk levels and warned that the probability of a U.S. recession has risen to 93%.

Additionally, a number of transactions under suspicion of fraud or where fraud already has been discovered have been reported in the press in recent months, such as financings involving First Brands, Tricolor and certain funds tied to Cantor Group and California real estate transactions.

If fraud arises in one of your transactions, operate like a doctor diagnosing and then working to cure a mysterious illness, or like an investigative journalist shining light upon bad behavior. Ask the questions appearing below.

Once answered, work with your client to create an action plan to solve the problems caused by the fraud. Remain flexible as new discoveries may result in a modified plan. Be thorough, but work fast, as speed may make the difference in limiting losses.

In many cases, a borrower and a lender have common goals. Stop the fraud, make affected parties whole and maintain reputations. Don't underestimate the power of shared objectives.

The following questions and fact patterns, based on real-world experiences, serve to provide

practitioners with an action plan when confronting fraud in the future.

No two frauds are identical, so a practitioner is well served possessing a broad set of investigative questions and a wide-ranging set of possible solutions to address fraud when it first surfaces.

Setting aside obvious confidentiality constraints, there is limited utility for most practitioners in reviewing any particular fraud that already occurred. The patient has passed. Acting as a coroner examining a cadaver will not bring back the patient.

Rather, the following questions allow a practitioner to operate like a doctor-detective, seeking to discover the source of an ailment and then cure it.

What and Who?

Calls from clients surfacing fraud are pressure-filled and difficult. Lower the temperature of the discussion. Some amount of damage already is done. Don't make things worse. Calmly ask about what happened.

For example, in an asset-based loan, has the borrower submitted fraudulent borrowing base reports? In a cash-flow financing with ongoing financial covenant compliance, has the borrower submitted fraudulent compliance certificates?

Perhaps unauthorized extensions of credit have been made, funds have been diverted from the intended recipient, an insider has stolen loan proceeds, or collateral does not exist.

A gift in one jurisdiction may constitute a bribe in another. A crime may result in aiding-and-abetting concerns for secondary parties, like lenders. One fraud may lead to another, such as malfeasance in a loan transaction potentially resulting in securities fraud.

After determining what happened, ask what perhaps is the toughest question — who is involved? Some frauds are obvious, and the perpetrator is easily identified. Others are complex and may include a client's employee or adviser.

The client may not have an answer at the time of your initial call. Alternatively, the client or its customer already may have one or more employees under surveillance.

Discuss whether parties who were not involved in the underlying transaction need to replace some part of the existing deal team, at least during the initial phase of the investigation. In-house law departments play a crucial role in remediating fraud. Involve them in these deliberations.

Remind the client and its employees that this phase of the investigation is not personal. Most people are quickly cleared of wrongdoing and often will play an important role in solving problems resulting from fraud, as they are most familiar with the underlying transaction.

Also ask the client about the individual who discovered the fraud. Was it a member of the lender's compliance team? Someone in the borrower's C-suite? A whistleblower? Learning the identity of the individual will help to answer who is behind the fraud.

Be mindful that lawyers will not be able to solve some of the problems resulting from fraud. Multiple

third-party advisers specialize in criminal investigations. Consider whether one should be retained and the potential scope of the adviser's engagement.

For example, will the adviser be asked to interview possible suspects, locate missing funds or collateral, or determine how technology was used to perpetrate the fraud?

Discussions with a borrower's principal equity holders or board of directors may help uncover the party who committed the fraud. Such discussions also may result in the replacement of one or more members of a borrower's management team.

Be mindful of the line between actions permitted to be taken by a lender in exercising remedies, including the recovery of stolen funds, versus those that ultimately must be taken by a borrower, its board members or its equity holders.

Also consider confidentiality constraints when sharing information and whether walls need to be erected within the borrower or the lender during an investigation.

When and Where?

After discussing the nature and scope of the fraud, and identifying actual or potential suspects, attempt to determine how long the fraud has occurred. Statutes of limitations for some crimes are shorter than others. Discern possible causes of action and claims resulting from the fraud, as well as time periods available to pursue those actions and claims.

Also note that lenders often are not required to immediately report crimes to regulators, to the extent they are regulated entities, or other authorities. For example, if the fraud involves stolen funds, lenders often are provided the opportunity to recover those funds before taking other measures.

It may be the case that law enforcement is contacted only after funds are recovered or a recovery attempt fails. The amount stolen will, in part, determine the timing of reporting to applicable regulators. Fraudulent financial reporting may affect loan pricing or covenant compliance under loan documentation.

Lenders may be owed more than initially reported. They also may have the ability to declare an event of default and may elect to exercise certain rights and remedies — for example, the delivery of enhanced reporting, the accrual of default interest, and the delivery of tangible collateral to a lender or third-party custodian.

Bankruptcy may follow the fraud, and actual, instead of constructive, fraudulent conveyances may have occurred during the term of the transaction. Knowing when things happened will help decide the sequencing of action items in your remediation plan.

Along with establishing a fraud timeline, determine where the fraud occurred.

Was it at the borrower's headquarters, a plant a storage facility, or within the lender itself? Is property located where it is required to be maintained pursuant to the terms of loan documentation? In an era of digital assets, is there a third-party e-vault housing those assets, or are they maintained on a borrower's own server? Where are the passwords for those assets?

If the fraud involves property financed by more than one lender without the other lender's knowledge and consent, lenders will compete to recover proceeds, and each needs to know where assets are located, even if they are in the possession of a competing creditor.

For example, a borrower may have engaged in double-financing a pool of collateral. One lender extended credit and secured its claim by filing a UCC-1 financing statement. Another lender extended credit and secured its claim pursuant to the pledge and delivery of tangible collateral, such as warehouse receipts.

Neither lender permitted the financing extended by the other, and both are victims of the resulting fraud, with a lien priority dispute to follow. In some cases, collateral may not even exist, in which case, as noted below, other sources of repayment should be considered.

How and Why?

Some fraud is limited in duration and scope. Other fraud is widespread and far-reaching. In order to stop the fraud, the affected parties must understand how it occurred.

Were appropriate systems in place at both the borrower and the lender to ensure borrowing requests were legitimate and authorized? Were proceeds of accounts receivable diverted from a controlled cash management system? Were collateral audits and field exams performed, and were they appropriate in frequency, scope and detail?

Was wire information verified? Were third-party custodians performing their duties as required and reporting collateral file discrepancies both to the borrower and the lender? Were covenant computations checked?

Did loan documentation provide the lender with the ability to engage in ongoing due diligence like account verifications or site visits, and was the diligence accurately conducted? Did entities other than borrowers and guarantors knowingly consummate transactions in violation of loan documentation?

Answering these types of questions should help determine whether a fraud is ongoing and how to stop it from continuing.

Ask why the fraud happened. Was it simple theft by a lender's employee or a borrower's chief financial officer for personal enrichment? Were employee bonuses tied to financial performance, such that inflated numbers resulted in more compensation? Did certain contracts provide payment kickers if sales targets were achieved, so reporting was doctored to hit the targets?

Was financial information falsified in order to remain in covenant compliance, receive lower pricing, or complete a transaction away from the financing, like a sale or restricted payment?

Were the parties genuinely unaware that a type of transaction or form of payment in a jurisdiction constituted an illegal act, and will that lack of knowledge provide a defense to claims of fraud?

Understanding why fraud happened is critical to completing the client's action plan.

Once the initial work of an investigative journalist and doctor-detective is completed, construct a plan to stop the fraud, to the extent it is ongoing, and remediate the fraud, to the extent losses resulted from it.

Maintain communication with principal equity holders, boards of directors or other similar decision-makers for the borrower.

As with a workout, conduct a file review. Ensure you have a complete set of fully executed transaction documents. In a secured financing, ensure that security interests exist and are perfected (whether by filing, possession or control, as applicable), and the parties know where collateral is located.

Run lien searches to determine if other creditors will be competing for a potentially diminished pool of assets. Review financial and other reporting to determine what revenue streams are available for debt repayment.

Find the holes in your papers and plug them, understanding that tortious interference with contractual relations, voidable preference, constructive (not actual) fraudulent conveyance, and other laws, regulations and causes of action may limit the ability to improve your client's position.

Determine where your client sits in the borrower's capital structure. A senior secured lender always should consider the old tale about the bear that stumbles across campers in the woods. Your client may not need to outrun the bear (the borrower involved in the fraud). It only may need to outrun other campers (junior secured or unsecured creditors).

Fraud resulting in an event of default may allow a senior secured creditor to exercise remedies that fully repay that creditor, leaving other creditors with limited, if any, recoveries.

Those junior creditors may gladly buy out the senior secured lender's position, at par, in order to control the capital structure and the remediation process.

Stolen funds ultimately may be recovered. Assets purchased with stolen funds may be available for liquidation. Management teams may be replaced. Equity holders may directly repay amounts owed to lenders in order to salvage the affected business. Unsecured financings may be collateralized.

Fraudulent financial reporting and resulting events of default may lead to a workout that ultimately restores a borrower's financial health. Uncovering one fraud may result in the discovery of others.

A fraud starting in one jurisdiction may move to others, thereby requiring communication with counsel in those jurisdictions and a potential determination of where criminal proceedings need to occur. The nature of the fraud typically dictates the action plan required to stop it.

That plan will change based upon new information or the success of remediation efforts. Reputational risk is real, so the parties involved are incentivized to work hard and fast to address losses resulting from fraud.

Ultimately, your client may end up in a courtroom working to resolve these problems. Prepare them for that possibility.

Fraud is difficult to address and remediate. Emotions run high. Many who engage in fraud leave little evidence behind. Your client may be faced with pursuing actions against someone who has been a valued customer for many years.

In these pressure-packed situations, the finance lawyer who asks the right questions and demonstrates

sound judgment and commercial behavior in a timely fashion will help deliver a positive result for a very appreciative client.

If you think like an investigative journalist and a doctor-detective, and bring parties together for the common good, your client should successfully survive the scam. One last thought from Publilius Syrus in connection with fraud-tainted financings — "A good reputation is more valuable than money."

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[1] <https://thehill.com/business/5549424-22-states-recession-moodys-analysis/>.