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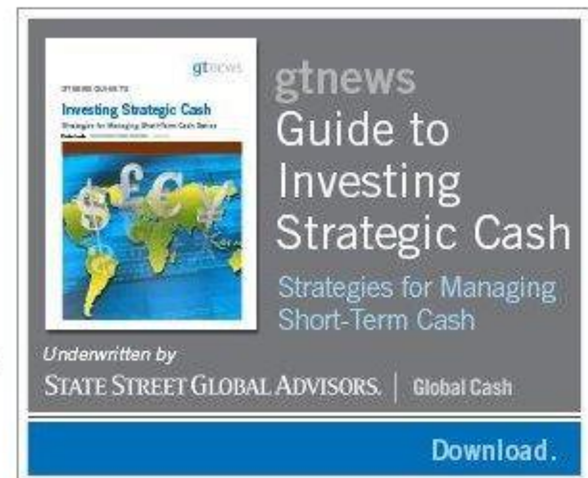
Why Specialist Financiers Should Welcome Regulation

Mark Wyatt, Falcon Group - 23 October 2014

Against a volatile global economic and political backdrop, there is nothing more important than the ability to manage risk. This article outlines the specific risks faced by specialist financiers and their corporate clients, offering insights into how best to manage them.

Specialist financiers, such as non-bank, corporate and trade financiers are flexible, sophisticated, fast and necessary to the financial landscape. They are also growing in number and expanding their market share.



Despite this, the industry as a whole has yet to become fully regulated, meaning that some may question whether they are vulnerable to risk. In fact when the 2008 global financial crisis hit, and risks of all shapes and sizes became abundant, specialist financiers not only stood strong but actually profited and grew. So they must be doing something right!

Indeed, risk management is a major priority for specialist financiers. They are focused on ensuring that clients are able to operate with confidence and certainty; not least because a defaulting client can have an obvious impact on their own financial health. Mitigating any risk that could hinder cash flow is therefore essential.

What's more wherever corporates go and need funding specialist financiers often follow. This global nature of speciality financing means that understanding and managing expansion risks in order to allow secure and efficient growth is also imperative.

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Developed Risks

Risk is a perennial concern. Indeed, the risks presented by developed markets - as opposed to emerging markets - can often be overlooked. Insolvency risk, which describes the possibility that a company cannot satisfy its debts, is a particular concern as it may force corporates into administration. Doing so can have severe consequences, not just for the company and its financiers but also for suppliers, customers and employees. Most recently this was demonstrated by the case of UK mobile phones retailer Phones 4u, which went into administration last month threatening around 5,600 jobs.

Of course, economic risk is also unavoidable. The uncertainty of foreign exchange (FX) markets can significantly affect a company's operations. For instance the eurozone crisis and, more recently, the impact that the possibility of Scottish independence had on the pound sterling both illustrate the sometimes fragile economic backdrop that companies have to operate within, even in the developed markets.

Cashflow is a particular concern of economic risk, especially since the collapse of Lehman Brothers six years ago. Most of the global banks challenged by the financial crisis were from Europe and the US. These banks are now restricted by regulatory proposals, such as the Basel III capital adequacy regime, that force them to keep more capital on their balance sheet. As such, they are restricted with respect to which corporates they can help. While this provides more business for specialist financiers, it also means that their corporate clients are more vulnerable - having lost an important lifeline.

Emerging Risks

As with developed markets, the same is true - only more so - in the developing world. Commercial risks exist in emerging markets as much as they do in developed markets. While the emerging markets have enjoyed strong economic growth in recent years the rate is now slowing, leading to potentially acute economic risk. What's more, the global banks restricted by regulation have become insular, focusing much of their attention on the domestic domiciles due to pressure from the governments that bailed them out. Emerging market companies, therefore, often fall fairly low on the list of global bank priorities.

Emerging markets also face country risk. While the developed markets have also seen their fair share of political strife, current political risks are concentrated around the emerging markets - such as the Arab Spring, Islamic State conflicts and the crisis in Ukraine. Any company expanding into the emerging markets must stay aware of these potentially cataclysmic events - as must any specialist financier funding them.

Emerging Opportunities

Despite these risks, companies and financiers of all sizes and industries are eager to expand into the emerging markets. With a steady (albeit slowing) economy, burgeoning south-south trade and expanding middle class (and therefore consumer base), the opportunities are manifold.

Added to this where there are opportunities for corporates to grow, particularly in areas feeling the impact of reduced global bank funding, there is also a demand for speciality financing solutions. As such, it is imperative for specialist financiers to have strong risk management teams and capabilities in place.

Managing Risk

While specialist financiers have always managed and mitigated risk, the increase in demand for innovative solutions and non-bank funding - as well as a heightened attraction to the emerging markets - means many have had to significantly improve their risk management in order to support their rapid growth.

For Falcon Group, this has meant developing risk management expertise by developing a dedicated team - both in terms of people and processes.

When looking at a corporate client, specialist financers must not only evaluate the client's financial strength, the structure of the deal to be financed and the risks associated with the company's location. They must also manage and monitor each of these elements on a regular basis. Monitoring news with respect to suppliers and customers, as well as the cash flow of a company, can help mitigate insolvency risk. Similarly, staying aware of location or operational changes and political risks can alert the specialist financier to any country or economic risks they may face.

What's more, by predominantly using trade instruments such as letters of credit (LOCs) and by mastering hedging specialist financiers are able to ensure that the solutions themselves, and the way they are structured, are as low-risk as possible.

Additionally, there is risk mitigation on the simplest level: better safe, than sorry. For a fast-expanding specialist financier this means making prudent choices, as well as maintaining a diversified and balanced portfolio. Accepting too much business in one region or one industry, for instance, leaves a specialist financier exposed to greater risk. By spreading operations, you also spread and reduce risk.

A Need for Regulation

Yet building strong risk teams and ensuring diligent risk management is only the first step. The rest will come from the inevitable regulation of the speciality financing industry.

Such regulation will not only distinguish strong financiers from those who are less credible, but also enhance the transparency and security of the industry. While some financiers are already transparent and have dedicated risk teams, the regulation of the industry could be beneficial in forcing other financiers to introduce similar precautions. Moreover it would also act as the stamp of approval for the leading specialist financiers. In this respect, specialist financiers should welcome regulation. Back to top