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Cheyne president hails 'golden age' of alt credit

Stuart Fiertz warns regulation could challenge the market's growth

BY WILL WAINEWRIGHT, 20 NOVEMBER 2019

Cheyne Capital co-founder Stuart Fiertz believes we are in a "golden age of alternative credit" but warned of challenges posed by regulators and approaches like peer-to-peer (P2P) lending.

Giving a keynote speech at the Alt Credit European Intelligence Summit in Sussex on Monday, Fiertz said banks should see fund managers operating on their traditional turf as partners rather than competitors.

"There is good business to be done as a partner, whether in providing reg-cap solutions or providing mezzanine debt to sit under the senior debt," said Fiertz, who founded Cheyne with Jonathan Lourie in 2000. "We don't want them to see us as noisy neighbours."

A combination of low interest rates and strong demand for yield meant "the attractive returns we can squeeze out of credit are needed now more than ever," he said, predicting the shift from bank to non-bank lending in Europe to continue.

Bank balance sheets are still "far too large relative to deposits and the ability of local governments and regulators to bail them out," he explained.

"There are [also] sectors like infrastructure – and I include renewable energy, housing, climate resiliency – that call for large amounts of capital. The constraints on public finance actually scream out for innovative solutions from alternative credit."

Cheyne is one of Europe's largest and longest-running credit managers and invests across the capital structure.

Fiertz, who serves as chair of trade body the Alternative Credit Council, said banks were good at lobbying but were "calling for a levelling of the playing field when I would say the playing field is still skewed" in their favour.

"The regulators need to understand the inherent advantages of our business model where we're rewarded by the long-term performance of the loans and credits we extend rather than by the sheer volume of credit extended, regardless of whether it was extended prudently or recklessly," he said.

"Poorly conceived limits on our ability to service loans will cut our willingness to extend credit. If you don't have the tools to collect then you are making perpetually zero-coupon grants rather than sensible loans."

The credit cycle has not been eliminated by strong investor demand, nor the structural shift away from traditional sources of credit, he said. "In fact we must be especially vigilant when the going gets easy."

Fiertz said direct corporate lending was showing worrying signs, including high demand, growing numbers of lenders, loss of covenant strength and coordination, and pervasive use of add-backs.

He called on the industry to avoid "shortcuts" in order to safeguard investors and to "make the case for our business model" with regulators.

"We need to have the kind of capital that allows you to support new borrowers and optimise recovery for investors."

He criticised the EU's proposed credit servicing directive, which would limit non-bank purchasers of European bank loans from being able to foreclose the underlying assets. "I have suggested, somewhat strongly, that this might discourage us from lending going forward," said Fiertz.

"In Europe we have to keep making the case for securitisation as a fantastic, risk-reducing technology."

Contrasting the transparent nature of securitised products with the banking sector, he referenced the financial crisis of 2007-08 and asked: "When and where were the runs on CLOs, as at Northern Rock? Which CLOs need bailouts?"

He also said managers needed to prepare for more ESG-related requirements being imposed by allocators and regulators.

"Externalities like carbon and other pollutants are increasingly being priced explicitly. I envision a time when carbon will be charged across the capital structure, perhaps using a weighted cost of capital to apportion the carbon between debt and equity."

Fiertz then moved onto other fund models. "I think peer-to-peer lending is a bad idea," he said. "Why is it a good idea to take the skilled credit manager out of the loop and leave the inexperienced and under-resourced peer to make the initial credit decision? What happens when this undocumented loan runs into trouble?

"I am a great believer in the use of blockchain technology and distributed ledgers. However, the 'unit-isation' of loans is almost as bad an idea as P2P lending. How can a loan that has been unitised ever be managed?"

He finished his speech by calling on the audience to "keep searching for new areas to lend into while remaining wary of the obvious markets. Nothing attracts excess capital and sliding standards faster than the easy sell."