SMEs and mid-market companies have traditionally been heavily dependent on bank finance. Banks are retrenching however, partly as a result of regulatory pressure. Potential new financing routes for smaller firms are securitization and private placements. It is proving very hard to resurrect securitization, partly because of the attitude of insurance supervisors to this asset class. The private placement market is well developed in the US and Germany and has been burgeoning (with official support) in France. But there is no tradition of such a market in the UK and, despite the efforts of many in the private sector, much of the infrastructure needed to support it has yet to be put in place. Many UK firms have to seek finance in the US where the private placement market is worth about $54bn. EU borrowers account for about 45% of funds raised there, and almost half of this is raised by UK companies.

Insurers need to find new asset classes to match their long term (especially annuity) liabilities. They face a number of challenges in going down the private placement route including some remaining lack of clarity about regulatory treatment. But if these can be resolved, there is clear interest among insurance companies and other institutional investors and some, such as L&G have already committed to expanding in the area of private placements.

Taking a wider and longer view, it seems certain that the UK is on the path to a more disintermediated system of financing small to medium sized businesses. Tighter banking supervision and conflicting demands being placed on the banks (deleverage but also lend more) are largely responsible. Equally however it is clear that the changes under way may do little to help smaller SMEs requiring £3-5 million. It may be that some sort of risk pooling arrangement can in time fill that gap but the changes under way in the asset preferences of institutional investors won’t of themselves do so directly.

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