

Decision Points

Global Experience Provides Direction

By John C. Deane



Understanding the New World of Risk Management

Leasing professionals have plenty of experience with risk management as it is commonly known. Each day, we evaluate credits, leverage detailed information on asset types and equipment valuations, and prevent fraud on deals funded.

But could your company be targeted in a class-action lawsuit, alleging unfair business practices or willful failure to disclose key information to lessees? Could regulators require you to revalue your portfolio because deals funded years ago no longer comply with capital adequacy requirements? Will boilerplate provisions of your standard documentation survive an attack by smart and well-funded lessee law firms, or ambitious prosecutors?

These are questions you need to ask about your risk management practices in today's business environment.

Another Paradigm Shift? Our industry is indeed on the hot seat. In its 2005 Industry Future Council (IFC) Report, the Equipment Leasing and Finance Foundation stated we have overcome major challenges in the past, but never have so many combined to reshape the future of the business.

The IFC was specifically referring to Sarbanes-Oxley, BASEL II and proposed accounting changes to certain lease structures. Are there more issues of concern? Based on The Alta Group's own market experiences, the answer is a resounding *yes*. More changes are upon us and they revolve around risk management, a most important aspect of our business.

Rules are changing and lessors and finance companies that do not understand them and their implications on business practices do so at their own risk.

The Alta Group regularly counsels clients and prospects about risk management issues, especially within the context of the infamous NorVergence quagmire, emerging priorities of

The Alta Group is a global consultancy serving equipment leasing and finance companies, investment professionals, manufacturers, banks and government organizations.

the plaintiffs' bar and the public response to these events. Too many organizations treat these as isolated incidents, rather than precursors of major changes to our industry - developments that may directly impact how we conduct business.

For example, a key issue in the NorVergence cases and other recent plaintiffs' bar actions against lessors involves the impact of certain practices on lessees that many of us take for granted. These include protection by the "hell or high water" clause - which appears in most lease documentation - or its cousin, the waiver of defenses clause. Or consider the reasonableness and full disclosure of various fees and costs included with a lease, and the fair treatment of the lessee at the end of the lease.

How these practices affect lessees has emerged as a crucial issue impacting the profitability - even the viability - of a growing number of lessors. This is not an isolated event, especially when the Federal Trade Commission uses the term "consumer" when referring to small business lessees.

Given these developments, is the evaluation of such standard business practices an important element of risk management? The Alta Groups thinks so. In fact, we think it is imperative the industry alter its prevailing views on risk management now.

Our industry has flourished during the past half century because it has offered products of genuine value to customers. This value

proposition is supported by simplicity, which is fostered by the need for transparency.

Unfortunately, there are lessors affected by compressed margins and high economic liquidity that use transaction presentation, structuring and pricing practices that are far from transparent. Much of this behavior is innocent; some more purposeful. This lack of transparency mirrors the daily operations of some lessors. And we wonder why the government is taking a close look at our industry?

The ELA is exploring the issue of such questionable business practices. While this is a bold step, The Alta Group thinks the conclusions drawn may not reflect the true impact such business practices have on risk management.

Lessors must recognize their business practices are a key element of risk management itself. Leadership must call for careful and open analysis of all practices and how they may affect a company's risk profile.

You can then decide if the new risk management assessment is a paradigm shift or not. The long-term success of your organization may depend on it.

Interested in discussing your risk management issues with The Alta Group? Please contact John Deane, managing principal, at 775-749-1028. www.thealtagroup.com/decisionpoints.php