



# Investor Case Study

## Tackling Funding Gaps: Asset-Backed Solutions in Specialty Finance

**December 2024**

## Investor Case Study: Tackling Funding Gaps - Specialty Finance

### About Channel

**Channel Capital Advisors LLP** is the FCA authorised and regulated unit of Channel Digital Holdings Ltd, a London based firm using technology to fund the specialty finance and innovation sectors.

**Founded:** 2007

**Location:** London, UK

**Funds:** Open pooled funds, SMAs and co-investment mandates

**Share class:** Traditional and Sharia compliant certificates

**Volume:** \$25 billion of financing

**Website:**

[www.channelcapital.io](http://www.channelcapital.io)

### Specialty Finance Defined

Specialty finance can be defined as any financing activity that occurs outside of the incumbent banking system, a sector with significant growth since the GFC period. Non-bank lenders require funds to on-lend to their customers.



Non-bank lenders leverage competitive advantages via technology, alternative data, speed, and market access. The specialty finance market is estimated to be \$20 trillion globally<sup>1</sup> and is experiencing rapid growth. Empirical research shows that non-bank lenders can lend to under-banked sources without taking undue risks<sup>2</sup>. Unlike direct lending, the underlying collateral pool often revolve throughout the facility term and thus offers substantial downside protection and lower return correlation. Asset managers like Channel fund specialty finance operators and typically incorporate protective features, including segregation of collateral, cash collection controls, robust termination events, subordination/alignment of interest and technology-led monitoring.

1. Pimco (2023)  
2. Philadelphia Fed (2019, 2022)

### 1. At a glance

**\$20 Trillion market<sup>1</sup>**

**+12-14%** returns

**+2-year** average maturities or revolving periods

**+100-1,500** average number of obligors pooled transactions

### 2: Collateral and Common Sector Players

#### Collateral

- Trade receivables/Invoice finance
- Short term merchant cash advance
- Revenue based finance
- Secured Inventory Finance
- Data centre, solar loans
- Credit cards, BNPL
- Auto loans, leasing

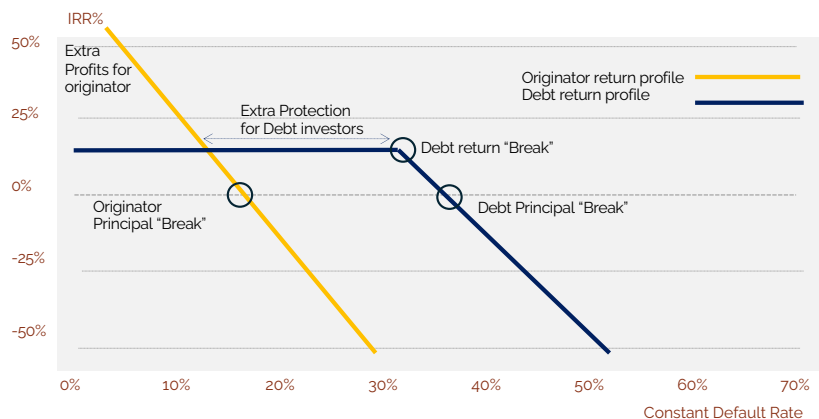


### 3. The Specialty Finance Frontier: How our structuring provides downside investor protection

Specialty finance assets can provide an attractive risk / return frontier compared to other private debt investment strategies. Furthermore, they typically exhibit pooled risks with diversification benefits, subordination and average 2-year+ maturities unlike private debt or direct lending to sponsor-backed firms.

Transactions include granular portfolios of B2B or B2C assets and termination events that trigger the repayment of more senior positions upon defaults, losses or other risk measures occurring, before any erosion of principal occurs to investors. The panel to the right illustrates an investment made by Channel in 2023.

**Return profile for an actual debt investment (red line) into specialty finance:** Completed by Channel in 2023 at a 14% return, with equity subordination and 5% reserves under varying constant default scenarios



In this example, the sponsor contributed a substantial first loss to the investment strategy in order to demonstrate their alignment of interest. As illustrated in the dark line above, while we do not earn returns greater than 14% per annum, we do expect to receive income until the Constant Default Rate (CDR) over the investment life to exceeds 30% on average, given the subordination and 5% accumulation of reserves. This compares favourably to the yellow line where higher profits can occur for low CDR rates but more quickly erode upon crossing over CDRs of 10%-12%.

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