

Texel Group Quarterly Newsletter



Q1 2020



Group Overview

The word “unprecedented” has probably never been used quite so appropriately during most of our lifetimes. Across our offices, Texel’s employees are currently working from their home offices, living rooms, bedrooms and managing nonetheless to deliver seamless service to our clients. So firstly, it is worth saying that we are very proud of the way that our staff have responded to these upheavals and can only thank them for maintaining their professionalism, efficiency and above all their humour during these difficult times. Video conferencing and social media applications are obviously a huge advantage professionally and we have also seen a significant increase in webinars from conference organisers, law firms, management consultants and other experts. Texel has made a point to arrange and participate in such events.

The insurance market as a whole has come under public scrutiny for relying on unexpected exclusions and small print which can exclude or invalidate cover for people’s travel insurance and other personal insurances. These events can negatively influence opinions of the insurance market and have unintended harmful implications for more specialist insurance coverages where such exclusions and small print is not present. Hence, we think it is important to reflect on the fact that the Non-payment Insurance (NPI) product when correctly structured and drafted does not include any such exclusion which be outside of the control of the Insured and the market’s claims performance since the Global Financial Crisis has been exemplary. We would therefore expect any claims arising from this current crisis would be treated in the same manner and we hope that this is another great opportunity to prove the value and performance of the products and evidence the benefits to new users.

The insurance markets in London, Singapore and New York remain open and we are closing new insurance across all offices. Clearly Insurers need to be prudent and considered when looking at new transactions but with open and transparent communication from our clients these Underwriters are able to take informed decisions to support new and seasoned deals. We continue to remind our clients that communication is

key and that regular and sometimes too much communication is well received by your Insurers at this time.

Generally, the partnership approach that our clients take with Insurers has helped to mitigate concerns there could be a loss of liquidity or volatility in pricing that is clearly more evident in other protections, such as the CDS market. We would therefore be keen to further reinforce the partnership mantra, as these are times when the insurance market can continue to show its resilience and ongoing support to meet our clients’ needs.



Simon Bessant, Director





William Shaw, Managing Director and founder of Texel Asia Pte Limited

This Texel Group Quarterly Newsletter has a particularly Asia-Pacific (APAC) angle, partly because North and South East Asia has been coping with the human, political and economic impact of COVID-19 for several months now and so has some more extensive perspective to work with. This is not to suggest that the situation is any less daunting, or that there is any greater clarity as to its effect on the markets as a whole or the supply chain which is so critical to this part of the world, but that there has been more time to consider its consequences.

Texel Asia Pte Limited, in line with the Texel Group's activities, has a client base of relationships within investment and commercial banking, ECAs and Multilaterals and the corporate and trading

worlds. Credit and Political Risk Insurance (CPRI), as a collective term for the different product offerings, and the underlying business which it supports and participates in, has always required an extremely close sense of personal engagement between counterparties and a clear understanding of the intricacies of the structure and value each deal, as well as the due diligence and credit process of the principals involved.

Structured credit, structured trade finance and trade finance in partnership with the single situation CPRI market, has always found ways to flourish and (importantly) to aid the rebuilding of damaged economies. That was true after the fall of the Soviet Union in the late 80's early 90's; the Asian/Russian/LatAm crisis in 1997 and 1998 (when the Texel Group was founded explicitly to work with the CPRI market to help raise liquidity in illiquid times), in the Global Financial Crisis (GFC) in 2008, and it will be the case now and in the recovery from the economic and political damage arising from this pandemic. Each of these times saw a severe flight of access to liquidity from traditional sources of local and international capital markets and from corporate lending, but an increase in the financing of performance risk and asset backed finance. Access to higher-rated obligors always grows in these circumstances, at the same time often showing that the CPRI market is a substantial and consistent partner to step in when the cancellable whole turnover insurers cut their lines. But to achieve this, there needs to a dedicated effort to identify the right transactions and obligors, with the appropriate structures, with proven, competent, transparent and dedicated Lenders/Insurers and to address these opportunities with positive intent and engagement, as well as stringent credit and underwriting criteria.

Many Asian markets have always led the way in terms of speedy "V-shaped" recoveries and with a gradual sense of return to some industrial activity within China already, together with clear intent from regional Governments, there is room to expect that momentum in the coming period.

It has been noted to us that, in a "flight to capital and currency", corporate obligors have increased drawing down loans in multiple US\$ Billions, on a purely precautionary basis. The same thing happened during the GFC as some obligors chose to draw down rather than risk that such commitments were honoured and it is not clear whether or when these funds will be utilised, perhaps in part kept as reserves against strain and for margin calls in volatile markets, but hopefully also in preparation for the recovery.

While there are certainly industries and sectors which are particularly difficult to finance/insure without significant Government support at this time. There are still areas which many banks in APAC are seeking growth, such as project finance in the renewable energy space, physical infrastructure finance (ports, warehousing, rail and roads), digital infrastructure, utilities, education and microfinance, for example. In the current market, some banks will obviously focus on existing long-term obligors, but also target strong new entrants who are looking to diversify their funding. Many banks will be looking to take larger tickets with these key obligors and with the CDS market again showing such volatility, the partnership with and consistency of the CPRI market will become more important. There is real opportunity here, but there is also a serious responsibility for practitioners from all sides of this market, to help qualify and properly represent and understand the true risks involved,





With transparency from true partners, it is critical that (within the difficult constraints imposed internally) Insurers are sure to engage their experience and resources to actively seek out the right deals to support. This responsibility does not only apply to the need to sustain and build the commercial viability of the banking and insurance markets, but also, particularly in APAC, to achieve what can be done to support emerging economies, businesses and ESG initiatives, without which the growth in poverty and withdrawal of sustainable solutions will surely have a far greater impact than COVID-19.



APAC Insurer Perspective

APAC Insurers started 2020 with cautious optimism following a rewarding 2019, although certain challenges started to surface towards the end of the year. Unfortunately, optimism has been challenged as Insurers come to terms with the serious threat to global business and supply chains throughout the region. CPRI has tended to buck the trends of other insurance lines with additional capacity and capabilities added in recent years, however there is now added scrutiny on CPRI teams to reanalyse new and existing exposures to satisfy heightened senior management and/or reinsurer scrutiny.

The APAC CPRI market, with the exception of one or two insurers, remains open for new business. That said, Insurers are identifying sectors which they believe are most at risk, including aviation, shipping, oil and gas, retail, real estate and in a limited number of cases, their general credit appetite overall. At the start of the year there were indications that onshore lenders were tightening credit lines for Chinese POE's in view of the challenging market conditions and fears over possible default. The outbreak of COVID-19 has led to further monitoring and internal discussions to decide what the CPRI market's position is vis-à-vis binding new transactions in China. While most Insurers are not closed entirely, they remain very cautious, particularly on obligors in the commodities space whose imports and sales are heavily reliant on trucks, rail transport and other associated logistics, and employees returning from other provinces. Appetite for marginal, unsecured credits is limited, however there may be opportunities as insurers turn their focus towards sovereign/sub-sovereign obligors as countries seek funding to assist the recovery. Investment Grade credits will naturally be a focus for APAC Insurers, however the inevitable hardening of premiums rates and increase in funding costs could make the placing of insurance a considered process.



James Tiarks, Broker



A low oil price environment has resulted in many Insurers re-evaluating their stance towards the energy sector. There are a limited number of RBL's in the APAC region and Insurers were encouraged at the start of the year by the stable oil price and number of potential new deals being structured for 2020. That sentiment has changed as Insurers have seen redeterminations across their global energy books and although some are still willing to consider RBL and BB structures, they will be selective.

Naturally new enquiry traffic and policy closing has slowed, but we continue to encourage clients to discuss potential names with Texel soonest, ahead of a rebound of CPRI activity in the region. One lead Insurer provided a very encouraging quote on their approach to business in these difficult times, its clear to us many insurers trust their existing processes, modelling and stressing of risk:

“Open for business, no change in underwriting strategy, no change to underwriting process. Same standards apply.”

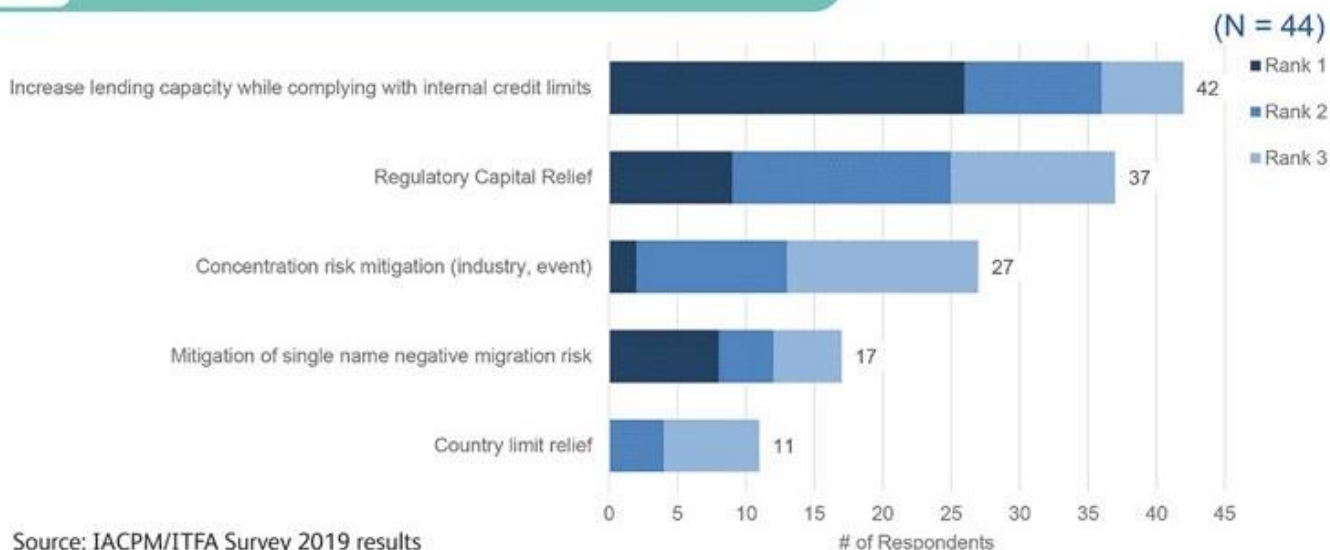
Global Claims update: USD3.3bn was paid between 2007-2019 under policies placed via brokers to financial institutions. 100 % of NPI claims made in 2018 and 2019 were paid on time, and in full.

(Source: Independent Broker Survey published April 2020 as a follow up to the Lloyd's Market Association and International Underwriting Association Survey commissioned in 2017)

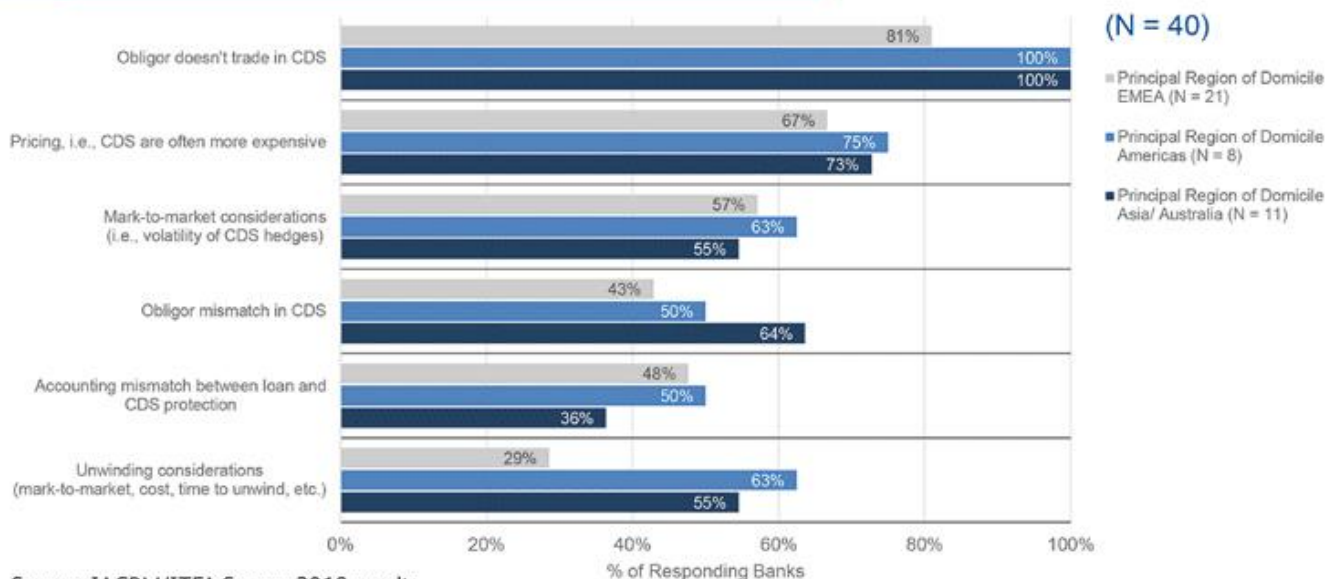




Top 3 Goals for Using NPI



Main Reasons for Choosing NPI over CDS



Carol Searle,
General Counsel

Regulatory Update

In this unprecedented time of global uncertainty, on 27 March 2020, the Basel Committee endorsed measures to provide additional operational capacity for banks and supervisors to respond to the immediate financial stability priorities the global banking system. The measures endorse the deferral of the implementation of Basel IV by one year. See: <https://www.bis.org/press/p200327.htm>

In our 2019 Newsletter we reported on the EBA work after the past two years on the CRM framework, including its guidelines to the credit risk mitigation (CRM) for institutions applying the IRB approach with own estimates of LGD. Most of the issues raised in the public feedback were beyond the scope of the guidelines as they touch upon the reforms proposed in Basel IV. The EBA had not explicitly addressed NPI in its report to the European Commission in response to the Call for Advice. [Recap: key area of focus for insurance stakeholders is the proposed input floor of 45 % LGD for insurers].

EBA opinion on the treatment of NPI:

On 9 March 2020, the EBA provided additional input in the form of an opinion on the treatment of NPI as a CRM technique, intended to complement previous policy advice.

The EBA proposes that NPI considerations are more complex than the mere recognition of the impact of claims priority and favour an alignment with internationally agreed standards for Basel IV and concludes insurers should not have a specific regulatory LGD.

The EBA also commented on the lack of empirical evidence to support the claim that in the event of default of an insurance company the losses of the policyholders would be significantly lower than 45%. The complexities raised for consideration include that amounts of claims on NPI are typically higher during the period of economic downturn and this should be taken into account in the estimation of LGD. -Industry bodies (both banking and insurance) are continuing with their efforts to seek recognition by the European Commission (EC) to cater for the unique characteristics of insurance in Basel IV. The deferral of Basel IV implementation affords additional time for the market to collect data to support its work and address some of the considerations raised by the EBA opinion. This includes two recent reports/surveys already conducted.

KPMG study:

The EU began the process in 2001 to harmonise and strengthen insurance regulation and a number of directives and regulations were introduced. Policyholder protection is at the heart of the changes to insurance regulation. Solvency I and Solvency II came into effect in 2004 and 2015/16 respectively, as part of the addressing the lack of readily available data to support efforts in recognising the unique features of NPI as a CRM, a number of industry bodies commissioned KPMG to conduct a study of every insurance company insolvency in seven European markets since 1990, including France, Germany and the UK;



The results of the study revealed that the bulk of failures occurred in the early 1990s, due to the dramatic increase of asbestos, pollution and health hazard claims arising out of the United States of America.

The study also noted that the enhanced capital and regulatory requirements introduced by Solvency I/II contributed to a marked decrease in the number of insurance company insolvencies. According to the study, for those insurance companies that became insolvent after introduction of Solvency I regulatory changes, all policyholder claims were paid in full where KPMG were able to obtain details of distributions.

The aforementioned EBA opinion was written without the benefit of this KPMG report and it may address some of the concerns raised.

IACPM/ITFA industry survey:

In addition to the KPMG study, the IACPM conducted an industry survey in collaboration with ITFA to explore NPI general practices among 46 global financial institutions which included the majority of European A-IRB banks. The survey indicated that the top three reasons why banks use NPI is to increase lending capacity whilst complying with internal credit limits, regulatory capital relief and concentration risk mitigation.



Looking forward:

The market is continuing with its efforts to gather evidence to support recommendations for changes to Basel IV to accommodate. We will continue to report on these initiatives, along with any further regulatory developments relevant to NPI.



In these challenging times we are all having to think and act differently. At Texel Foundation we wanted to strike a balance between promoting a positive sense of community amongst our staff, clients and market partners whilst also ensuring that we support those most at risk from the pandemic.

To address the former, we set up the Texel Foundation 1000km Challenge, to raise funds for Age UK and Trussell Trust food banks. Since forming the group we've had 44 members join us by running, hiking and cycling in solidarity. If you would like to participate, please search for Texel Foundation 1000km Challenge on Strava or sponsor us here.

We will be aiming to collectively cover 1000km over the next few months, through walking, running, cycling or swimming.

Suggested donations: 20p per km run/walked, 5p per km cycled and 50p per km swim.

We have decided to take a fresh look at 2020 grants in light of COVID-19 and its impact on the causes we support. We have asked all applicants to update us on how the virus is affecting their beneficiaries, so that we can give as effectively as possible to those in greatest need.

In 2020 Texel Foundation founded 'represent.', a social theatre company offering professional performing credits and on-the-job training for actors from a lower socio-economic background.

With heavy hearts the cast of represent. have had to step away from the rehearsal room, but that doesn't mean the creativity stops! Training has gone virtual and the cast are having daily online rehearsals as well as a series of workshops to enable them to continue developing their craft.

Please follow them on social media @representtheatre for more updates and films.

Texel Asia colleagues along with clients and insurers from the APAC CPRI market kicked the year off with a Texel Foundation fun-run to help support FootballPlus Ltd, a local Singapore charity that works with young people in the community and schools and sees them working with 200 players every week throughout the year.



This briefing does not necessarily deal with every topic or cover every aspect of the topics with which it deals. Notwithstanding anything to the contrary herein, it is not designed to provide legal or other advice.