

Texel Group Newsletter



A Review of Q4 2020

Non Payment Insurance (“NPI”) Insurer COVID-19 Survey

Firstly, on behalf of the Texel Group I would like to wish all our business partners the very best for 2021, both personally and within work.

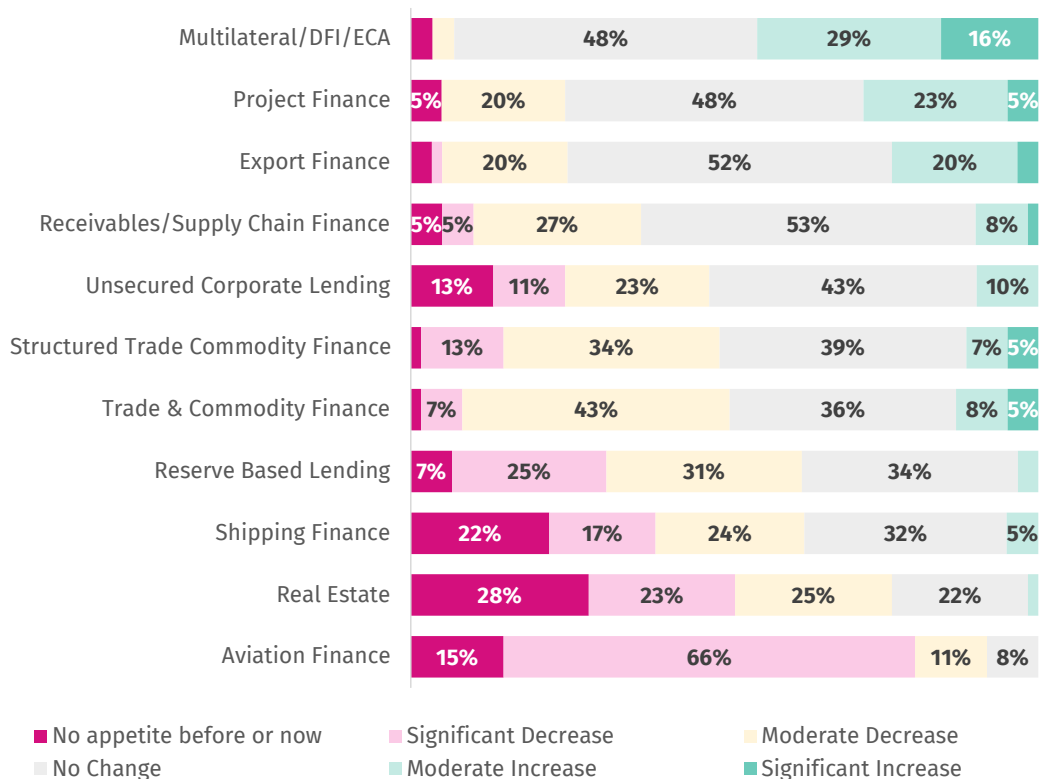
In December 2020, we shared the results of our [Non Payment Insurance \(“NPI”\) Insurer COVID-19 survey](#) which included responses from 67 underwriting teams across the London, Singapore and New York NPI hubs.

We wanted to provide some data-backed analysis of how the NPI market has evolved since the arrival of the pandemic, being mindful that the results may be a function of many factors unrelated to COVID-19 e.g. new ESG guidelines, prior claims activity changing sectoral focus and a client entering/exiting the market. The results reiterated NPI as a reliable long-term risk distribution tool and advertised the breadth and depth of insurer capacity and capabilities.



Simon Baker
Broker
Texel Finance Limited

Change in appetite for transaction structures – Texel NPI Insurer COVID-19 survey

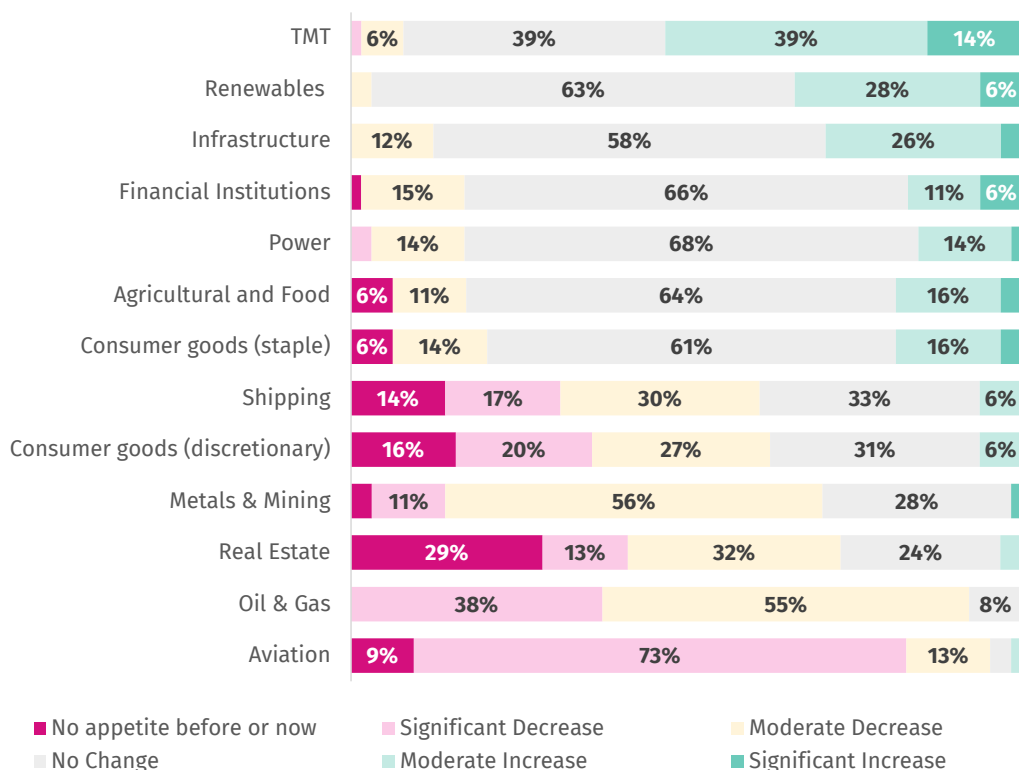


From Texel's position with daily (if not hourly) contact with insurers across our four offices we know the – currently virtual – NPI market is receptive, binding policies, paying claims and continuing to grow as before. Like any year, insurers calibrate their underwriting focus on an ongoing basis in response to demand from clients as well as their independent credit analysis on obligors and sectors. The year 2020 was no different, with insurers adjusting their appetite in line with the shifting dynamics and risks present in a global economy reacting to COVID-19.

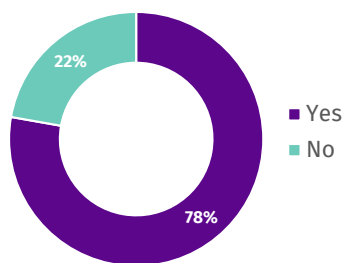
Despite every insurer having a unique underwriting strategy, the survey results demonstrated common changes in the market allowing us to summarise certain trends since March 2020:

1. The three sectors with the greatest increase in insurer interest have been in TMT (Technology, Media and Telecommunications), Renewables and Infrastructure within Project Finance, Export Finance and structures involving the participation of Multilaterals/DFIs/ECAs.

Change in sectoral appetite - Texel NPI Insurer COVID-19 survey



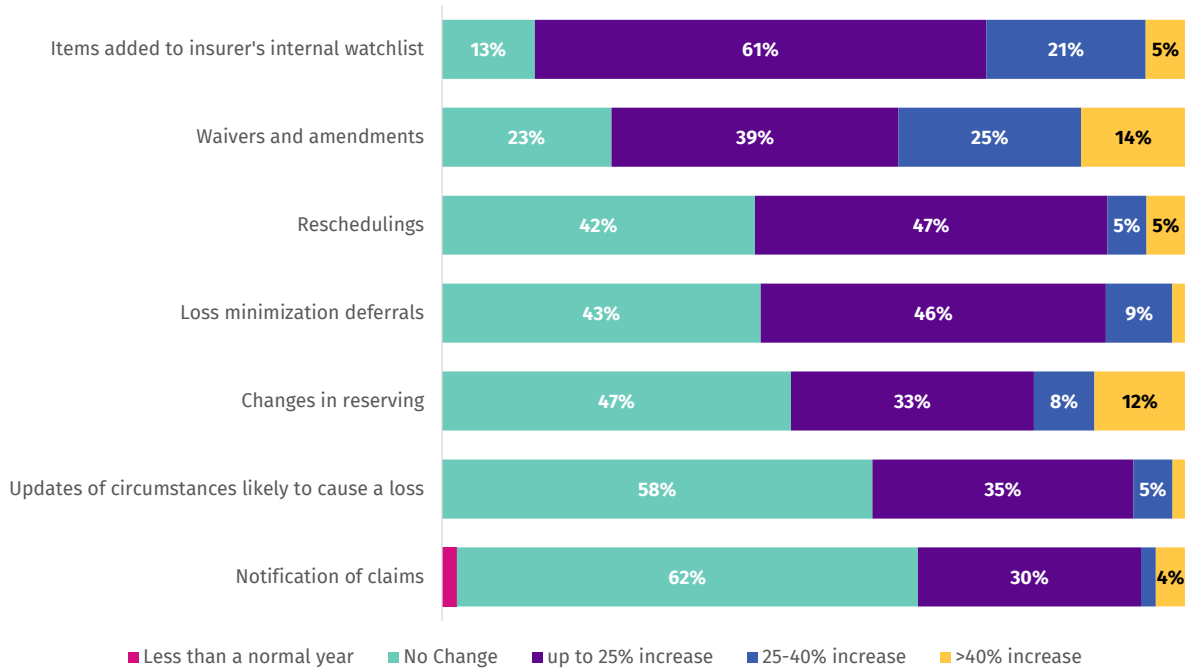
New client support since March 2020 - Texel NPI Insurer COVID-19 survey



2. New clients have entered the market and 78% of insurers underwriting NPI have bound a first policy with a new insured. In a new client, insurers predominantly look for the quality of due diligence shared including credit methodology and a long-term NPI strategy.
3. There were some changes to the demand and supply of NPI. There was an approximate 25% average reduction in each of NPI enquiries received, enquiries indicated, and policies bound but these metrics recovered from July 2020 onwards. The pricing on 58% of Non-Binding Indication (NBIs) issued prior to March 2020 needed to be amended in some form, with insurers predominantly explaining that their enhanced credit risk assessment of any obligor required a change in terms.

4. The NPI market has not yet seen widespread claim notifications. There is an expectation that if there is an uptick in COVID-19 related claims it would happen in 2021 and onwards. Whilst 87% of insurers note an increase in obligors/transactions added to their internal watchlists, 62% comment there has been no change in their typical notification of claims levels.

Policy amendment and claims related changes to NPI portfolios – Texel NPI Insurer COVID-19 survey



We are very grateful for the NPI insurers' participation in the survey and hope that the data will permit a trend assessment over the months and years to come, as we continue to engage with the NPI market to ensure stable growth in the buying patterns of existing clients and increased collaboration with new entrants.



Yacintha de Lannoy
Director
Texel Europe BV

Texel Europe BV

Notwithstanding our locked-down world, Brexit remained on course and came to its conclusion by the first day of 2021. The UK left the EU Single Market and Customs Union, its policies, and various international agreements behind. Politicians reevaluated the different stages of economic integration and decided on a new EU-UK Trade and Cooperation Agreement.

Financial services temporarily were largely neglected and will be taken up for discussion during the months to come. We can expect that one of the major topics to be discussed will be 'Regulation'. One of the potential outcomes, albeit it slightly utopian, could include the UK receiving market access rights regarding certain services, on the basis that their laws and supervisory frameworks are deemed 'equivalent' to those of the EU. From what we gather, it is likely that the EU is planning to keep a strong stance on equivalence and will only provide consent when there is a mutual interest. Only time will tell what will become the realistic and pragmatic new playing field for financial services between the UK and the EU.

The reality of today is that the UK is now officially a third-country party to the EU, meaning that its European backbone, whereby European passporting rights allowed EU-based enterprises to provide services between member states, has ultimately fallen away. As with most other UK companies in the financial services industry, the Texel Group prepared for the worst-case scenario of a no-deal Brexit and successfully established its European subsidiary Texel Europe BV in the capital of the EU, along with its UK Branch in London. Using its reverse-branch structure, the Texel Group has to date ensured a smooth transition for its European clients. Texel Europe BV is supervised by the local Belgian regulator, Financial Services and Market Authority (FSMA) and its UK branch is registered under the Financial Conduct Authority's (FCA) Temporary Permissions Regime. Our European subsidiary subsequently has access to other EU member states and clients through its own European Passport. Our compliance team is dedicating a lot of time and effort in gathering advice from numerous sources and organisations based in the UK and the EU, particularly the FCA of the UK, FSMA of Belgium, the European Insurance and Occupational Pensions Authority (EIOPA), the London & International Insurance Brokers Association (LIIBA), and continues to keep a close watch on any further developments.

As for the Texel Group, we are adamant that regardless of your political persuasion Brexit must now be treated as an opportunity. Proximity to several clients is one attractive angle of Texel Europe BV but effective client service remains our key priority. Growing this EU base further in a measured manner, alongside our expert teams in London, Singapore and the United States, we are well positioned globally to support the use of NPI and other insurance products as drivers for trade and economic growth.

Regulatory Update

We turn our focus back to a 2020 summary of the implementation of Basel III reforms (also referred to as Basel IV). Basel IV is a package of reforms agreed by the Basel Committee on Banking Supervision (BCBS) in December 2017.

The BCBS' implementation date for these reforms, with the exception of those relating to the output floor, is 1 January 2023. (Originally these reforms were to be implemented by 1 January 2022 however a deferral of the implementation of Basel IV by one year was agreed in March 2020 due to COVID). The implementation of Basel IV will require extensive amendments to existing EU banking legislation, particularly the Capital Requirements Regulation (CRR).



Carol Searle
General Counsel
Texel Finance Limited

Certain elements of Basel IV reforms have already been transposed into EU law – Capital Requirements Directive V (CRD V) and Capital Requirements Regulation II (CRR II) published in June 2019 concern the trading book, counterparty risk and large exposure guidelines. Member States were expected to adopt and publish measures necessary to comply with CRD V by 28 December 2020 and CRR II applies from 28 June 2021. The initiatives that the insurance industry has been concerned with are the remaining reforms. It is anticipated that a legislative package to implement the remaining Basel IV reforms will be published during Q1 2021.

Basel IV removes the option to use the advanced IRB (A-IRB) approach for certain asset classes, and amongst other things has adopted "input" floors for metrics such as probabilities of default (PD) and loss-given-default (LGD) with a prescribed LGD of 45% being applicable to the exposures to insurance companies where insurance is used as CRM. There is a concern that failure to take into account the unique features of insurance to justify a lower LGD floor would reduce the efficiency of the NPI product, leading to less use of it with the unintended consequences that European banks will decrease their levels of lending impacting the real economy. (See Texel Group Newsletter Q4 2019 for further details of the consultations that had taken place during 2019).



As a result, there has been a great deal of cooperation across banks, insurers, brokers and their industry bodies to explain the insurance industry perspective and the vital role that insurance plays in financing the real economy to the European Banking Authority (EBA), European Commission (EC) and Member States. The concern is that a 45% prescribed LGD does not reflect the senior position of banks as policyholders. The industry continues to actively seek appropriate legislative regulatory treatment for insurance and these efforts are going.

In March 2020, the [EBA published an opinion](#) on the treatment of NPI in response to concerns raised relating to the LGD, especially in the context of the EU implementation of Basel IV. 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 insurance companies should not have a specific regulatory LGD. The EBA has 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%.

Industry bodies had already been working during 2019 to collect data to support its position, including commissioning KPMG to conduct a study of insurance company insolvencies in European markets and the EBA did not have the benefit of these when it issued its opinion (see Texel Group Newsletter Q1 2020 for further details). The efforts to seek recognition by the EC to cater for the unique characteristics of insurance in Basel IV continued throughout 2020 by a number of industry bodies working in cooperation with each other, of which we mention two initiatives:

- Industry 'joint association' letter commissioned by the International Trade & Forfeiting Association (ITFA) in consultation with the International Association of Credit Portfolio Managers (IACPM), Bankers Association of Finance and Trade (BAFT), Berne Union, Lloyd's Market Association (LMA) and International Underwriting Association (IUA). This letter was sent to the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and EU Member States Permanent Reps with the aim of acknowledging the initiatives that were then under consideration concerning provisioning for non performing loans. [Recap - CRR Quick Fix of June 2020 introduced some targeted changes for non performing loans] (see Texel Group Newsletter Q3 2020).
- Industry cooperation continued and in November 2020 ITFA (with the endorsement of the IUA, IACPM, ICC, ICISA and LMA) submitted a presentation to the EC which included the KPMG study to demonstrate the senior position of the insured and to demonstrate that insurance and bank industries are not correlated but complementary. The further information has also been provided to the EBA and will be disseminated to Member States.

The industry efforts are on-going and we will report further developments in our next quarterly newsletter.

What happens to the UK's adoption of CRR post-Brexit?

The UK focus has been to maintain the status quo on the UK's departure from the EU. This process is known as "onshoring", which concerns transforming existing EU regulations into UK law and ensuring the UK statute book works effectively post-Brexit. The CRR is accordingly preserved as UK law at the end of the transition period.

As noted above, Member States were expected to adopt and publish measures necessary to comply with CRR II from 28 June 2021; so most of CRR II is not preserved as UK law. Further, any implementation of Basel IV by the EU in the future will not apply to the UK.



The Financial Services Bill, which was introduced to Parliament on 21 October 2020, looks to the future, as to how the UK will regulate financial services outside of the EU. This Bill has completed all stages in the House of Commons and will now go to the House of Lords. The PRA is responsible for updating the CRR (which will also include CRR II and updates required for Basel IV). The Bill provides (in a new section 144C of FSMA) that the PRA must, when making CRR rules, have regard to: (i) relevant Basel Capital Standards; (ii) the likely effect of the proposed rules on the relative standing of the United Kingdom as a place for internationally active credit institutions and investment firms to be based or to carry on activities; (iii) the likely effect of the proposed rules on the ability of credit institution and PRA-designated investment firms to continue to provide finance to businesses and consumers in the United Kingdom on a sustainable basis in the medium and long term; and (iv) any other matter specified by the Treasury by regulations.

We do not yet know to what extent the UK will adhere to financial services regulatory standards implemented by the EU, where it no longer has a say, and how this will be balanced against equivalence with the EU. It is a work in progress and one we will follow closely through the year.



Texel Foundation

The last year has presented unimaginable challenges for us all. There have been devastating and heart-wrenching impacts but also astounding examples of community, innovation and joy. At Texel Foundation we have navigated this uncharted territory by listening to our trusted charity partners and doing our very best to support them as they address both immediate needs and longer term scars. We are truly inspired by the incredible tenacity and compassion demonstrated by our partners this year and it has motivated us to feel optimistic about what we can collectively achieve in the coming year.

Katy Beechey
Programme Director
Texel Foundation



In the following podcast interview, I talked about how COVID-19 has impacted Texel Foundation's giving in 2020, lessons learned, the meaningful impact our donations have had and why we are optimistic for the future. Listen to the podcast [here](#).

