

### Fibre Market Analysis

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This article will spotlight an area where we have seen an increasing number of enquiries over the last couple of years: digital infrastructure, and most particularly fibre-optic broadband (“fibre”). The number of banks who do not have a Technology, Media and Telecommunications group is fast shrinking as lenders seek to better engage with this growing market area, and as a result, the number of enquiries presented to the CRI market is also ever-increasing. In this article we will briefly outline the i) nature of fibre broadband, ii) highlight some general aspects of these deals which have made them interesting for the Non-Payment Insurance (“NPI”) market, and iii) consider some potential target areas for future enquiries.

#### **i) What is fibre broadband?**

Fibre broadband is the fastest known technology for data transmission: without going too far into the technicalities, it operates via light signals beamed down a glass core, in contrast to traditional technologies which use electrical signals via copper cables. This means the data transmitted can travel at the speed of light, offering a very high bandwidth and symmetric upload/download speeds. Household speed of internet connection has become increasingly crucial in the working from home era, and therefore the likelihood that fibre infrastructure will come to be the ‘fourth utility’ in future years is ever-increasing. Deal volumes for digital infrastructure have rocketed over the last few years, increasing by 2.3 times between 2018-2020 as illustrated in the graphic below (Proximo Infra, 2021). Consequently, the number of enquiries to the NPI market have also increased, with insurers rising to the challenge of meeting the demand.

	2018 (USD bn)	2019 (USD bn)	2020 (USD bn)	2020 vs. 2018 volumes
<b>Digital Infrastructure</b>	<b>\$8</b>	<b>\$10</b>	<b>\$19</b>	<b>2.38</b>
Power	\$117	\$117	\$126	<b>1.08</b>
Infrastructure	\$72	\$83	\$70	<b>0.97</b>
Oil & Gas	\$48	\$82	\$63	<b>1.31</b>
Metals & Mining	\$7	\$9	\$7	<b>1.00</b>
Chemicals / Petrochemicals	\$9	\$12	\$4	<b>0.44</b>
Transport	\$0	\$3	\$2	-

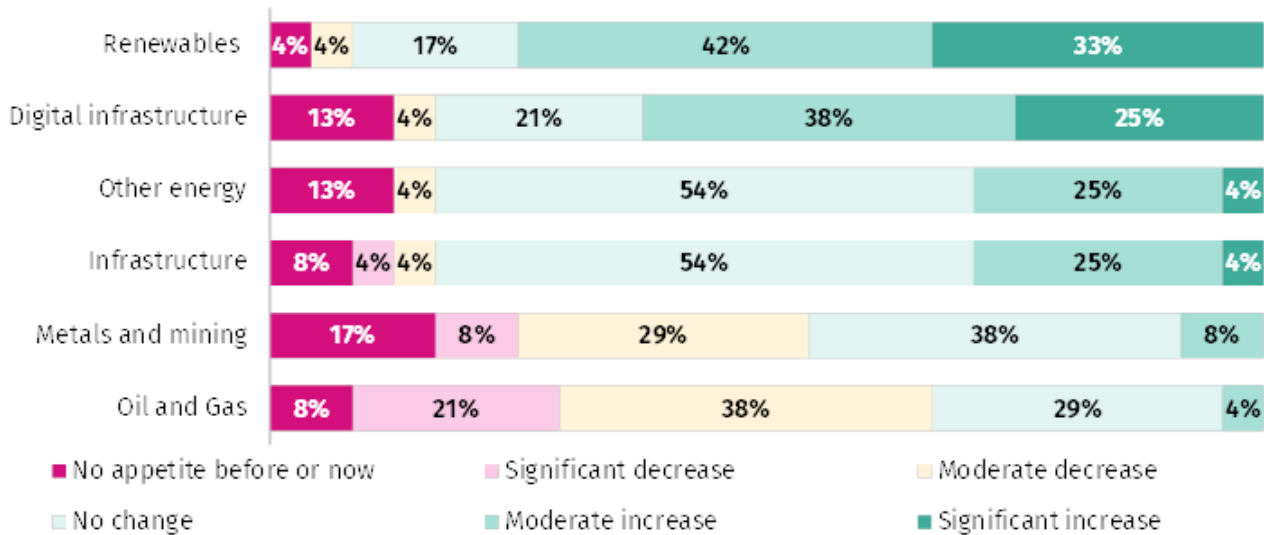
Source: Proximo Infra, 2021, 'Decoding Digital Infrastructure Finance'

## ii) **NPI market appetite**

Assisted by several client presentations into this topic, insurers have generally been increasingly supportive in the fibre space, getting comfortable with the aggressive repayment profiles (many projects feature bullet repayment at the end of a 7-year financing, with an ultimate 15-25 year repayment profile dependent upon the deal) and the frequent lack of locked-in revenue streams which are common elsewhere in project finance. Many of the financing characterises are indeed more akin to leverage financing, which also involves Private Equity sponsors.

So far, the most sought-after deals have been in those markets where there is clear state support for rollout (France) or where existing penetration rates are very low (Germany, UK), but we have also seen significant insurer support in the Nordics, Benelux countries and Southern Europe. Most insurers seem agnostic over whether the project is in a rural or urban location, or has a retail or wholesale model, preferring to concentrate the strength of the sponsor, the scale of the existing business and the conditions of the rollout strategy (demand aggregation being considered a positive). Insurers are now predominantly comfortable with the technology risk, both in terms of the useful economic life of fibre and the potential for competition from 'alternatives' such as 5G (fibre arguably being a crucial part of the backhaul requirements of 5G networks, with the two technologies likely to co-exist in a complementary rather than competitive manner).

The COVID-19 pandemic has certainly provoked a shift in insurer appetite and strategy, which has largely benefitted project finance enquiries and in particular digital infrastructure. Many insurers are no longer targeting more traditional short-term business in the commodity and trade finance sectors, and instead are focussing on greater engagement in 'COVID-resilient' non-cyclical sectors; 63% of insurers surveyed as part of Texel's recent Project Finance survey responded that they had had a significant or moderate increase in their appetite in the digital infrastructure sector over the last year (per the graph below). Fibre has quickly caught up on the existing strong NPI appetite for the other main area of digital infrastructure, data centres. Please see the survey at [this link](#) for more information.



Source: Texel Finance, July 2021, Project Finance Survey

### iii) **Growth going forward**

In terms of areas where insurers have seen fewer enquiries and therefore some education from experienced clients could be beneficial, we have identified the following gaps:

- Business-to-business (“B2B”) transactions, most enquiries presented having been in the Business to Consumer (“B2C”) space so far.
- Engagement with non-European markets once fibre rollout begins on a global scale. Multilateral involvement here will be an important first step, given the political risk associated with emerging/frontier markets.
- Acquisition finance-type deals where different entities with existing footprint are consolidated into one.
- Financing other than the project finance and capex facilities for rollout – insurers would be interested to see if NPI could be useful for banks who are financing other entities in the chain, such as surety towards the construction companies.

NPI for fibre transactions is a continually developing area for the insurance market with significant liquidity potential over the next few years, as insurers continue to get comfortable with the diverse range of enquiries presented, and as obligatory refinancing of existing debts falls due. Please do contact us at [connect@thetexelgroup.com](mailto:connect@thetexelgroup.com) if you would like to consider using NPI for your digital infrastructure book.



## UAE Financial Institutions

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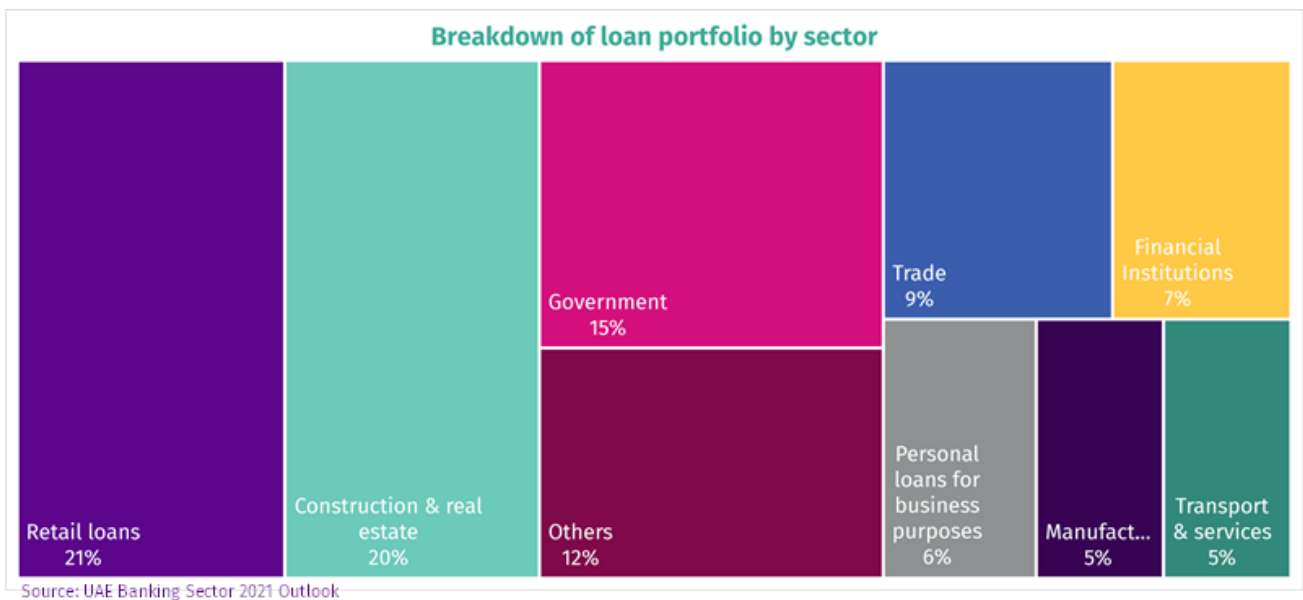
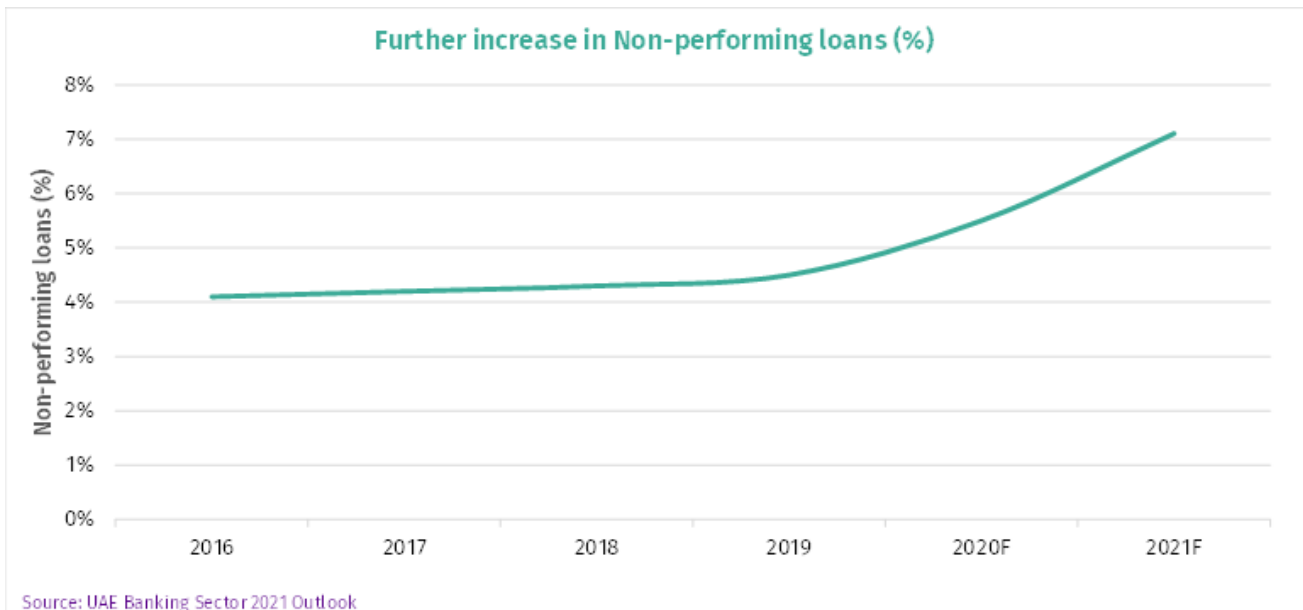
*Only a crisis – actual or perceived – produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. – Milton Friedman*

Whether applied at the macro or micro level, Milton Friedman’s words feel truer than they ever have as we slowly emerge from the first pandemic in over a century. On the macro level, we have witnessed the largest fiscal stimulus in history. By June 2020, governments had already allocated USD 10 trillion of fiscal support to their respective economies, nearly ten times the levels seen in the entirety of the financial crisis of 2008-09<sup>1</sup>.

On the micro-level, many behaviours which were previously perceived as intransigent have changed forever. With the help of existing remote working technologies, many of us will never return to the office again for a five-day working week. There are countless other examples of how the world has changed since the pandemic arrived, and no doubt we will not fully understand the implications of these changes and how long lasting they will prove to be for many years to come.

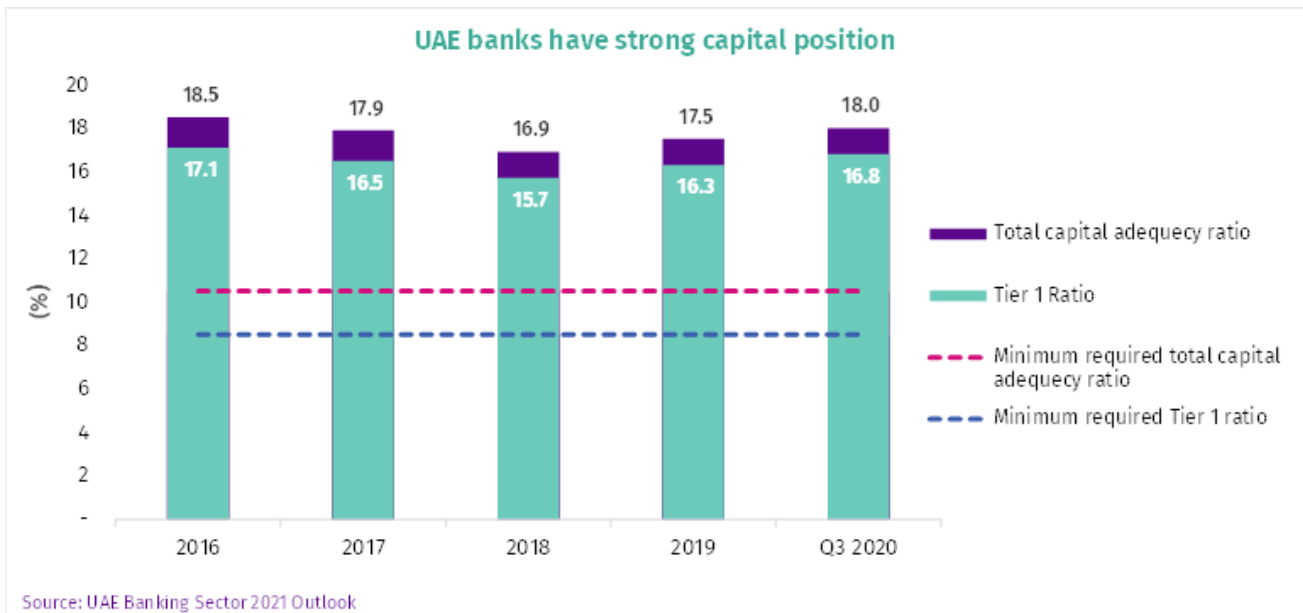
So, how, if at all, have the developments affected our banking clients in the United Arab Emirates (“UAE”)? And what ideas does Texel have ‘lying around’ to support these clients in the new world we find ourselves in?

The economic impact of Covid on the UAE was perhaps felt more acutely than many other countries given 53% of the country’s GDP is derived from the tertiary sector, which includes international trade, air transport, financial activities, and tourism<sup>2</sup>. It is therefore unsurprising that the combined loan portfolio of UAE banks reflects these underlying economic fundamentals, with a 20% concentration in construction and real estate. Non-Performing Loans (“NPLs”) are forecast to rise from 5% in 2019 to over 7% in 2021. Real estate, construction, hospitality, consumer-related sectors, and Small and Medium-sized Enterprises (“SMEs”) are expected to be the largest contributors<sup>3</sup>.



Meanwhile, the UAE Central Bank continues to push ahead with the implementation of new capital requirements, with Basel III expected to be fully implemented on 1st January 2022<sup>4</sup>, and, more recently in February 2021, a new minimum requirement for paid-up capital of AED 2bn was set<sup>5</sup>.

Whilst overall capitalisation of UAE banks remains strong, current trends suggest an ever growing need to manage capital in a more efficient manner and reduce the inevitable increase in Risk Weighted Assets (“RWAs”).



In Non-Payment Insurance (“NPI”) we have, as Milton Friedman might say, an idea that is lying around. Currently the product is predominantly used amongst UAE banks as a limit relief and risk mitigation tool, but there is huge potential for it to be picked up and used as a means of obtaining capital relief.

Whether through consultations with financial regulatory authorities, or, arranging secondments for our brokers to provide clients with sustained internal implementation guidance, Texel can provide a wealth of experience when it comes to supporting our FI clients through the various stages needed to utilise NPI as an effective capital relief tool.

Sources and references (All were freely accessible in July 2021):

- <sup>1</sup> [Total stimulus for the COVID-19 crisis already triple that for the entire 2008–09 recession, 11th July 2020](#)
- <sup>2</sup> [United Arab Emirates: economic and political outline, July 2021](#)
- <sup>3</sup> [UAE Banking Sector 2021 Outlook A Long Recovery Road Ahead, 26th January 2021,](#)
- <sup>4</sup> [Is Basel III turning four? How will the reforms to Basel III affect banks in the UAE?, 2018](#)
- <sup>5</sup> [UAE banks fall short of UAE's new capital requirements in Q1, 7th June 2021](#)

## Regulatory Update

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During Q2 the Non-Payment Insurance (“NPI”) industry has continued with at work to raise awareness of the value of insurance as a credit risk mitigation tool seeking appropriate legislative and regulatory treatment for NPI in the implementation of Basel III reforms (also referred to as Basel IV). A key area of focus is the proposed input flow of 45% Loss Given Default (“LGD”) for insurers when computing Risk Weighted Assets (“RWA”) based on internal models. For the purpose of NPI, banks do not act as lenders but as policyholders

which justifies a lower LGD floor. 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 consequence that European banks will decrease their levels of lending, impacting the real economy.

Efforts over the past few years have been directed at Europe, with focus turning to the UK post Brexit. In this update we report briefly on the initiatives in the UK.

See [Texel Group Newsletter Q4 2020](#) for a summary of the implementation of Basel IV and the position in the UK post Brexit. Since that update, the Financial Services Bill is now law having received Royal Assent on 29 April 2021.

RECAP: Some of the Basel III standards implemented into EU law were transferred into UK law through the CRR and CRR 2 Regulations. However, some Basel III standards were not implemented in the EU before the end of the transition period and so remain to be implemented in the UK. The Financial Services Act gives power to the Prudential Regulation Authority (“PRA”) to make new rules and adapted versions related to the outstanding Basel III standards.

In February 2021 the Bank of England (BoE) published Consultation Paper CP5/21 on the PRA’s proposed rules of the implementation of international Basel standards through a new PRA Capital Requirements Regulation (CRR) rule instrument. At the initiative of the insurer industry bodies (Lloyd’s Market Association, International Underwriting Association and International Credit & Surety Association (“ICISA”)) a response to this consultation was prepared to draw the PRA’s attention to the industry initiatives in Europe to seek recognition of the unique position of NPI in the implementation of Basel IV. The response was endorsed by the aforementioned insurer bodies as well as the International Trade and Forfeiting Association (“ITFA”) and the International Chamber of Commerce (“ICC”). Further engagement has since taken place with the PRA during Q2 to ensure that the UK is provided with the same information that has been submitted in Europe.

We will report in the next quarter on developments with initiatives in Europe.



## Texel Foundation

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Following on from our previous newsletter, I am delighted to report on the fantastic success of our Refugee Routes fundraising challenge for [The Bike Project](#). We had over 60 participants across all our regions, who collectively cycled / ran more than 6,000 miles and raised over £15,500, which will provide 155 refugees with a bike and support! A huge thank you to all those who took part.



Alongside The Childhood Trust, Castill Holdings and Enterprise Holdings we offered matched funding for the [Mayor's Fund For London's](#) Champions For Children campaign, which raised over £60,000! The funds raised will go towards supporting young people aged 4-24 across London, increasing the impact of the Mayor's Fund For London's food, wellbeing, careers and employment programmes and transforming the lives of 100,000 young Londoners by 2023.

Finally, the agricultural cooperative programme we sponsored in rural Zambia has been a huge success, with everyone's effort materialising into bountiful crops! The team visited a local organic farm to learn some best practice techniques and spent many a back-breaking hour preparing the soil and nurturing seedlings. The local community, including pupils at the village schools are all benefitting from the delicious harvests, sweetcorn being a favourite!

With the first growing season well underway, this programme is set to provide hope and nourishment for many years to come.



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*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.*

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