IACPM
INTERNATIONAL ASSOCIATION OF
CREDIT PORTFOLIO MANAGERS

ITFA
International Trade and
Forfaiting Association

IACPM / ITFA Non-Payment Insurance Survey 2019

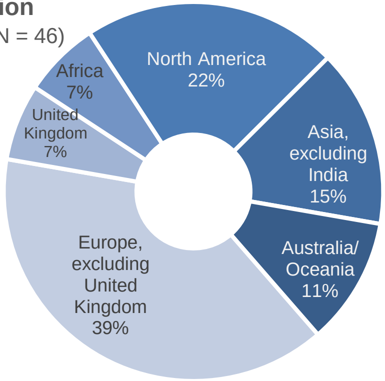
Select High-Level Results

www.iacpm.org

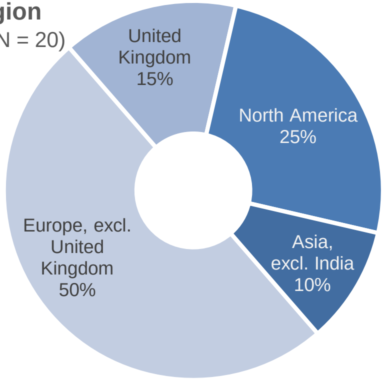
Survey Goals and Demographics

- During the Fall 2019 the IACPM partnered with ITFA, the International Trade and Forfaiting Association, to conduct a qualitative benchmarking survey on Non-Payment Insurance. It is a continuation of ITFA's Credit Risk Insurance survey conducted earlier this year.
- The survey focuses on current general practices and the LGD treatment for Non-Payment Insurance (NPI) policies used by lenders as a credit risk mitigation (CRM) tool to release capital or increase lending capacity.
- 46 IACPM and ITFA member firms participated, including 43 banks, one Development Bank, one Export Credit Agency, and one Investment Firm. Almost three-quarters of the participating banks are active users of NPI; almost two-thirds have a total balance sheet size above USD 500 Billion. They represent a majority of European AIRB banks.

Participating Firms' Principal Region of Domicile (N = 46)



Participating GSIBs' Principal Region of Domicile (N = 20)



© IACPM

Executive Summary (Page 1)

For this inaugural non-payment insurance survey, the universe of survey respondents was global with 52% of banks from EMEA, 22% from North America and 26% from Australasia. The non-payment insurance (NPI) product attractiveness has grown among survey respondents as a tool to mitigate risk on corporate loans. NPI ranks as a close second right after secondary loan trading and well ahead of CDS and synthetic securitizations. Next to conventional credit protection products, banks are increasingly using NPI solutions across all asset classes: corporate loans, asset-based finance, trade finance, etc.

European banks are currently more advanced than non-European banks in usage of insurance-based solutions for credit risk mitigation. They have used the product for much longer on average and show more volume and number of transactions per annum than their American or Asian counterparts, diversifying thereby their sources of credit protection.

The survey shows, that responding banks are using NPI solutions as an additional risk distribution channel to increase lending capacity to borrowers while complying with internal credit limits and avoiding accounting or risk mismatch between the loans and the protection instrument. Unrated and non-investment grade borrowers that do not trade in CDS are the main beneficiaries as banks turn to NPI to release regulatory capital.

Releasing regulatory capital is the second most important objective for the use of NPI by participating banks as most obligors do not have a traded or liquid CDS. This is not surprising given that 75% of all insured loans (and 38% of insured corporate loans) are non-investment grade. It is therefore clear that NPI fulfils a unique function as Credit Risk Mitigant (CRM) for banks to support core lending, as well as specialized finance. Lending could become more restricted if regulation affects the NPI product in a negative way, especially given that 65% of the respondents follow the AIRB approach.

IACPM

Executive Summary (Page 2)

Total insured bank exposure cannot be inferred from the survey as respondents indicated ranges as opposed to exact numbers. The answers however confirm the conclusions from the ITFA survey in May 2019 where the total was stated to be USD 90bn from a smaller set of respondents. That number was said to have facilitated at least USD 150bn of loans.

Most participating banks have set up centralized teams, often in Syndications or Credit Portfolio Management, to deal with the opportunities but also with the specific challenges of non-payment insurance, notably in implementation (confidentiality management, KYC, secondary limits, etc.) and unclear regulatory treatment. Even for the most mature users of NPI solutions, unclear regulatory treatment remains the second most important operational challenge.

Methodologies to calculate the RWA impact of credit insurance protection vary substantially between responding banks. The top three approaches employed by responding banks are PD substitution and best LGD of both, followed by PD & LGD substitution and finally double default.

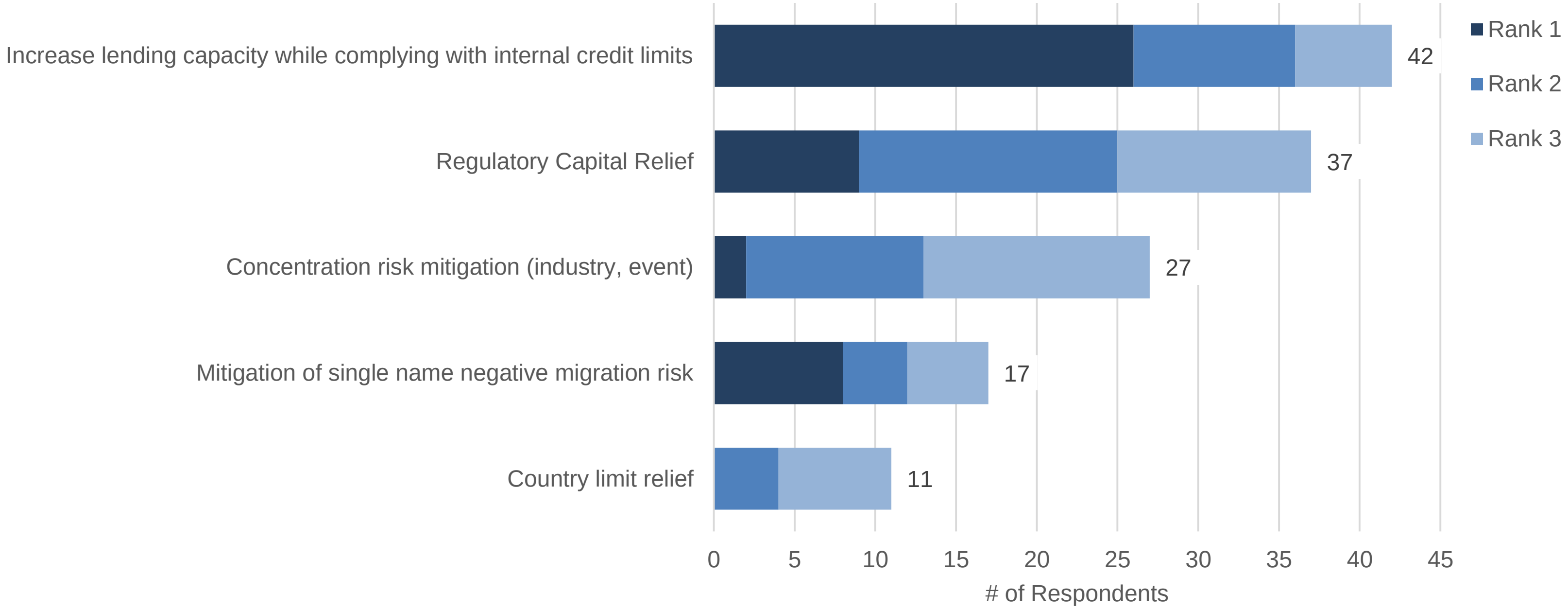
Diverging practices are also highlighted in the wide range of LGD used when accounting for insurers as CRM providers (from zero to 70%!). The median lies interestingly at 45% which is the prescribed level for Financial Institutions under FIRB approach that is intended to govern the product under the finalized Basel III framework and has attracted much concern from users of the product. Given the possible disappearance of the flexibility of approaches, fair recognition of the LGD when applying it as a CRM becomes essential.

More clarification is needed from regulators as to the appropriate capital treatment of credit insurance as a credit risk mitigant. This was started through the EBA’s consultation paper dated February 2019 but requires now more engagement on both sides as the Capital Requirements Regulation (CRR) review never envisaged NPI as a separate instrument.

© IACPM

Top 3 Goals for Using NPI

(N = 44)

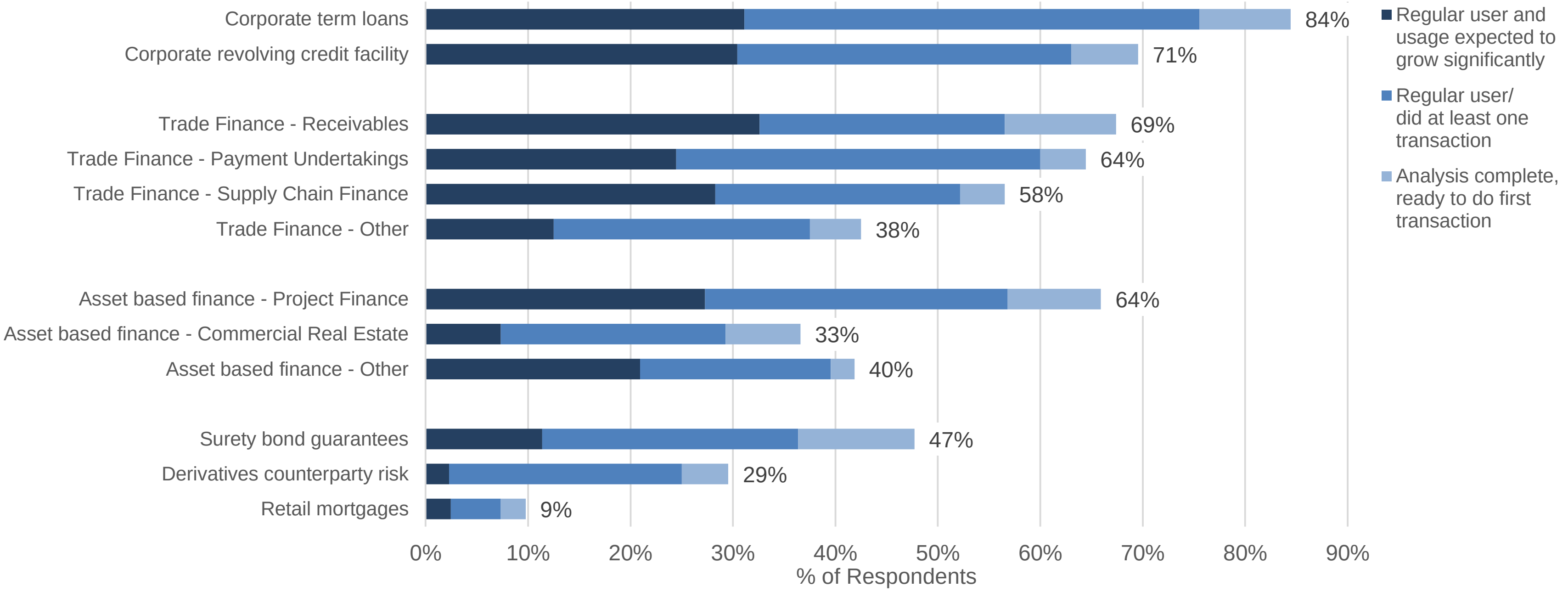


Source: IACPM / ITFA Non-Payment Insurance Survey 2019 | Question: What are your top 3 goals when using non-payment insurance for any of the asset classes indicated in the question below? Please rank from 1 (primary goal) to 3.

Usage of NPI for Credit Risk Management

Contrary to other risk mitigation tools, NPI can cover a large array of asset classes, which is a unique feature of NPI.

(N = 45)

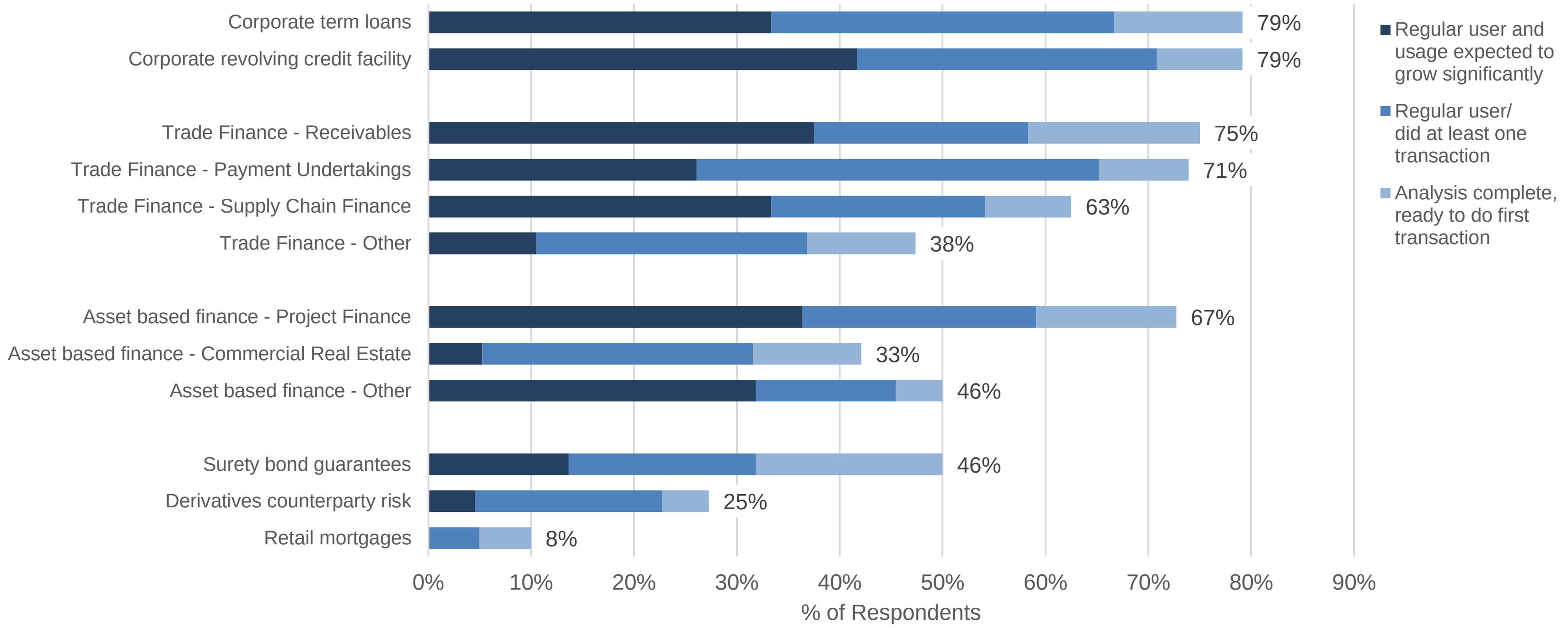


Source: IACPM / ITFA Non-Payment Insurance Survey 2019
Question: For which of the following asset classes has your bank used non-payment insurance to manage credit risk over the past 1-2 years, including today?

© IACPM

Usage of NPI for Credit Risk Management

Respondents with Principal Region of Domicile in EMEA (N = 24)

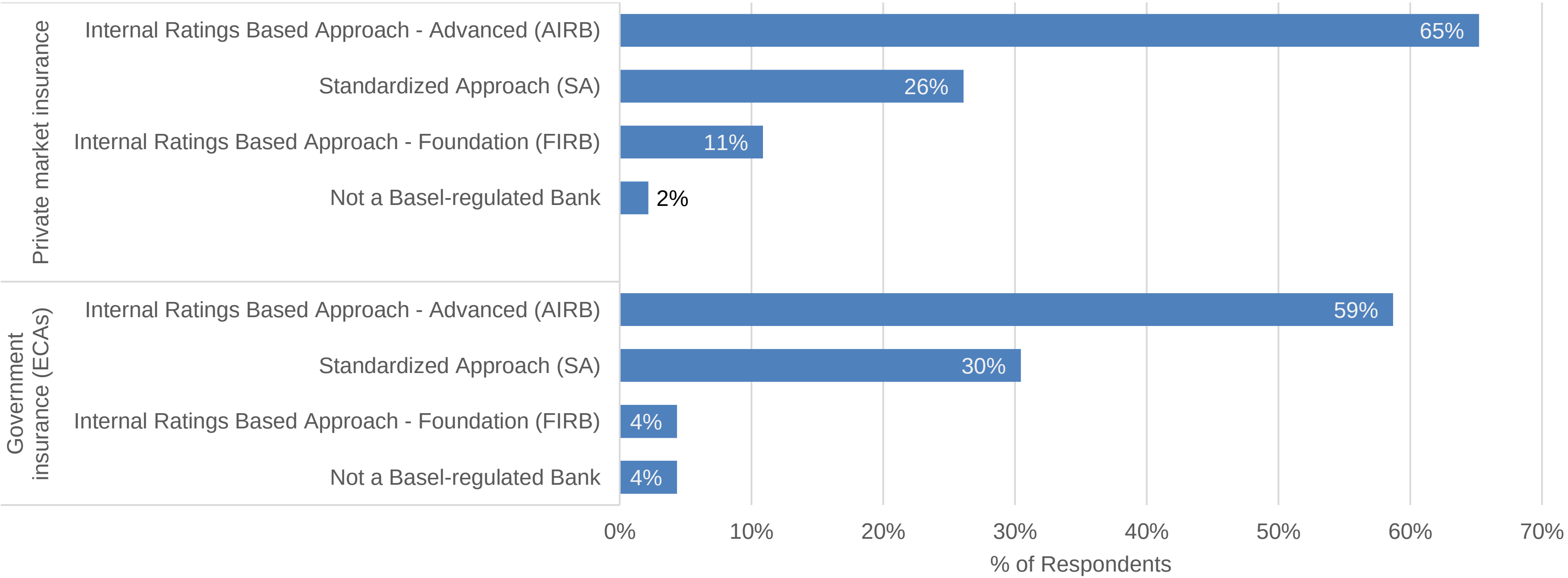


Source: IACPM / ITFA Non-Payment Insurance Survey 2019
Question: For which of the following asset classes has your bank used non-payment insurance to manage credit risk over the past 1-2 years, including today?

Regulatory Capital Approach for Lending/ Insured Portfolio

(multiple responses were possible; N = 46)

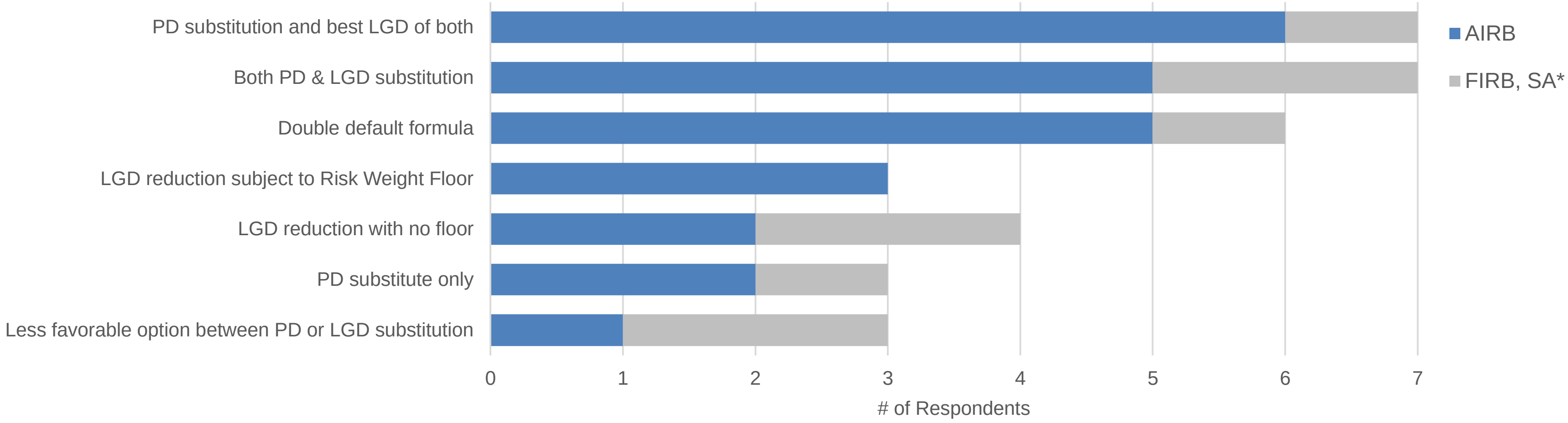
A small number of respondents reported operating under different regulatory capital approaches depending on region and legal entry/ subsidiary.



Source: IACPM / ITFA Non-Payment Insurance Survey 2019
Question: Which regulatory capital approach does your bank follow for most of its lending/insured portfolio that is the current binding constraint? If your answer is SA, FIRB, or are not a Basel-regulated bank, please fill-in the remaining questionnaire from the perspective of your internal risk management.

Approach Followed for Private NPI Covers

For Pillar I Minimum Requirements (N = 35)



Almost half of the responding AIRB banks are following the same approach for Pillar I, Pillar II and IFRS 9/ CECL.
For FIRB, SA banks the percentage is about 40%.

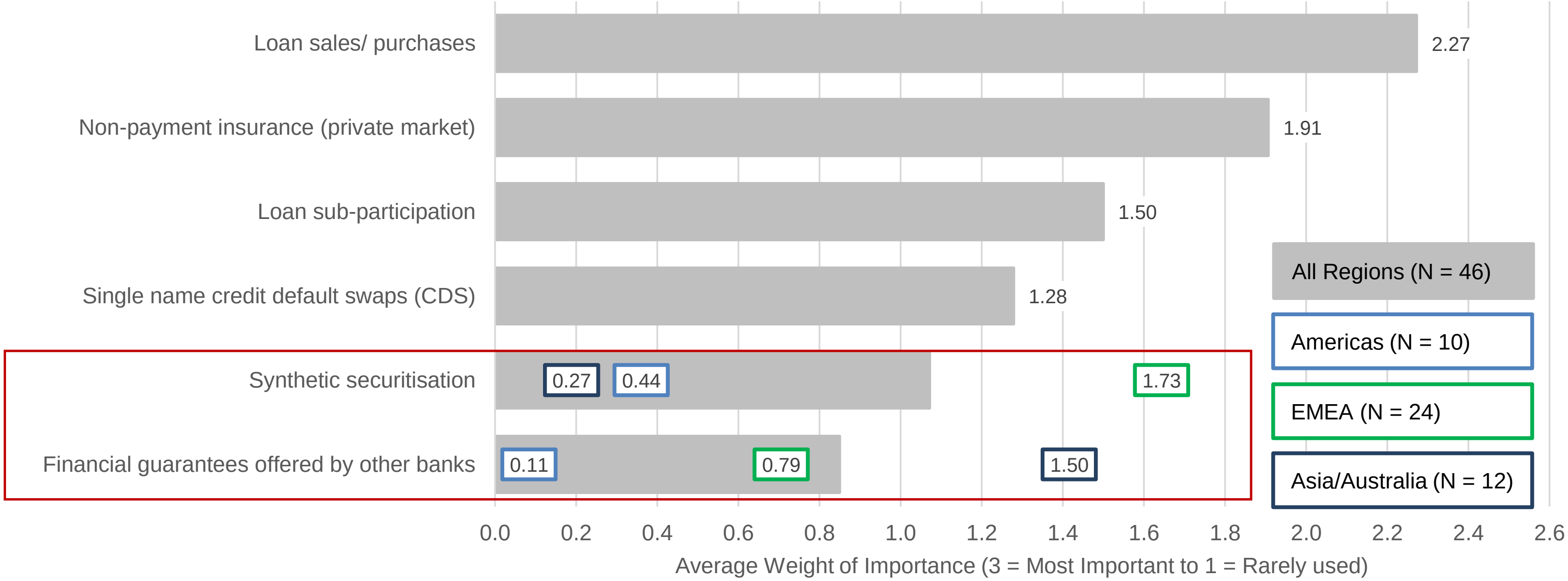
About two-thirds of responding banks, regardless of AIRB or Non-AIRB, are following the same approach for NPI and ECA covers.

A few banks are following multiple approaches for Pillar I Minimum Requirements.

** Not enough observations to show FIRB and SA separately.*
Source: IACPM / ITFA Non-Payment Insurance Survey 2019 | Question: Which approach do you follow when dealing with private Non-Payment Insurance (NPI) covers? Please respond separately for Pillar 1 RWA calculation, Pillar 2 internal risk assessment, and IFRS 9 / CECL reporting, if applicable.

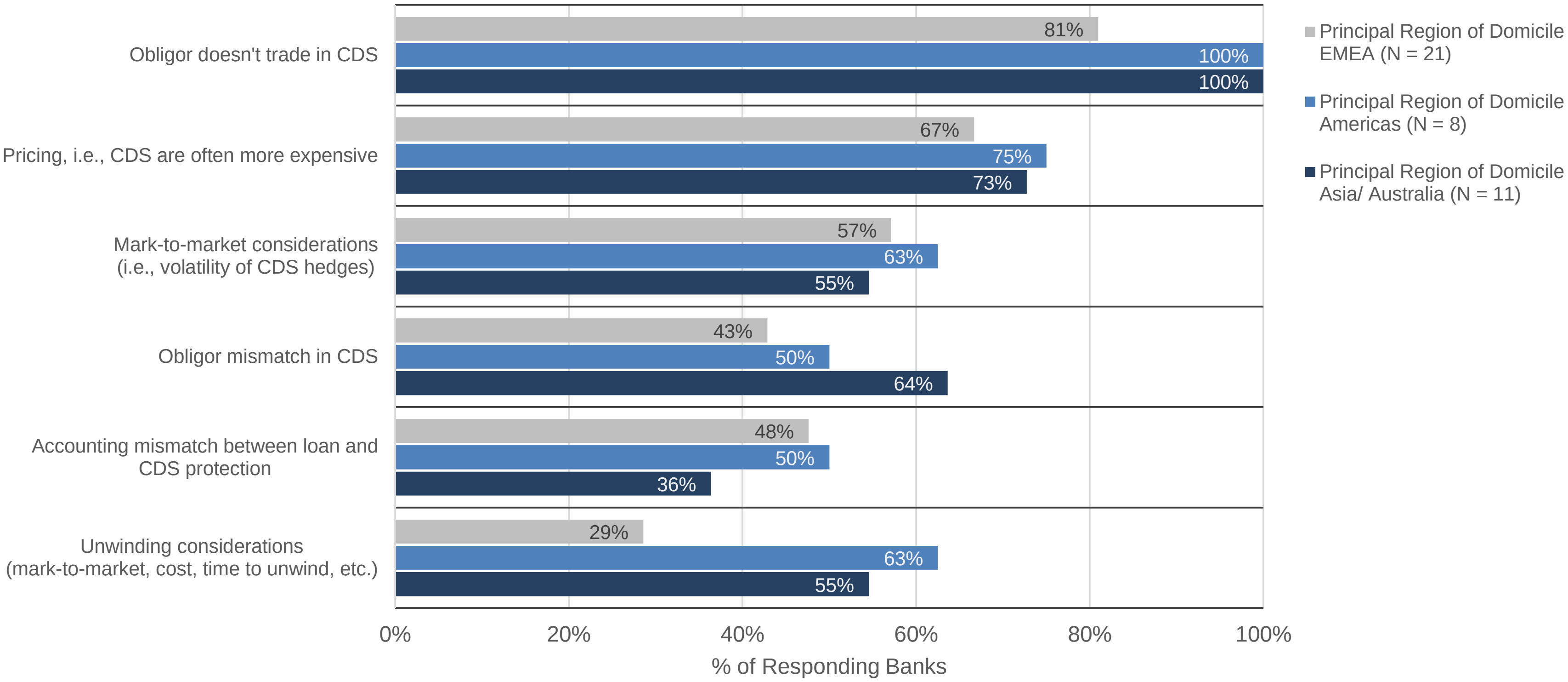
Relative Importance of Market Tools for Risk Mitigation (N = 46)

Notable regional differences for Synthetic Securitizations which rank much higher in EMEA and Financial Guarantees offered by other banks which are of higher importance in the Asia/Australia region.



Source: IACPM / ITFA Non-Payment Insurance Survey 2019
Question: Please rate the following market tools your firm uses to mitigate corporate loan risk by importance.

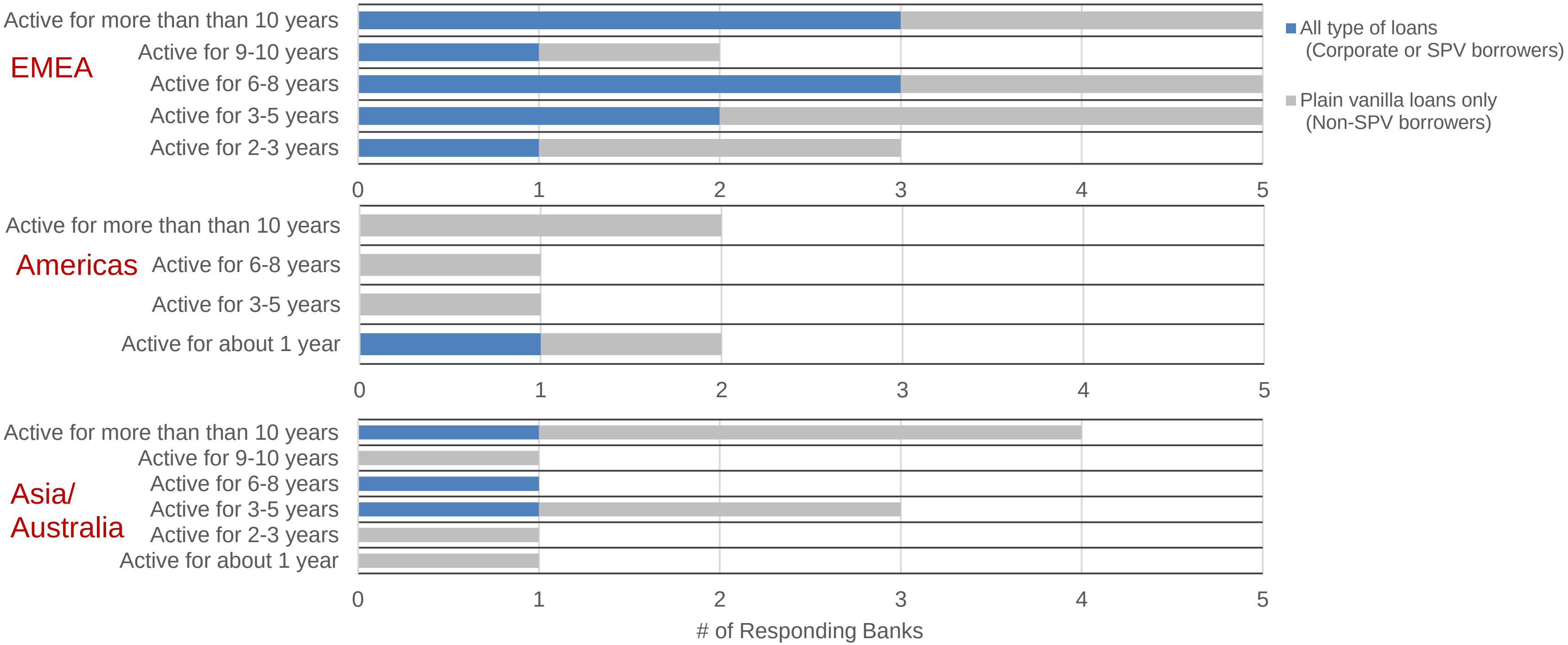
Main Reasons for Choosing NPI over CDS (N = 40)



Source: IACPM / ITFA Non-Payment Insurance Survey 2019
Question: What are your firm's main reasons for choosing non-payment insurance over single name credit default swaps (CDS)? Please check all that apply.

Length of NPI Experience

by Responding Banks' Principal Region of Domicile (N = 34)



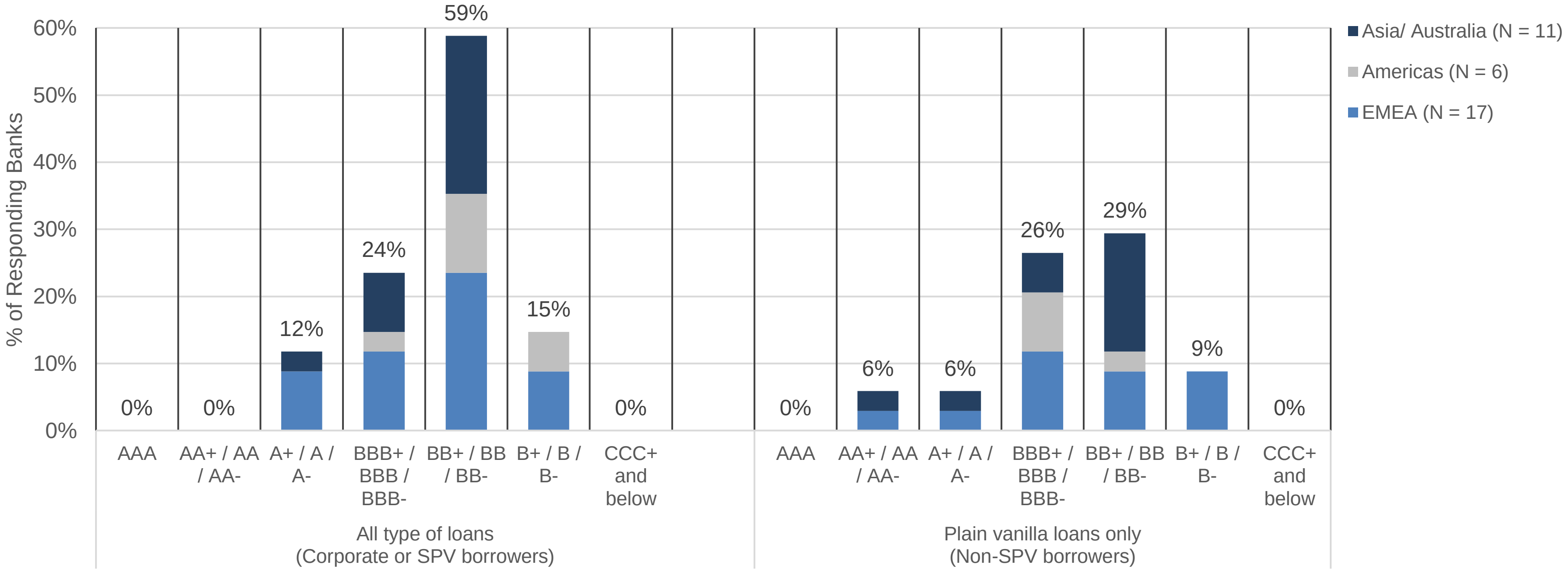
Source: IACPM / ITFA Non-Payment Insurance Survey 2019
Question: Please indicate when your bank started executing non-payment insurance transactions, assuming your firm is still active in this space.

Underlying Borrowers’ Average Credit Rating

By Responding Banks’ Principal Region of Domicile (N = 34)

None of the participating banks reported underlying borrowers' average equivalent credit rating for insured exposure of either AAA or CCC+ and below. Four respondents provided more than one average rating.

One respondent commented that the weighted average rating reported does not include those ratings of obligors included in SLRP pools (Student Loan Repayment Program) that are insured.



Source: IACPM / ITFA Non-Payment Insurance Survey 2019
Question: Please indicate the underlying borrowers' average equivalent credit rating for your bank's insured exposure.

Glossary

Comprehensive Private Risk Insurance (CPRI)
Non-Payment Insurance written by firms in the private sector of the economy and covering non-payment by the borrower/obligor for any reason whatsoever.

Corporate Loans
A debt-based funding arrangement between a business/ corporate customer and a financial institution such as a bank. It is typically used to fund major capital expenditures and/or cover operational costs that the company may otherwise be unable to afford.

Credit and Political Risk Insurance
Credit and Political Risk Insurance cover non-payment by the borrower/obligor and Government intervention that prevents payment. The only conditionality outside the insured bank's control might be a nuclear/biological warfare and radioactive contamination exclusion and even this is not always required. All other conditionality which can prevent a claim payment are within the bank's own control.

ECA Cover
Credit Insurance provided by a governmental Export Credit Agency (ECA). The insurance premium is to be paid by the importer.

IFRS 9/CECL
Approach used for accounting–based assessment of expected losses (Point-in-Time (PIT) and forward-looking expected losses).

Non-Payment Insurance (NPI)
Any comprehensive insurance policy covering non-payment by the borrower/obligor for any reason whatsoever, as long as premium payments are made, including Credit and Political Risk Insurance, ECA cover, Comprehensive Private Risk Insurance, surety bonds as well as master participation agreements on surety bond portfolios.

Pillar 1
Approach used for calculation of minimum regulatory capital requirement (Through-the-Cycle (TTC) regulatory expected losses and RWA).

Pillar 2
Approach used for internal risk assessment (TTC expected losses, economic capital and internal stress tests).

Private Market Insurance
Insurance coverage written by firms in the private sector of the economy (as opposed to government insurers).

SPV borrower
Special Purpose Vehicles are typically banks' counterparties in Project Finance, Transportation Finance, Trade Finance transactions.

Surety bond (incl. Master participation agreement)
A surety bond is a contract between three parties—the principal, the surety and the obligee (the entity requiring the bond)—in which the surety financially guarantees to an obligee that the principal will act in accordance with the terms established by the bond. When the guarantee relates to non-payment, the surety bond can be a form of Non-Payment Insurance.