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info@itfa.org

WHO CARES ABOUT LGD? By Audrey Zuck, A2Z Risk Services Ltd

Although last year's consultations by the European Banking Authority (EBA) and European Commission have now closed, the need to engage with regulatory authorities – both at the supranational (e.g., EU) and at the national levels – is as strong as ever. However, having submitted answers to the questions posed in the consultations, the questions we must now pose ourselves (and answer) are: how can we best engage with regulators? And what answers to regulator concerns can we provide outside of the formal consultation process?

To date, we have been answering questions posed by regulators with respect to the impact of the Finalisation of Basel III in Europe on bank modelling and risk weighted assets. Answers have been provided from the perspective of banks and from that of insurers who support the lending done by those banks. The concerns identified and solutions proposed in ITFA's response have one common goal: to recognise the need to differentiate the treatment of non-payment insurance as a credit risk mitigation tool. In particular, the proposal is for regulators to recognise the privileged position of the bank as policyholder and not require the same 45% LGD that the bank would have to use as unsecured creditor to that insurer.

The concern expressed by ITFA and other organisations who have responded to the consultations is that use of non-payment insurance by European banks could become less effective as a credit risk mitigant. With this mitigation of credit risk less available, banks could in turn make less credit available: that is, reduce the credit exposures they are taking.

The ITFA response provided practical examples of the potential impact on the use of insurance by banks, threatening a reduction in banks' willingness to take credit risk and reduced lending. ITFA and the Lloyd's Market Association, International Underwriting Association and the International Credit Insurance and Surety Association have worked to provide evidence of the benefits of insurance as credit risk mitigation. This includes jointly funding a study by KPMG to be issued shortly that demonstrates how insurance regulation protects the position of policyholders. Insurance brokers are working to update the claims data to provide additional proof that the product works. There are also several initiatives to try to come up with more exact data on the level of insurance support for bank lending, as well as the ability of the insurance sector to prudently manage the credit risks underwritten for banks.

These are all important answers. However, the question that we haven't answered – and we cannot answer ourselves – is what would be the impact on the economy, both in Europe and globally, of the threatened reduction in bank financing without better recognition of the advantages offered by insurance as credit risk

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mitigation. That perspective must come from those who borrow from the banks, and who benefit from the willingness of banks to take credit risk, bolstered by the effective use of insurance as credit risk mitigation.

To answer this question, and make regulators aware of this perspective, we must enlist the help of corporates: the large employers, the small- and medium-size enterprises that are the lifeblood of the economy: they too have a stake in the outcome. They also have the information about the economic activity financed by the lending of banks, currently effectively supported by non-payment insurance. Just to give one small example: an insurer put me in touch with a very large European company with significant manufacturing operations in several European countries, who is aware of the advantages of credit insurance and interested in supporting our efforts. Getting them – and many more companies, large and small – to argue the case will demonstrate to regulators that this is not just an issue for banks, but for the wider European economy.

ITFA continues to lead the charge, with its members sacrificing their time and energy to meet with regulators identified and access through ITFA’s lobbyist, Hume Brophy. But this cannot remain an issue addressed only by banks and insurers. Because it isn’t just their issue. Educating regulators about the need for non-payment insurance to continue as effective credit risk mitigate must also include a better understanding of the role that non-payment insurance plays in bank financing of trade, investment and economic activity.

For the non-European readers of this article who asked themselves why what happens in European banking regulation should matter to them, the answer may be that regulators pay attention to regulation elsewhere. For those more directly affected, enlist your clients. This is an issue for all of us: providers, users and beneficiaries of insured financing. We must all answer the question of why non-payment insurance needs to be recognised as effective support for financing.