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ITFA to press forward with credit insurance advocacy work in light of EBA Opinion and Basel III delay/ By ITFA Insurance Committee

ITFA's Insurance Committee has noted the recent Opinion from the European Banking Authority (EBA) on the treatment of credit insurance in the prudential framework; is pleased that consideration is being given by the regulatory agency to this important topic; and is committed to continuing its advocacy work to ensure that bank regulators are well-versed in the relationship between banking and insurance – including new studies on the matter.
The ongoing discussions about the treatment of credit insurance have been initiated in the context of the reforms of the final Basel III framework for exposures under the Internal Ratings-Based Approach (IRB Approach).

The EBA's Opinion, published on March 9, is in response to the extensive feedback received – including from ITFA (ITFA members may refer to the document titled: 190524 ITFA response to EBA GLs on CRM for IRB approach (05.09.2019)) – in its public consultations on draft guidelines on credit risk mitigation for institutions applying the IRB Approach with own estimates of Loss Given Default (LGD).
Although the EBA Opinion does not align with ITFA's stance on these matters, the Association does take comfort in the fact that:

- The EBA did not yet have the recent KPMG Insurance Insolvency Study, as commissioned by ITFA and other industry bodies and released in February, when reaching its decisions – meaning that alternative conclusions may be drawn by the legislator now that it is armed with these statistics.
- The delay in the implementation of Basel III as a result of Covid-19 means that ITFA now has more time to continue its efforts in putting across its policy asks to the European Commission and member states.

What does the EBA say?
In the Opinion, the EBA concludes that there should not be a specific value of regulatory LGD for credit insurance claims. It says most of the claims in unwinding proceedings would benefit from the higher seniority priority with the result that if an insurer fails, its policyholders may still suffer significant losses, and there is no evidence that these losses would be significantly lower than the currently applicable LGD values.
The EBA therefore calls for the implementation of the final Basel III framework as agreed by the Basel Committee on Banking Supervision.
In its advocacy efforts, ITFA has long argued for maintaining the present A-IRB approach for credit insurance used as a risk mitigant, or adopting a lower LGD floor than 45% for credit insurance to reflect banks' position as policyholders as opposed to unsecured creditors.
ITFA believes that the Basel Committee's suggestion of a shift from A-IRBA to F-IRBA for exposures to large corporates or FIs in particular would mean that it would no longer be economically viable for banks to insure better rated credit risks because of the 45% prescribed LGD. This, in turn, would impact insurers' appetite to continue offering credit insurance policies, which may lead them to decide to pull out of this business line entirely, and could result in banks decreasing their levels of lending, and, ultimately, putting approximately €600bn-worth of support to the real economy at risk.

Despite the fact that the EBA Opinion has not heeded these concerns, ITFA is encouraged that progress is being made on the discussion about the treatment of credit insurance, which may now accelerate given the recent study by KPMG entitled 'Insurance Insolvency Study: Review of Insurance Company Insolvencies and Business Transfers in Europe', released in February.

Availability of data

As noted by the EBA in its Opinion, when considering the arguments and received proposals, several elements that have direct influence on appropriate calibration of regulatory LGDs had to be taken into account. One of these considerations, it says, was the fact that “no data is currently available to the EBA on the levels of payouts to policyholders in the event of default of an insurance company”.

Although this may very well have been true at the time that this work was being carried out, in the meantime, KPMG has released its study revealing the robust nature of European insurers, and the positive contribution of regulations – most notably the Solvency II directive – to further strengthening that position.
As noted in ITFA’s press release on the KPMG study, the Solvency directives have established and harmonised policyholder priority in an insurance company insolvency, meaning that banks – as credit insurance policyholders – rank ahead of other creditors, making it more likely that they will be paid in full than would have been the case pre-2004, which is when the requirements were first introduced. The study finds that in all completed insolvencies since 2004, insurance creditors were able to recover all claims due, thanks to their preferred policyholder status.

ITFA trusts that this data will be of further assistance to the EBA and the European Commission as they continue to draw their conclusions on the treatment of credit insurance under the Basel III reforms.

“ITFA is pleased that the topic of credit risk insurance for transaction banking is being considered and analysed seriously. As we now have this statistical evidence, and because there is an awareness that things need to change, we feel comfortable that we have what we need to continue our discussions with the legislator,” says Silja Calac, ITFA Board Member and chair of its Insurance Committee.

The deferral of Basel III

The recent decision by the Basel Committee's oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), to delay the implementation of Basel III to increase the operational capacity of banks and supervisors to respond to Covid-19, means that ITFA now also has more time to communicate its concerns to the European Commissions and member states.

The measures endorsed by the GHOS now indicate that the implementation date of the Basel III standards finalised in December 2017, the revised market risk framework finalised in January 2019, and the revised Pillar 3 disclosure requirements finalised in December 2018 have all been has been deferred by one year to 1 January 2023. The accompanying transitional arrangements for the output floor have also been extended by one year to 1 January 2028. Our sources indicate that the European Commission proposal to implement the standards in the EU should be tabled for negotiations in Q4 2020.
During this time ITFA’s Insurance Committee, together with Hume Brophy, the Brussels-based consultancy specialised in European public affairs that ITFA has contracted to assist with its advocacy efforts, will continue to press ahead with their work in the interests of the Association’s members.