USE OF CREDIT INSURANCE REMAINS BUOYANT DESPITE REGULATORY CONCERNS

*Written by **Rebecca Spong**, Editorial Consultant, January 2024*

The use of credit and political risk insurance (CPRI) by banks as a major risk mitigation tool continues to grow despite concerns about the potential impact of Basel III regulations on the financial product, according to a survey conducted by ITFA and the International Association of Credit Portfolio Managers (IACPM).

The total insured exposure among banks participating in the survey grew by 35% from US$130bn in 2019 to US$167bn in 2022, the survey found. This growth has ensured that CPRI is the second most popular credit risk mitigation tool used by banks, only surpassed by secondary market activity such as true loan sales, syndication and funded sub-participations.

The survey is conducted every other year. The current iteration is the third to date and the second to be produced in conjunction with the US-headquartered IACPM.

"The goal is to have a snapshot of what the market participants are doing on the bank side – how they are organised, how much insurance they buy, and the reasons behind their buying decisions," explains Jean-Maurice Elkouby, chair of ITFA's regulatory advocacy working group and member of the Insurance Committee.

The survey focuses exclusively on insurance provided by private companies and excludes government-backed insurance such as cover from export credit agencies (ECAs). A total of 48 institutions – members of either ITFA or IACPM – participated in the survey.

The data collected holds significance from two perspectives, Elkouby explains. "It serves two purposes. One, to give contributors some feedback on where they sit in the market and what other people are doing, making it a benchmarking exercise. Additionally, it is a helpful tool to use in our advocacy work with regulators."

The data gathered this year aligns with insurers' optimistic expectations regarding market trends, says Sian Aspinall, member of the ITFA Insurance Committee.

"You have a perception of the way everything is developing, and you see expansion in the market and incremental growth in volume – so it is really nice to get those preconceptions supported by concrete data," she says.

Furthermore, this year's survey offers both quantitative and qualitative insights that explore the motivations driving banks to purchase insurance cover, she explains.

For example, 56% of respondents indicate that their primary goal for using CPRI is to increase lending, while 69% highlight gaining regulatory capital relief and/or increasing their return on capital as one of their top three reasons for using CPRI.

This year's survey also breaks down the usage of CPRI by asset class. "We knew credit insurance was facilitating lending, but we didn't have that granularity of where that facilitated lending was ending up and who was benefiting," Aspinall says.

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info@itfa.org

The data indicates that CPRI is predominantly used to cover large corporate loans or asset-based finance, such as project finance. However, it also reveals a growing use of CPRI to cover SME term loans and revolving credit facilities.

“I think there was an assumption previously that insurance would not necessarily support financing in the SME space due to perceived challenging risks,” Aspinall says.

On the trade finance front, 40% of respondents say they “frequently use” CPRI to cover receivables financing, while approximately a quarter of respondents say they “frequently use” the product to cover supply chain finance or payables finance as well as other payment undertakings.

“The results of the survey demonstrate how CPRI is supporting the real economy and where we are making a difference – not just to our direct clients but also to the broader economy, whether in infrastructure development, support for small businesses or contributing to the energy transition,” she adds.

Supporting ITFA’s Advocacy Work

ITFA hopes that this collated data will be a useful tool to demonstrate the benefits of credit insurance to regulatory bodies in order to avoid market-hindering regulation.

Indeed, the survey found that 48% of those surveyed were “very worried” about the long-term future of the CPRI market under finalised Basel III rules.

The primary concerns appear to be concentrated in Europe, with 59% of participants expressing they are “very worried”, compared to 32% in the Americas and just 2% in the Asia Pacific region.

The survey also found that 18% of respondents predicted a substantial reduction in the use of CPRI after the implementation date of Basel III. A further 11% expect a marginal reduction.

The current proposed Basel framework does not identify credit insurance as a distinct credit risk mitigant, Aspinall explains.

While banks can obtain capital relief from the use of insurance, the treatment of that capital relief remains consistent regardless of whether the bank is lending to an insurer or obtaining the protections of a CPRI policy from an insurer.

Aspinall highlights ongoing advocacy efforts aimed at recognising the distinction between these positions, advocating for the acknowledgement of credit insurance as a distinct risk mitigant in the European interpretation of Basel III.

To date, advocacy efforts have resulted in an “enabling clause” – or Article 506 in the latest CRR3 – the European transposition of the Finalised Basel III regulations.

This draft clause, which was secured in 2021, urges regulators to consider applying a ‘reasonable loss given default ratio’ on the treatment of credit insurance – ideally less than the 45% proposed under current Finalised Basel III regulations.

If implemented, this would – from ITFA’s perspective – recognise the merits of credit insurance and allow banks to use the product to support trade and the real economy.

“The onus is now on us to perform and give the European Banking Authority (EBA) the right information. And this survey is one of the supporting materials we will present to the EBA as the latest snapshot of the market – which should help regulators’ understanding around this product,” Elkouby explains.

ITFA is also continuing its advocacy work with other regulators – including the UK's Prudential Regulation Authority (PRA) – on their interpretations of the Basel III framework.

The EBA is set to complete its report on CPRI by the end of June and this latest data will be submitted to the regulator in advance of the final report.

To view the executive summary of the IACPM/ITFA survey and a selection of high-level results, click here