PRI: Risks that never went away

Emerging economies may be enjoying their best performance in a generation but political risk is alive and thriving, writes *Kevin Godier*.

The recent military coup in Thailand and the violent conflicts in parts of the Middle East are just two manifestations of a spectrum of political risk perils that refuse to go away. Other examples are the resource nationalism which has made a return in Africa, Latin America and Russia, and discriminatory practices in China and South Korea stumbled into by foreign investors.

The only welcome aspect of this pattern, says Kit Brownlees, managing director, political, project and credit risks at the Arthur J Gallagher insurance brokerage, is its blunt reminder that political risk still exists.

Such events, he underlines, have spawned rising requests for the many types of political risk insurance (PRI) cover offered by private sector underwriters, having triggered "a heightened awareness among multinationals and the wider investment and banking community of confiscation and all the other political perils globally".

Brownlees at AJG **Blunt reminders**

Venezuela and other parts of Latin America now appear as a political minefield to some observers. "It is hard to ignore the expropriation action of the Bolivian government earlier this year when it ordered troops to surround oil facilities owned by Petrobras," stresses Dan Riordan, managing director of Zurich's political risk and trade credit arm. He adds that "developments in Argentina are not necessarily over yet – and there is also a sovereign debt rescheduling in Belize, where we have some exposure."

Claims, claims everywhere

The claims environment bears out the genuine political risks involved in emerging markets. 2005 saw what was described to GTR by one underwriter as "the largest paid claim in recent history", a reference to a reputed US$160mn payout by private market underwriters for non-delivery on a pre-export financing in Tajikistan.

Hiscox's Underwood **Balancing portfolio is best**

In Iraq meanwhile, the State Oil Marketing Organisation is involved in a debt workout after defaulting on payments last year. More recently, the Israel-Lebanon strife "has generated two claims that I know of," says the underwriter.

Elsewhere, around US$20mn in claims from banks were paid in 2004-05 by Zurich after the Dominican Republic's ministry of finance failed to honour its guarantees following a foreign debt rescheduling.

Other hits have been taken by resource industry companies that failed or chose not to buy insurance, "and so must write off their losses," says Bernie de Haldevang, financial and political risk underwriter at Atrium Syndicate 609 at Lloyd's of London.

An especially strong argument for taking out PRI is that "you can never really predict how, when and where the next political crisis or credit crunch will occur," emphasises Andrew Underwood, head of political risk at Hiscox Syndicates. "Having paid out some 600 claims everywhere across the world in 26 years of underwriting, we have learned that balancing the portfolio is always the most effective action for an underwriter."

For insureds seeking protection within the contract frustration area that his Hiscox team specialises in, Underwood recommends buying comprehensive forms of cover, as "specific perils may not cover every eventuality".

Requests upturn

All the PRI professionals canvassed by GTR reported a demand upturn of some kind. Mark Cooper, managing director at TFC Brokerage in Hong Kong, notes there are "plenty of situations to trigger demand in Asia for credit and political risks. From our experience we can confirm that transactions are getting done."

Berry at BPL Global

Rewriting terrorism cover

At Zurich, "it's our biggest year yet – we have seen higher levels of submissions, transactions and closings, in all our products," underlines Riordan. "On the PRI side, the non-honouring of sovereign and, particularly, sub-sovereign guarantees has been in demand," mainly in Eastern Europe and Latin America, he says.

As insurance volumes rise, "reinsurance capacity is holding up well as evidenced by some markets having increased line size and tenors as well as new market entrants," notes Danny Oades, partner, credit and political risk, JLT Risk Solutions.

Cooper at TFC Brokerage

Asian demand

Here he cites Liberty International, Garant, Atrium, and Bermuda-based Lancashire and Houston Casualty. Underwriters' more professional approach, and greater focus on products that address market needs, mean that "PRI is more of a standard form of cover actively sought by clients," Oades adds.

In the US market, companies are looking more keenly at equity insurance, according to Evan Freely, New York-based senior vice-president at Willis Financial Solutions. "Denial of justice cover – to protect against a government delaying or denying an insured from resorting to an arbitration mechanism – is increasingly requested," he says.

Freely also cites an uptake in trade disruption insurance, where insureds protect – often via a small handful of Lloyd's market syndicates – against loss of profits stemming from supply chain disruption by governments or other entities.

Terrorism focus

Demand for traditional expropriation and political violence cover has also grown, comments James Cunningham, senior vice-president at Marsh Political Risks in London. "9/11 was the key turning point, and triggered the development of standalone terrorism and subsequently political violence products," he observes. Before this, property underwriters typically provided terrorism cover. Afterwards, however, terrorism was excluded as a standard, and the PRI market began to write the cover.

One of the London market's most experienced political risk brokers, Charles Berry, chairman of the BPL Global brokerage, takes up the story. "It became obvious to us that the insurance market's T3 standard terrorism insurance wording was designed for OECD countries as it excluded both war and political risks, which was hardly appropriate if you held assets in certain emerging markets."

Three years ago, says Berry, BPL Global redesigned its global political violence cover to encompass emerging markets terrorism. "It was logical to take words like insurrection, civil war and war – all of which were in the T3 exclusions – and include them in the product."

BPL Global has also broadened out its offer of PRI cover on mobile assets in emerging markets, to cater for some of the "increasingly common insurgency and guerrilla actions" in emerging markets like Nigeria, Iraq and Afghanistan, Berry comments.

Is enough PRI cover capacity available for such markets? "Parts of the PRI market can do Iraq and Lebanon, but there are risk issues, not least that reinsurers won't cover war on land, which generates country aggregate concerns" says an underwriter.

"Also, if an underwriter has a US$10mn line available, and a choice between Iraq and a mushroom farm in California, he might only write US$500,000 for Iraq," he suggests.

Middle East conflicts have "prompted underwriters to scale back on contract frustration and political violence exposures," confirms Alistair Mole, director at London-based brokerage Benfield Political Risks. Yet cover is still plentiful – and cheap – on a market such as Syria, where war on land cover is available at "less than 0.2-0.25%", says de Haldevang. "Throw in terrorism and it won't cost you a great deal more, if anything," he adds.

There is nevertheless one other potential peril to contend with, states another underwriter who prefers anonymity. "Sometimes decisions whether or not to indemnify may come down to who your underwriter is – insurers can still differ in their interpretation of the same claim," he cautions. The key to all PRI purchasing is "to go to a broker that totally understands the subject matter," he concludes.

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