

FINANCIAL CRISIS 2009

## Global crisis fails to derail political risk market

A decade of modest losses and robust profits has allowed structured credit (re)insurers to withstand the worst downturn since the Great Depression

There is no doubt that 2009 is the worst year that the political risk (PR) class has had since it moved away from indemnifying insureds against confiscation by tin-pot dictators and started insuring investors backing banks in far-flung countries against default.

A steady stream of bad news emerged as the market wrestled with bank collapses in Ukraine, Kazakhstan and Bahrain (UKB), the failure of Dubai World and problems with the colossal Blue City hotel development in Oman.

In its half-year results Novae reported a negative profit of £2.1mn – with much of the adverse development down to losses from the structured trade credit business that it had been writing. Catlin also alerted the market to considerable exposure in its half-year results.

In its November trading statement, Beazley said that its estimated losses would have a negative impact on profits of £33mn. Chaucer was next to notify the market of its exposure to the bank default problems in UKB. In its third

quarter statement it strengthened its reserves by £23.5mn.

Scary numbers started to emerge for ultimate market-wide losses too. Charles Berry, chairman of specialist political risk broker BPL global, estimated that gross claims would total \$2.5bn and claims net of recovery somewhere between \$1bn and \$1.5bn. A broker working at one of the “big three” placed total London market exposure at \$1.5bn. Although the number was later withdrawn, Aon Benfield released a Lloyds-only loss estimate of \$750mn for claims coming out of Ukraine.

But the mood in the market is starting to turn. Last year’s gloomy predictions are now coming under question. The sky has not fallen in, while nothing new has emerged in the fourth quarter. Brit and Hiscox did not feel compelled to release political risk-specific loss numbers. Catlin has reported losses of under \$30mn, telling the market that it does not expect this quantum to grow. Novae acknowledged only an £11mn loss. Beazley reported claims in its PR and contingency division of £54.7mn, up from £14.4mn the year before, but believes that its Q3 reserving is adequate. Capacity has not dramatically fallen away.

There is a quiet pride in the market about the way that it has ridden out the crisis. One underwriter told IQ: “This

is our hurricane. No more, no less. It was a perfect storm. And nothing in particular has to change. The product has performed exactly the way it should have done.”

It seems unlikely therefore that 2009 losses, heavy though they are, will dramatically change the face of the market. Marsh’s UK practice leader for political risk and structured credit, James Cunningham, said that the UKB crisis was “not catastrophic and game-changing for the market”. Another senior source in the London market said that it was “pretty much business as usual”.

Political risk, industry insiders argue, is a mature market that cannot be derailed by a single catastrophe year. A decade of modest losses and robust profits, as well as the relatively small size of the political risk books, means that (re)insurers are able to withstand the pain even of the worst financial crisis since the Great Depression. Three normal years would be enough to fully offset the losses, in the view of multiple sources. UKB has not been “a capital eroding event”, one underwriter said.

There are two principal caveats that need to be set alongside this upbeat assessment. First there is the reinsurance perspective. Primary insurers may not have taken fright, but reinsurers might have done. Since September last year Munich Re has ceased writing structured trade credit where the risk is solely attached to banking activity. Swiss Re too has re-evaluated its position, substantially reducing capacity in credit and surety as part of its efforts to de-risk its portfolio.

And then there is the question mark over the status of the world’s economic recovery. All of the major economies may now have emerged from recession, but many commentators still expect the withdrawal of stimulus packages to trigger a “W-shaped” recession. If that happens a second tranche of financial institutions could still fall down, inflicting a second wave of losses on the insurance industry.

### Political risk losses 2009

| Country        | Forecast losses  | Notes   |
|----------------|--|---|
| Ukraine        | Lloyd's only losses < \$200mn (a source inside Lloyds)<br>London market losses \$500mn (Broker)<br>Lloyd's only losses \$750mn (Aon) | Bank Nadra was put into temporary administration in February 2009. At the close of the year the government was moving to transfer its deposits and assets to the state-owned Rodovid Bank in preparation for its liquidation. Ukrprom bank has already been through the same process. A number of other banks with obligations to Western banks have been able to restructure the debt. |
| Kazakhstan     | Almost \$800mn (Aon)   | In April, Kazakhstan's second-largest bank, BTA, failed, defaulting on circa \$12bn of obligations  |
| Bahrain        | \$200mn  | Bahraini banks AWAL and The International Banking Corporation (TIBC) collapsed. Both were Saudi-owned banks. AWAL by SAAD and TIBC by the Al Gosaibi Group.   |
| Oman/Blue City | \$399mn+?  | Axis Capital has considerable exposure after the \$399mn bond issue for the \$20bn Blue City hotel complex was downgraded.  |
| Dubai          | Unknown  | In November Dubai World, the largest state-owned conglomerate in the Emirate suspended payments, sending the world's stock markets into free fall. Euler Hermes admitted EUR10mn of exposure, while Hannover Re said that it would pay out a single-digit million Euro sum.   |
| Russia         | Unknown  | RusAl, the aluminium giant owned by oligarch Oleg Deripaska, suspended payments in Q1 2009. In December \$16.8bn of debt was refinanced with more than 70 lenders.  |

Source: The Insurance Insider