WORLDLY WISE

The international business climate and a changing socio-political environment have resulted in an increased demand for political risk insurance. Stuart Anderson examines the political landscape

Viktor Yushchenko commanded top billing in the foreign pages of newspapers worldwide for several months either side of his dramatic election to the Ukrainian presidency last December, and was widely hailed as the greatest hope for reform of his country’s beleaguered economy. As part of that reform he is currently pushing through a review of privatisations, mainly within the energy and gas distribution sectors, carried out by his controversial predecessor Leonid Kuchma.

The beneficiaries of the contracts are predominantly Russian companies, and the likely outcomes will be renegotiation or even if new auctions rather than outright renationalisation. The process nonetheless serves as a timely reminder of the ability of democratic governments to revisit and, should they wish, cancel contracts awarded by previous administrations.

In the case of Yushchenko we have a Western-leaning leader advocating the prosecution of exactly the same policies against Russian companies as the West was told would be imposed upon theirs in Brazil when the socialist Luiz da Silva was elected with a 61 per cent majority back in 2002. The latter spree of confiscations and renationalisations has, however, never materialised. It seems to be the case that, when it comes to political risks to trade and investment in emerging markets, politicians have changed their minds.

Such reminders that the climate for international business is not always benign are, in 2005, combining with continued literature in climate change, to produce increased demand for political risks insurance (PRI).

Although a significant hardening of political insurance premiums post-September 11 (as much a result of reinsurers pulling capacity from specialist lines in order to concentrate on property, as any perceived increase in risk) rates are now, according to Ian Haynes, head of political risk at Marsh, “not hugely dissimilar to 2000”.

“Rates went up dramatically in 2001-02 and have been falling by about 10 per cent per year since,” he continues. This is partly due to recent increases in market capacity and also a result of floating batches, which make up about 70 per cent of the overall market for PRI, seeing their margins squeezed by high levels of liquidity and, in what is increasingly considered a market, exerting pressure on their insurers to reduce premiums.

Insurers also note that investment and trade. Investment covers misappropriation of the assets of a venture and physical damage as a result of political violence, while trade insurance provides protection against the frustration of contracts and insolvency of partners consequent on political actions. These actions do not necessarily have to be carried out by the host government — when banks in a particular country run into difficulties with their foreign branch in that country, preserve or improve their assets in the market. The base of the index is the world risk in 2000.

New capacity coming into the market has, the Ukrainian government and the IMF, to be watched. Here, according to Haynes, 10-15 per cent of additional capacity has been provided over the past year or so. This has been accompanied by new entrants including Quinta, Atradius and Hardy Underwriting Group, a move that has been accelerated by the London market.

London has become one of the best places in the world to place short-term political risks business, as Michael Hornsby, director of the political and trade division at Jardine Lloyd Thompson’s, explains: “It has to be because it can’t afford other countries than the US, three to five years. Longer coverage is available in the US but it comes at a price. In order to write, the Lloyd’s market is currently offering attractive deals for those willing to accept a shorter duration policy.

Insurance underwriters will be keen to retain the business that they already have. If underwriters lose a deal, they may be persuaded to reduce rates on renewal,” says Charles Keville, director of Aon Crisis Management.

“Otherwise new players could come in and underwrite the risks and take all their hard work.”

Although rates are softening, demand is forecast to increase. One factor in this is the expansion of capacity in insurers’ insurance budgets. Silas says, “In recent years companies have allowed what they perceived to be non-essential covers, such as political risks, to lapse as pricing hardened for their core property and casualty policies. Those lines are now reducing their premiums and issuing budgets for specialist insurance. Although capacity in the market is at an premium level, insurers are likely to be keen to follow the defined ‘political’ risks set out in the country’s insurance agreements.”

As with all market developments, improvements to cover across the board only occur at the expense of other people having their fingers burned. Political risks cover is a highly complex beast, relating as it does to many different aspects of an insurer’s financial management, physical assets and operations. For that reason, probably more than with any other type of cover, it pays to tailor policies carefully and look before you leap.

Regional range of risks

The regional risk index is an average of the country risk rating weighted according to the country’s exposure in the regional GDP. The base of the index is the world risk in 2000.

Lowest Risk

Northern America

Japan

Europe countries

Emerging Asia

Australia

New Zealand

Source: Capfin

Highest Risk

CIS

Near & Middle East

Emerging countries

CIS

Latin America

Sub-Saharan Africa

Industrialised countries

World

CIS