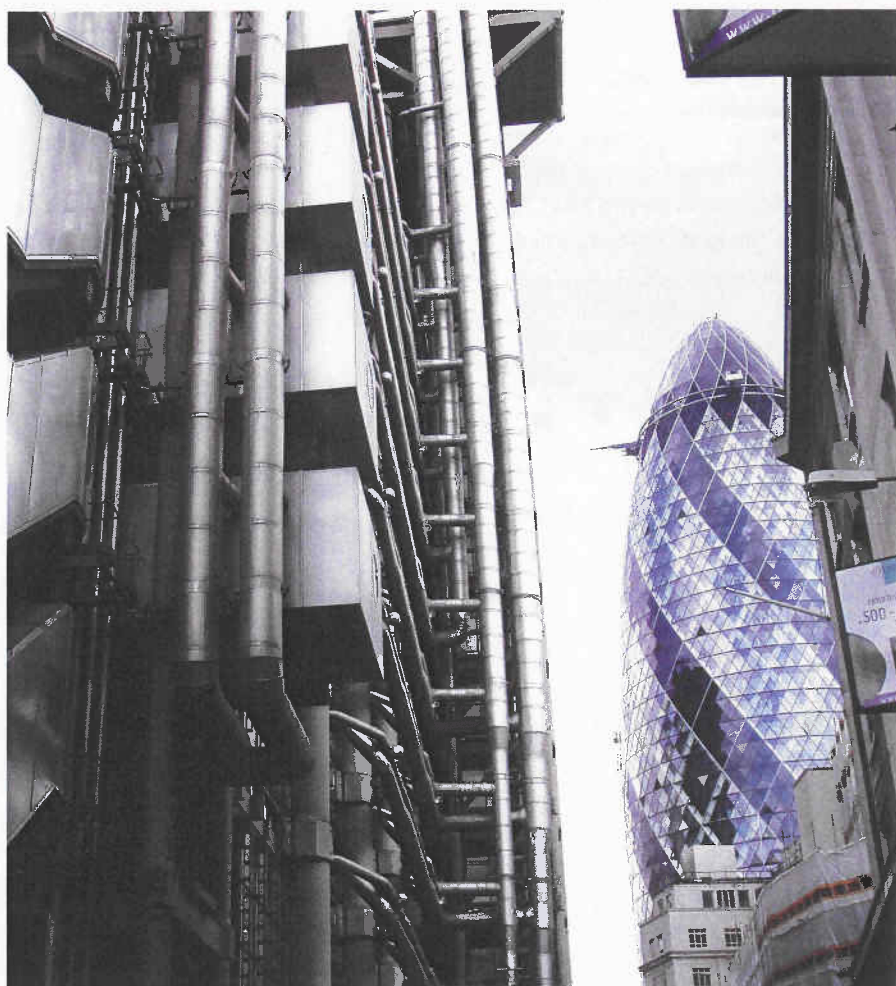
Let's talk insurance...



GTR recently brought together 10 well-known brokers and insurers in London to discuss some of the more salient trends and issues in the trade credits and political risk insurance industries. With these markets seemingly poised for a turn, as the financial market events of 2007 begin to bite into risk perceptions globally, the talk around the table provided a series of revealing insights into how this business is being approached.

Roundtable participants:

Charles Berry, chairman, BPL Global, London
Joe Blenkinsopp, head of London Markets team for Coface in UK
Kit Brownlees, managing director, political, project and credit risks, AJ Gallagher, London
James Cunningham, head of Marsh political risk team in London
Peter Jenkins, senior underwriter for Beazley syndicate, political risk and credit, London
Rupert Morgan, partner, trade and political risks, First City Partnership, London
David Neckar, executive director, political and credit risk at Willis, London
Neil Ross, head of AIG's trade credits division in London
Paul Sanders, AVP, Zurich EMS, London
Andrew Underwood, head of political risks, Hiscox, London
Chairman: Kevin Godier, freelance financial journalist

GTR: What has been the most significant, interesting or challenging market event or trend for each of you in 2007?

AU: Lloyd's revised the regulations for trade credit insurance and contract frustration (CF) insurance. Sometimes insurers make changes to their products that seem huge to them, but actually to everyone else are not huge. I think we need to listen to our clients more, embrace change and not be afraid of it, because product development is a job for life, not just an event that happens every 10 years or so.

PS: For ZEMS this year, one of the most interesting developments has been the development of a nascent customer base across emerging markets. We seem to be picking up more and more inter-emerging market trade as we are rolling out our office network.

JB: For Coface UK, the most interesting market trend has been the continuation of the highly competitive nature of the whole turnover trade credits business in the UK and the emergence of us as the only one of three major credit insurance underwriters able to offer trade receivables finance, as well as insurance.

NR: The growing presence of Basel II. Although it hasn't impacted most of the banks yet, we are already seeing significant changes and our customers are telling us that they're seeing changes in appetite from the banks now they are dealing with Basel II. So what we are trying to do is align ourselves to help support trade finance more effectively going forward.

PJ: I'm slightly off the beaten track here. The most interesting thing was seeing the queues outside Northern Rock. It's a symptom of the ongoing turmoil in credit markets. We don't know what the outcome will be yet, but that, more than anything else, is going to be the thing that influences what happens in 2008.

KB: As an international broker, we have seen much more increased competition from certain export credit agencies (ECAs). We've tended to be rather dismissive of their performance, but are finding that ECAs such as Nexi, Sace, EKN and ONDD are now providing a more aggressive approach to both short and long-term products, in areas such as local content rules and pricing.

RM: I'd point to the relaxation of the CF rules, which Andrew touched upon, and to the ongoing fallout from last year's resource nationalism. Also the emergence of yet more political risk markets chasing the same business.

JC: The most challenging and overriding trend has been how to successfully and profitably run a business effectively in what is a very low margin and low premium rate environment. I think that this affects our clients, the brokers and the underwriters. That's maybe about to change.

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DN: Two things. First, an underlying movement related to the Basel II position. Our market product was previously a rather rough and ready product, and is now being tailored to fit into specific transactions, and to be monetised so that it can be effectively treated the same way in syndication and other alternatives.
If that tie continues, it's potentially a huge opportunity for our markets, given the way that derivatives have grown. Of specific events, I feel that the sudden twist occurring with the sub-prime markets is going to raise questions in many different places that will have a big impact.
In Hannover, Zurich and Munich, there will be questions from reinsurers about what is actually going on, and whether margins should be tightened. An event such as the Sonangol syndication launch just before the sub-prime crisis – where it was both very cheap and also very difficult to find cover – may come to be seen as á turning point.

CB: I'd go with the credit crunch. My feeling is that this is the beginning of a long slow motion train crash in the financial markets, which is beginning to impact in emerging markets.
In mitigation of that, I do think that our PR market – compared with other financial markets - will probably escape relatively lightly. This is because so much of our activity is so close to real economic activity in primary sectors of the economy. There are aspects of this which could be very good for our market – but I do see this running on through the whole financial system.

GTR: There have been a series of good underwriting results for the past few years in your markets. Is there any hard supporting evidence that the very benign risk climate is now turning around?

PJ: Most of the evidence so far in terms of the credit crisis is really anecdotal. It's very difficult to actually point to hard and fast numbers. Within the market there are various LCs with various financial institutions giving some indications of price improvements on some of the underlying mechanisms there.
From an underwriter's point of view, there have been a couple of cases where somebody has come in, and I have said –'you have really got to be joking at that price – we are talking double that price for short –term 180-day paper risks'.
They respond that there are clients trying to offload things into the market, where they are clearly desperate get it off their balance sheets.

Neckar at Willis:
Sonangol turning point

KB: We've noticed an increasing disparity between credit risks and state/public buyer risks. The public buyer risks have still been lowly priced, and just recently the credit risk rates have started going up.

RM: From an investment, rather than a trade perspective, I would question the idea of a benign risk climate. You cannot overlook the situations in Bolivia, Ecuador, Venezuela and so on, which is anything but benign.

JB: If we're talking about the credit crunch, it's important to know where it

BPL Global's Berry:
Bad PR is undeserved

will most likely hit, because there are many very highly leveraged companies out there. It won't take a lot, on the evidence, for this to become very apparent quite quickly, when credit pricing does go up and availability for these type of

Cunningham at Marsh: Growth in structured trade products

companies dries up. It could mean that a few big casualties will fall over and we are being vigilant in this area.

NR: I've not seen any real hardening of the rates in the whole turnover credit underwriting market. I think, historically, that this market has been very unresponsive to the changes in economic circumstances until the claims start hitting home. I'm hoping that there will be a change, but we've not seen it yet.

PJ: There will be a lag in any pricing turnaround in our markets, because we are in a situation where there is relative over-capacity in many traditional areas of the market, such as CF and PRI. For medium-term credit business the capacity is much tighter, so the lag will be shorter.

PS: We're already seeing price increases in certain markets, as the margins go up on the banking business.

JC: I think one of the interesting concepts from the last year has been the relationship – and difference – between the banks' pricing and the insurers' pricing. What we've seen is that as bank margins have come down, specifically the pricing in the comprehensive insurance market has also come down, within a set ratio. I think what we've started seeing more recently is the beginning of a stage where the insurance market was unwilling to drop by quite as much as the banking market. Those signs were there in the summer, in some of the comprehensive cover on trade-related assets.

AU: When we talk about price, I think some insurers have got very lazy. I think they have got used to charging x% of the bank's margin, simply holding the coattails without really assessing the rate that they want themselves.
I think actually what we have seen recently is margin plus pricing, so actually the insurer has said I don't care what the margin is, our minimum pricing for this is x, and regardless of whether that is 100% of the bank's margin, we want to achieve that sort of price.
So to me that's an indication that demand is still great on certain names.

GTR: Where is insurance capacity very tight, or failing to meet demand?

KB: Russia, Turkey.

PJ: Certain aspects of Nigeria.

AU: I think that things are constantly changing, so demand is constantly shifting.

PJ: We were all full on China and Brazil three or four years ago. I think we all now have a reasonable amount of capacity for both. In terms of Russia, Turkey, Ukraine and Belarus, especially Ukrainian banks and Nigerian banks, the market is now pretty full across the board.

AJG's Brownlees: How far for reputational risk?

JC: In the same market curve and context that Andrew mentioned with the banks, I think we have also seen insurance markets becoming very flexible in meeting the needs of financial institution clients, by going from direct trade-related to quasi, or non-trade related business with banks.
I think there is a very clear line, though, between doing trade and non-trade related business, and I think that's a business, regulatory and underwriting issue.
Essentially, I think the market has probably gone close to as far as it's going to go in the mainstream market. I don't know how many insurers here are prepared to write non trade-related deals, but probably not many of you.

CB: Certainly, compared to a few years ago, rules are no longer the constraint on what we can do. I know it's only symbolic, for lots of people who aren't in Lloyd's, but the Lloyd's rules have been relaxed a lot, on any interpretation. There is a growing activity in non-trade related business.
Everyone is still, quite correctly, looking at structure, but if there is sufficient structure so that people want to write it, on the whole the constraint is now purely appetite, and reinsurance appetite.

NR: One of the changes we see often is that in many countries the legal infrastructure is not well established and your ability to take recourse is very limited. That drives appetite as well. Were there to be an economic downturn, then you know it will be very difficult to get satisfaction over some of your debts.

CB: That's a real underwriting constraint, which is good, and not an artificial constraint.

GTR: Is there any sign at all that the non-US market could open out more to Iran in the near future?

RM: I think there is still appetite for the right investment risk in Iran, whatever the right investment risk in Iran might be. Not up to the level you might expect in other markets, but you might get US$100mn for the right risk, with the right ingredients. The market is not shut.

PJ: It's not necessarily an issue of whether there is capacity for Iran. There is Iranian capacity out there, but for any underwriter, the maths would only add up where the probability is that a risk can survive an American strike. A lot of markets have priced the risk in as being the risk of a limited US strike, but it makes no rational sense to the Americans to do a limited strike.

If they are going to strike, it has to be a big strike, almost a regime change strike. A surgical strike just delays the nuclear programme, and so from the American starting point of Iran having a bomb being

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unacceptable, doesn't achieve the aim. The question would be whether one can underwrite around that reality with a premium calculation.

GTR: To what extent is premium calculation the issue – and to what extent the repercussions of the Ofac's stance in the US?

DN: I think that is a major regulatory constraint, particularly for insurers and brokers that have any North American or US ownership. Both from a regulatory point of view and from a market perception point of view, there is a problem with Iran.

JB: It's linked to reputational risk issues as well. If you are perceived to be supportive of a particular activity that appears on the front of the newspapers, that's not a particularly pleasant place to be.

PJ: And its not just about Ofac and what the formal legal requirements are – the last 12 months have seen huge US political pressure on institutions and other regulators to do what they can to shut down other Iranian-related flows.

KB: Burma is also rather interesting now. We're an American broker anyway, so cannot go there. But for those who aren't, just how far are you prepared to go in insuring or placing a Burma policy, when it's a reputational risk?

GTR: Where are reinsurers standing on the next set of renewals?

PS: We're looking for a favourable outcome. Zurich is looking to increase our limits to US$125mn. The proof will be in the pudding, but that's the expectation. I think that for operations with a good track record, there should be few problems.

AU: I think that reinsurers are looking for non-correlated classes, and political risk as a niche area is one of those non-correlating classes. So I believe there is still demand, and our industry's results have been looking very good for the past few years.

NR: We just renewed our treaty and I think we found the reinsurers to be very supportive. They have seen a very good run of results over the past five years, and I think that they're not seeing anything immediate which is going to impact that, although they are obviously looking very carefully at what's going to happen in the sub-prime markets.

Zurich's Sanders: Follow Russia carefully

JB: I would agree with that. From the Coface point of view, the relationship we have with the reinsurance panel is excellent. They are very supportive, and we value their partnership.

DN: Are you aware of them making sallies into the direct market, which seems to be happening in some areas of credit and political risk? At Munich Re, they are setting up sort of special political risks unit to do that. Any comments on where that competition might lead to?

Underwood at Hiscox: Increased competition but few newcomers

JC: I think that is a trend we have seen as well.

PJ: I have heard a lot of talk about it but, as an underwriter, I haven't seen any direct reinsurer participation on transactions yet.

CB: The mood is definitely positive. I can confirm that our class of business is being looked at favourably by reinsurers, whereas I think three or four years ago, it was being looked at very unfavourably. It is quite a turnaround.

KB: Charles, do you think there will be any repercussion with recent arbitration settlements on Argentina? There has been a large arbitration settlement recently, and I hear that other Argentine deals are being arbitrated right now.

CB: We are happily not directly involved in the fallout from the Argentine crisis. But everything that I hear says that those events have been fully discounted into the market, and that the outcome for

reinsurers might be better than they once feared.

PJ: We're all in the business of insurance, and if we don't pay claims, people won't buy cover. We'd all prefer it not to end up in arbitration or settlements, but be straight claims at the time. In terms of actual impact on the reinsurance market, I'd agree with Charles that these issues have been outstanding for a while, and largely have already been priced in.

Coface's Blenkinsopp: Level playing field fallacies

KB: As a broker, we talk to clients for whom big claims were paid last year and this – Tajikistan comes to mind and I think that's great.

GTR: Is it a source of embarrassment for any of you that claims such as those in Argentina take so long to be resolved?

CB: There is a lot of bad PR around claims in our market, but a lot of it is undeserved, and one ongoing trend is an attempt to be more transparent about claim statistics. Without breaching any confidences, we make available the statistics that we have built up in the past 25 years on claims. And as a whole, it tells a very good story, much better than the word on the street about this class of business.

I would add that in any discussion about claims, I always insist upon making a distinction between non-payment, failure to pay class, and the pure PRI covers. The story on the non-payment side is frankly excellent, but somewhat misunderstood. It is more complicated on the pure PRI side, but even that side of the story is not too bad.

RM: The brokers around the table are defending the insurers who have these questionable claims settling reputations. What are the insurers doing, within the parameters of the confidentiality agreements, to combat this?

AU: Bear in mind that reputations are hard won and easily lost, so one of the things that Hiscox has done, for example, is to have a list of claims paid on our website. This is to help brokers, to give them ammunition and details that they can show to clients.

> "It's a clear product, a fair product, a good product and it works – and we are hoping to see more business"

PJ: There's also a generic marketing issue in that people remember bad news, because bad news is interesting, however transparent we are.

CB: To be fair, I do think that the insurers have responded to the pressure that we put them under. There is definitely an acknowledgement that they need too improve. This is partly a problem of image, but there is some real effort going on in certain areas actually to improve the claims performance of the market.

Jenkins at Beazley: Still Basel II questions

Particularly in terms of the timings of payment.

KB: I think it's been an improved market over the past ten years. The fact that more and more banks are buying the cover must prove something.

AU: It's also a question of getting the wordings right, and I think there have been huge strides in that area in the last 10 years as well. If you can get clarity in the wordings then that helps to avoid misconceptions among the buyers.

GTR: How is Basel II kicking into the PRI and trade credit insurance markets?

CB: There is a much better engagement between the banking and insurance markets. If you're going to use insurance as a credit risk mitigant, it has to work – and that's what people are focused on. As we've discussed, the wording for financial institutions have improved in leaps and bounds in the last five years or so. And I think that the message is being digested by the banks that the old simplicity that insurance is bad and guarantees good has gone out of the window. Basel II has made the debate more real and serious.

DN: This has been coming for a long time. I think that those banks that have practitioners who have spent a lot of time on claims payouts, were drafting wordings, some three or four years ago, that they felt covered the risks that they wanted to see covered. They have learned that what they have agreed to, and put through their legal and credit committees, is hardly any different to what a Basel II ideal policy should look like, if you were to put the two together. These banks seem to be saying, we are relatively comfortable, we have learned to live with the insurance.

But as Neil said, the main thing is that change is happening. If that is going to be translated into more deals, as I think it will do, then insurance has the huge advantage

of not requiring marking to market, which should trigger much more use of the product. The only limit will be the individual counterparty limits on each individual insurer.

PS: I think that we write a product that is hugely improved compared to 5-10 years ago, and the good thing is that most of it is within the insured's control. It's a clear product, a fair product, a good product and it works – and we are hoping to see more business. Basel II is a good opportunity for our market.

RM: Our existing banking clients seem to like it. The fact that the uncertainty surrounding Basel II is now dissipating means that more banks are coming to the table. The fog hanging over Basel II for such a long time seems to be lifting.

PJ: In general terms, there is a cohesion now between bank requirements and what insurers are now willing to do on Basel II. The interesting issue going forward is going to be the banks' regulatory environments themselves and the differences between the various national and regional regulators. How that battle plays out will be quite crucial to some of our bank insureds, because *in extremis* we might end up in a situation where our market is happy to do a Basel II wording for a bank regulated in London, but is not happy for a bank regulated somewhere else, re the potential interpretation of Basel II.
We still lack clarity on how the regulators are actually going to interpret Basel II in terms of our market, which is fundamentally such a small piece of the pie that the regulators in most markets haven't really got to that level of detail yet.

AU: I agree, and I don't think it's down to insurers to sell certified policies as being compliant. It's down to the insureds to make that decision. They tell us what their requirements are and we do our best to meet those requirements, but we can't guarantee that it's compliant. I've not been asked to guarantee compliance.

NR: I think that when you have an underlying payment instrument then it's much easier for wording to become Basel II-compliant or get close as the payment obligation is separated from performance. But most of the trade around the world is done on open account with unrated and sub-investment grade buyers, where you are heavily reliant on the seller/servicer for the transaction.
I think that from that angle, you might take the view that a bank isn't in control of all the aspects. I think that it will be quite challenging to bringing the two together.

JB: We've seen credit receivables management business booming because we've seen the banks actually requiring a third party to manage that business with certainty. Echoing what Charles said about clarity, I think there's a greater understanding among banks that insurance isn't just about a product that has terms and conditions and warranties. There are good insurers versus slightly less well regulated and less disciplined insurers. So depending on where you are in that food chain will determine how people react to you and your product. Also, to expect a level playing field to result from Basel II is a bit like saying there is a level playing field for all ECAs. Which, equally, I think, is a fallacy.

GTR: Which are the ECAs whose business overlaps the most with private market business?

KB: I mentioned some earlier. Sace, EKN, ONDD and increasingly we find, Nexi in Japan. I think frankly they should stick to the SMEs and the very large projects, and get out of the middle ground. They are beginning to irritate me – I think that some of these ECAs are bending rules ridiculously, and I think the taxpayer in

Godier: Chairman

Italy or Belgium or wherever is taking on risks that they shouldn't be. We have had two instances in the last year, where the

AIG's Ross: Waiting for change

local ECA allegedly couldn't do the deal, we provided terms for the deal, and then suddenly, the local ECA could do terms for the deal, even though, let's be honest, it's borderline within their remit.

PS: We have a totally contrary view. We work with over 15 different ECAs, reinsuring and co-insuring; we are part of the Berne Union, and we think that ECAs still have a major role to play.

RM: On the investment side we have found that people such as EDC of Canada and Australia's Efic are keen to work with the private market in a more commercial, creative and productive way than ever seemed possible before. Within the public sector there is a greater understanding of clients' needs and a growing desire to be flexible.

JC: I'm intrigued by Kit's view not being supported by the insurers. I think he's saying that there are a number of examples among ECAs where they are effectively stepping into our products, where there is enough evidence to suggest these are being provided by the private market. What is the rationale for them to step in if it's not a market of last resort, or supporting an area of development where there is no private market support?

DN: I wouldn't wholly agree. I do think there's one particular factor that you mentioned which is important, which