The political risk insurance market is flourishing in these uncertain times, attracting new clients with novel needs.

Rising geopolitical tensions, induced by the growth in populist politics around the world, increasing protectionism and continuing trade disputes represent the “new normal” trading environment for businesses, investors and banks today.

Nor is the political risk outlook likely to improve any time soon, according to broker Marsh’s recently published Political Risk Map 2019: isolationist, plus protectionist, practices rising in some countries have effectively put globalisation on hold, Marsh noted in its commentary.

Trade tariffs and geopolitical disputes between the US and China could escalate in 2019, spurring the risk of further Chinese retaliation and US counter-retaliation, Marsh says. Russia’s relations with the West will remain tense and could result in further sanctions on the rogue state in 2019.

Meanwhile, the UK’s negotiations to exit the European Union continue to loom over the political risk landscape.

In Africa, uncertainty around elections and deteriorating economic and humanitarian conditions have led to sharp increases in political risk in Zambia, Mali, Algeria, Tunisia, Cameroon, and the Central African Republic.

Such heightened levels of uncertainty have underlined the importance of credit and political risk insurance (CPRI), leading to an expansion of the market, its client base and the sort of coverage on offer.

CPRI broker Aon confirms that several hotspots around the world are stimulating CPRI business. London-based Mairtin O’Griofa, Executive Director, Political Risks and Structured Credit, tells Reactions that Aon has seen an increased flow of enquiries following the recent US-China trade war. “Businesses are concerned about the fallout and how this may impact their investments, supply chains and trade opportunities,” he says.

On top of this, Aon consistently receives a number of enquiries in the Sub-Saharan African region due to the ever-changing political climate, O’Griofa adds. Aon has also seen an increasing number of enquiries in the Middle East, with investors’ concerns centring around the proxy war between Saudi Arabia and Iran.

Peter Jenkins, Head of Political and Credit Risk at CPRI carrier Brit, echoes the brokers’ analysis. “For us, the China, Africa and Middle Eastern markets have always been big drivers. In terms of sectors, the market will always be overweight in oil & gas, whether due to direct exposure to related deals or to oil and gas producing countries,” he says.

“In 2019, we expect China/US
tensions to have a significant impact on trade flows and consequently demand, with the possibility of certain scenarios giving rise to loss activity. Additionally, Turkish economic uncertainty may get significantly worse depending on government responses,” Jenkins adds.

Julie Martin, a managing director in the US Political Risk and Structured Credit Practice at Marsh, says the global outlook is leading more businesses to consider covering certain political risk exposures for the first time.

"Clients increasingly see that they need to assess their CPRI risks and price them into their investment costs or figure out how they can mitigate their risks,” she notes. "Businesses know they must make an informed decision over whether to buy cover."

Positive market response

Fortunately for buyers, the political risk market is responding well to client needs. According to Sian Aspinall, managing director at CPRI specialist broker BPL Global, market conditions are positive: “Alongside non-trade and non-payment public obligor risk, the line was a key growth area for the wider CPRI market,” she says. “This year, maximum per-risk capacity available for political risk rose to $3.2bn, representing a $200m increase from 2018 and indicating healthy appetite within the market to write political risk insurance business.”

The CPRI market has evolved rapidly in the last decade, growing from around 25 carriers with dedicated teams 10 years ago to around 60 today, despite some comings and goings among players recently.

“CPRI is still a relatively niche market, so it is expected that we will see changes in participants from time to time. Likewise, although we did see some insurers discontinue writing CPRI last year, we also saw new entrants enter the market in their stead, which has sustained growth in capacity and product offerings,” Aspinall adds. “CPRI continues to be an attractive business line for global insurers looking to maintain a diversified book of business.”

Aon’s O’Griofa agrees. “It is evident that there has been an increase in M&A activity amongst insurers, predominantly focusing on Lloyd's carriers, with underwriting teams often consolidating as a result,” he says. “However, there continues to be numerous new entrants to the political risk and structured credit insurance market as capacity providers still see the opportunity within this market to achieve a solid return on investment.”

Changing client base

O’Griofa’s reference to structured credit is significant. At the same time that the CPRI business has broadened in terms of the participating risk carriers, the market’s client base has also widened, with financial institutions now accounting for more than two-thirds of business flowing into it, according to some estimates.

Roddy Barnett, veteran political risk underwriter at Beazley, explains: “Exporters and multinationals with contracts in risky parts of the world, with a focus on commodities and natural resources extraction, used to be the traditional client base. Over the decades there has been growth in the number of banks and other financial institutions looking for risk mitigation from our market on the comprehensive credit side, to improve the risk-adjusted return on capital they can achieve.”

There’s also been growth in non-bank financial institutions like pension funds or other lenders that use the market to mitigate the political or credit risk they encounter, Barnett adds.

In its 2019 CPRI Market Insight report, BPL references continuing demand from banks for single situation credit insurance beyond emerging markets.

“Demand for single-situation credit insurance to cover OECD-located risk is significant – it was, in fact, the subject of a third of our risk enquiries in the second half of 2018. Much of this demand came from banks, which accounted for half of all our new enquiries in the same period. One in five of these enquiries relates to covering unsecured corporate lending, which has driven this demand shift towards OECD territories,” Aspinall explains.

Julie Martin at Marsh highlights a growing trend for private equity funds to purchase CPRI coverage. “It could be related to a fund that has established a portfolio company to invest in power in Africa, for example, and that portfolio company will buy the coverage,” she explains. “We also see growth in the use of the coverage among institutional investors, relating to long-dated buy and hold assets, on both the political risk side and non-payment insurance.”

Another trend identified by market insiders is an increase in the use of CPRI by public agencies, governments, export credit agencies and development banks, for example, which increasingly use CPRI to mitigate peak exposures in a similar way to facultative reinsurance. Export credit agencies especially have ramped up their use of private political risk insurance coverage in the last three years.

“The rise in protectionist policy being seen across the world means that governments are keen to promote and safeguard exports in order to manage trade balances. As a result,
Aon has seen export credit agencies become more active in seeking reinsurance from the private market,” O’Griofa adds.

Martin says Marsh deals with a huge range of investors, across sectors: she even has several NGO clients with operations in risky countries. “We have seen claims related to damage incurred during civil strife, where buildings or vehicle are damaged,” she says. “In one case, a big mosquito net distributor lost $3m worth of mosquito nets.”

**Market rate movements**

In line with the wider insurance market, CPRI premium rates continue to come under pressure due to the abundance of available capital. Pricing has remained relatively low – and it has helped expand the range of clients and types of deal that can be done, says Martin. It’s also had a differentiating effect on players, she adds: “Some underwriters have opted to focus on their niche, whether it is plain vanilla middle-market risk or complicated single-risk structures that command higher pricing. But overall, CPRI still isn’t a commoditised market.”

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There have been a number of new entrants into the market since 2010-2013, and most of those who already had a market presence have expanded their operations since,” says Brit’s Peter Jenkins.

“However, a significant amount of the market’s business comes from financial institutions and, broadly, competition in that banking market has led to generally lower margins and higher costs of funds for financial institutions, thus lowering the premium levels that deals can support. However, 2018 saw some price stabilisation in certain areas, and 2019 may show a bottoming out,” Jenkins says.

Competition, he adds, is also affecting terms and conditions: “Just as there has been some softening of terms on bank deals at the borrower level, so there has been some softening of contractual wordings which can be expected to have an impact over time,” he warns.

Beazley’s Roddy Barnett is more upbeat. “In other insurance classes when there is consistent demand and a big growth in the number of carriers, you could assume a soft market would result. In CPRI, the demand has kept up with supply.

“Events like the financial crisis in 2008, the Arab Spring in 2011 and Ukrainian crisis in 2014, for example, have ensured that [CPRI] underwriters are pricing risks adequately. And when clients see the cover responding appropriately, it’s sustained their interest – and attracted new business as well,” he says.

“Turkey is a good case in point today. There’s been big demand from investors and the insurance market has stepped up to provide cover,” Barnett adds. “But as the outlook has grown more risky, then the supply of insurance has attenuated and pricing has hardened accordingly.”

**Political risk takes a bigger bite out of Berne Union**

A record $2.5trn of trade and investment was supported by credit and investment insurers belonging to the Berne Union in 2018 – 13% of total cross-border merchandise trade. Political risk coverage amounted to $46bn.

The Berne Union is the international association of export credit and investment insurers. Its 84 members include government-backed export credit agencies, private credit and political risk insurers and multilateral agencies from 73 countries.

Berne Union insurers paid claims in excess of $6bn for the fourth consecutive year, with political risk claims more than doubling from 2017 to 2018. From a low in 2016 of just 9% of the total, political risk claims increased to 32% of all credit and investment claims paid last year.

Total indemnifications in 2018 rose 3% to $6.4bn, 17% higher than the peak of claims paid in 2009 at the height of the global financial crisis, and 75% higher than the yearly average for the previous decade.

Cover for risks in Western Europe (27%), North America (11%) and East Asia (10%) collectively accounted for almost half of all new commitments. Southern and Eastern Europe and Southeast Asia contributed over 20% together. South America, Africa and the Middle East each take around 5%. The fastest growth was seen in regions of Africa.