



Perspectives on Political Risk Insurance

Claims handling and collection in the PRI market
October 2011



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Claims handling experience is vital in the PRI market

Founded in 1983, Berry Palmer & Lyle Limited (BPL Global) is a pioneer of political risk insurance (PRI). Claims handling and collection is an integral part of the comprehensive insurance broking service that we offer to our clients, which include manufacturers and exporters, commodity traders and investors, banks and other financial institutions. Our knowledge of the PRI market therefore includes long term experience of how different insurers and policies perform when claims arise.

Over nearly three decades we have been able to compile a detailed record of PRI claims activity that provides a unique perspective on this specialist market. Our data encompasses, for example, substantial claims payments that resulted from the financial crisis affecting Asia and the CIS states in 1997 and 1998 and the impact on the 'real' economy in emerging markets of the collapse of Lehman Brothers and the global economic meltdown in 2008.

A unique perspective

PRI is by its nature a highly confidential class of insurance, and therefore details of individual claims cannot be identified. However, we have always been willing to share high-level information on our overall claims experience and to offer insights on lessons learned. Both of these reflect the efficacy of the PRI policies that we place and our experience in handling claims.

Lessons learned from our claims handling experience mean that the insurance policies and processes provided by BPL Global today are, we believe, superior to those of even a few years ago. This improvement has been validated and reinforced by the significant volume of claims that we handled in the wake of the global financial crisis.



A robust market in the face of adversity

The PRI market is involved in significant claims payments and there has been considerable activity during our 28 years in business. By the end of September 2011, BPL Global had collected over US\$1.3 billion of payments for its clients from a total of 296 settled claims. Of this figure, more than US\$625 million relates to policies placed in 2007 and 2008.

Over the 1983 to 2005 years of account, underwriters paid out in claims around 85% of the premiums they received. In the years from 2006 onwards, they have already paid out 89% of premiums received to date. An average gross loss ratio of 85% to 89% is relatively high, and once underwriting expenses are added the combined loss ratio at the gross level is probably in excess of 100% - i.e. insurers paying out more in claims than they receive in premiums. So recoveries play an important role for insurers in ensuring the viability of PRI business. For instance, for the years up to 2005, the net claims ratio after recoveries is reduced to a more acceptable 44%.



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PRI is a volatile catastrophe class

The claims activity data we have compiled since 1983 emphasise that loss ratios in the PRI market are volatile, most notably in 1997 and 1998 when the gross loss ratio before recoveries soared to 380% and 225% respectively. As yet it is too early to ascertain the final figures for 2007 and 2008, which will also be heavy. By contrast, in other periods the loss ratios have been relatively benign. This volatility characterises PRI as a classic catastrophe class of business. The fact that political risk is not correlated to other catastrophe classes of property/casualty insurance is one reason why specialist general insurers are attracted to PRI.

The market's lengthy track record has also enabled it to continue to attract capital, despite having to bear heavy losses in recent years as a result of the financial crisis. BPL Global believes that the market is solid, and clients can draw great comfort from its stability and robustness in the face of substantial claims activity. Indeed, clients should not forget that claims are an expected and necessary part of any insurance activity.

However, it requires more than just loss ratio figures and the assurances of the PRI market's solid foundations to satisfy clients that the insurance meets their requirements. Although the majority of individual claims have been settled successfully, for a small number either the insurers denied liability or the policyholders had to accept compromised or partial settlements. So a brief outline of these claims will assist clients in determining whether the market is effective from their perspective.

Analysing the claims

As the chart below illustrates, BPL Global had received a total of 322 claims as of 30th September 2011, of which 296 were settled and 26 were pending or being processed. The figures exclude a significant number of cases that were notified as potential claims but did not develop further, usually because overdue payments were received before the end of the waiting period.

There is nothing unusual about the 26 pending claims; in some cases the claim has been agreed but payment is being made in instalments to reflect the underlying transaction. In others the client is voluntarily not collecting claims otherwise due as it anticipates that the non-payment can be solved through an agreed rescheduling.

Of the 296 settled cases, 271 were for the full amount of the claim without compromise. A further 18 cases were compromised, meaning that the policyholder accepted less than the full amount of the claim in order to resolve a dispute. Only the remaining seven cases were denied by insurers without offer of a compromised settlement; three of these were accepted by the policyholders and four led to arbitration proceedings.

BPL Global: PRI Claims

Claims from 1983 to September 2011	'Failure to pay' policies	PRI only/misc policies	Total
Full settlements	244	27	271
Compromised	10	8	18
Denied			
of which			
- paid after arbitration	3	1	4
- arbitration lost	0	0	0
- denial accepted	2	1	3
Pending	24	2	26
Total	283	39	322

Source: BPL Global claims department

BPL Global divides PRI claims into two distinct categories:

- Claims relating to policies covering non-payment by a counterparty, whether under a commercial contract for the sale of goods or a loan agreement
- “Pure” PRI claims involving expropriation, political violence, embargo, unfair calling of bonds and miscellaneous political risks.

From a total of 322 claims, the non-payment/failure to pay category accounts for 88% and slightly less (83%) of amounts collected. In addition to being more common, this type of claim is usually cleaner and easier to handle than pure PRI claims as the policies simply address default on a payment obligation without needing to analyse the cause of default. By contrast, expropriation and other pure political risk claims may raise issues involving both liability and quantum.

Compromised claims, relatively few in number, are more likely to arise in the pure PRI area. Just over 3% of non-payment claims have led to compromised settlements, while for pure PRI claims the percentage is higher. With all these disputed claims, the underwriters had good reasons for questioning whether the insured had complied with the conditions of the policy or (for the pure PRI claims) whether the loss was caused by a risk covered under the policy. BPL Global has a good record of bringing such disputes to a sensible compromise, with only four of our claims to date being the subject of arbitration.

Timeliness of payments significantly improved

It is generally acknowledged that when the PRI market was still nascent, settled claims were not necessarily always paid speedily. Timeliness of payment has improved significantly in recent years – particularly for our banking clients, for whom comprehensive non-payment policies define the due date of settlement of valid claims. They also set out a timetable for the claims process, with penalties for late payment where caused by insurers.

Overall, our claims data support our belief that the PRI market’s comprehensive non-payment insurance policies provide clean and reliable forms of credit risk mitigation. Where problems arise they are usually caused by the policyholder’s non-performance rather than any inherent defect in the policy itself. Generally though, we are able to help our clients install the robust systems necessary to ensure that their performance risk is controlled.





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