

In the face of adversity

The political risk claims market has been subject to intense claims pressure. **CHARLES BERRY** examines its resilience

Over the past 30 years, emerging markets have witnessed their fair share of adversity – the financial crises 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 to name but two. In the political risk insurance (PRI) market, these stand-out events have resulted in substantial claims for non-payment, non-performance, political violence and country risk losses for companies and banks operating in emerging markets.

Yet, despite this pressure, BPL Global claims data over nearly three decades shows that the PRI market has performed remarkably well (see Figure 1).

Loss ratios

One of the key metrics of any insurance market is the loss ratio of insurers; in other words, the ratio of claims paid to premiums earned. Over the 1983 to 2005 years of account for the BPL Global portfolio, underwriters paid out in claims around 85% of the premiums they received, and, since 2006, they have already paid out 89% of premiums received.

Such loss ratios are relatively high, and once underwriting expenses are added the gross loss ratio is probably in excess of 100% – which means insurers paying out more in claims and expenses 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%.

Undoubtedly, 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. By contrast, in other periods

the loss ratios have been relatively benign and this volatility characterises PRI as a classic catastrophe class of business. However, we should not forget that claims are an expected and necessary part of any insurance activity and the market has stood firm regardless.

Figure 1: 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

Claims analysis

Yet loss ratio figures and assurances of the PRI market’s solid foundations are rarely enough to satisfy potential clients that insurance meets their requirements. As such, it is useful to analyse the nature of the claims we received and how they were resolved. The claims can be divided into two distinct categories:

- (1) those relating to policies covering non-payment by a counterparty (which account for 88% of all claims); and
- (2) ‘pure’ PRI claims involving expropriation, political violence, embargo, unfair calling of bonds and miscellaneous political risks.

In addition to being more common, non-payment claims are also usually more straightforward than pure PRI claims as the policies simply address default on a payment obligation without needing to analyse the cause of default. 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. With all these disputed claims, the underwriters had good reasons for questioning whether the insured had complied with the conditions of the policy or whether the loss was caused by a risk covered under the policy.

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. And, while the last few years have seen claims activity on an unprecedented scale, the market is solid and clients can draw great comfort from its stability and robustness in the face of this substantial activity.

For more information please see *Perspectives on PRI: Claims handling and collection* at bpl-global.com

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