Insurers bask in sub-Saharan boom

Strong commodities prices have lifted African economies, and equity investors are becoming more comfortable with taking advantage of opportunities in the region. Dickon Harris talks to political risk and trade credit insurers about their latest growth patterns and which risks are causing them to lose sleep at night.

Peter Jones at ATI in Nairobi

Where banks go insurers follow, and with the boom in commodity prices insurers have seen their volumes dramatically increase in Africa as banks and equity investors scramble to take advantage of opportunities in the region. Insurers claim that demand in sub-Saharan Africa (SSA) is growing 'exponentially' with large insurers seeing growth levels of around 30%, and in some cases even higher. Much of this growth has been driven by high commodity prices. Income for commodity exporting countries is increasing which means that host governments have greater revenues to invest, while foreign investors are keen to gain a stake in the lucrative resources sector. The Democratic Republic of Congo (DRC) alone, for example, has 14 separate major mining financings under way, including gold, copper, cobalt and silver projects. The abundance of projects in separate countries throughout the region has encouraged companies and banks to demand multi-country policies.

Dan Riordan, president of Zurich Surety, Credit & Political Risk explains: "We have definitely seen an increase in requests for multi-country policies. Part of this increase is due to the opportunities presenting themselves in Africa and other emerging markets. When you have multi-country exposures, you will have an aggregation of risk that can be quite large. Zurich's market-leading tenors and capacity of 15 years and up to $125 million assures our customers they have the proper coverage for the life of their investment. Even during these times of uncertainty, we have remained dedicated to providing this scope of coverage."

Nor has it just been mining contracts that have spurred this growth. Two countries that have been in particularly high demand have been Nigeria and Angola. The high oil prices and Nigeria's strategic location make it very attractive to investors - although corruption and political instability makes business difficult. The recapitalisation of Nigerian banks has drawn more Western banks into doing business in the area as the financial fundamentals of the Nigerian banks and tighter central bank control make it easier for credit committees to see the opportunities in the country.

In Angola the improvements have been even more marked with the government agreeing a full and final settlement with the Paris Club, and the OECD raising its rating from category seven to six. Pricing has not been depreciating across the board as a direct result, but the price for payment risk on backing the strongest public sector credits is under pressure. In early July, Standard Chartered won the mandate to raise $2.5 billion on behalf of Sonangol, the state-owned oil company. In addition the Ministry of Finance has been awarding billions of dollars of infrastructure contracts. Investment and finance opportunities seem 'practically limitless' and emerging market companies investing into the region have become a target for insurers as they acquire an increasing amount of both political and credit risk.

Banks using insurance

While investors may be becoming more comfortable with the region, bank demands and enquiries for insurance have actually risen. Anthony Palmer, deputy chairman, at BPL Global in London suggests this is less to do with an increase in bank lending but rather with banks becoming more risk averse in the region. The requirements of Basel II have made comprehensive non-payment insurance more attractive for banks. Banks are now able to get capital relief when they use this type of insurance and satisfy their credit committees, who are increasingly looking for risk mitigants on

Claire Simpson at Hiscox in London

their loans, particularly those who are entering into emerging markets for trade investment. The slight increase from banks to adopt more comprehensive types of cover rather than purely political adds weight to this observation. And for many banks insurance is increasingly becoming part of their overall risk strategy.

Riordan, states: "Political risk and trade credit insurance allows lenders to increase exposures to markets or companies which may have been at capacity. By leveraging political risk and trade credit insurance, lenders may be able to increase their exposure to a particular country or company due to the fact that some of the risk has been mitigated."

Overall business in the region is booming for insurers, though there has been no dramatic shift in terms of the kind of insurance being purchased – beyond multi-country coverage. Claire Simpson, political risk underwriter at Hiscox in London, explains: "Product mix seems stable for us - in Nigeria our focus remains on a mix of short term trade finance via bank instruments or payment undertakings on oil companies. In Angola the focus is on medium term export and commodity finance, backing the strongest public sector credits. We are also starting to see short term stand-alone credit risk (letters of credit) on domestic banks without the benefit of central government guarantees."

In addition to decreasing risks in Nigeria and Angola there have also been new markets opening up to investors. Brokers have seen dramatic rises for enquiries for Equatorial Guinea, Gabon and the DRC with especially high levels of enquires for Guinea based on its mining and mineral exploration. Equatorial Guinea is also in demand as investors mitigate their oil pre-export business in the country. In markets like Mozambique, Ghana and Kenya insurers are seeing demand for project finance transactions, particularly in the power and oil and gas sectors. Borrowers for these types of deals are typically taking full political risk insurance over the seven years of the deal tenor. As many of these projects involve government entities insurers are providing cover for both non-payment as well as political violence.

The confidence of insurers has shown a willingness to embrace new markets. Dr Elizabeth Stephens, political risk analyst, at Jardine Lloyd Thompson, elaborates: "We're seeing an increase in demand for transactions in Sudan. These are challenging to place because of the risk profile of the country but also because US sanctions limit the number of underwriters who can write the risk. US underwriters and underwriters whose reinsurance treaties are provided by US insurers are effectively excluded from the market. In Sudan it is a question of working with an obligor of excellent standing. Some agricultural transactions are proving successful and these are particularly appealing given the current high price of many soft commodities."

The boom has encouraged a nascent local market for insurance to emerge. The core demand for insurance is still from the banking sector as lenders to different projects. But driven primarily by South African companies investing in countries such as the DRC, and Angolan and Nigerian companies rich in petrodollars looking for investment opportunities there has been evidence of increased volumes of regional trade. Importantly for general development, countries in the region are eyeing up their neighbours for new business. One organisation that has really promoted regional trade has been the African Trade Insurance Agency (ATI).

The organisation recently was rated single A by Standard and Poor's thanks to the successful completion of a legal and capital restructuring process that has also allowed the agency to offer a range of new products. Peter Jones, CEO at ATI, and based in Nairobi, is explicit in the attraction of short term credit risk insurance for African companies. "For firms selling both internationally and regionally, insurance allows the companies to move up the value chain to buyers rather than have to go through wholesalers or auction houses, which allows them to make more profit. These firms can then use ATI to protect receivables as security for borrowing from their banks here in Africa allowing them to borrow against those receivables as opposed to fixed assets removing a constraint form their borrowing capacity. Because the credit risk is now ATI's as opposed to the firm it also means they can borrow in better terms and conditions."

Jones adds: "It is exactly what you saw develop in the 1920s and 1930s in North America and Europe when the ECAs [export credit agencies] were set up. We are replicating that role just seventy years later. If you look at Africa other than South Africa, or Botswana and a couple of others there are no indigenous investment insurers or credit risk insures. The best way to address this market failure is to allow firms to start doing business, albeit in partnership with someone else and prove that the risks aren't what they perceive them to be to get them to feel more comfortable."

The risks ahead

Insurers are still heavily involved with the traditional risks associated with the region including risk surrounding transportation and warehousing of goods, theft, fraud and crop failure. Risks for both South Africa and Kenya have fluctuated in parallel with their recent political turbulence, but the biggest single issue that concerns insurers is the potential threat of resource nationalism. Insurers worry that as commodity prices continue to soar, certain states may be tempted to re-examine the small print in their agreements with outside investors.

As Riordan notes: "Resource nationalisation is a very hot topic. Recent events in Bolivia, Ecuador and Venezuela, as well as Russia, Uzbekistan and Kazakhstan, are evidence that governments are taking a hard look at the value of their natural resources. The Government in the Democratic Republic of the Congo has recently undertaken a review of all mining contracts leading to uncertainty among many foreign investors."

New markets have effectively opened up for investors, and while insurers are wary of political instability more and more companies are becoming comfortable working with the region's banks and business. With such a high influx of investment it seems little is likely to dent insurers' impressive volumes in the region for the year ahead. ■