# Future history

**Post 9/11 and the global financial crisis the political risk insurance industry supported business as usual. Its stablity over the last 30 years is driving new opportunities, says CHARLES BERRY**

**The political risk insurance (PRI) market has developed dramatically since my Chartered Insurance Institute textbook referred to "political risk" with the dismissive remark that "no private insurer could bear so heavy a risk".**

Back in the 1970s, the PRI market offering was indeed pretty paltry: confiscation policies without political violence or breach of contract cover; the early, primitive forms of government obligor contract repudiation and non-payment cover; no lender's PRI (as banks were not permitted to be clients of the market); no credit capability at all; and limited markets and capacity with three-year periods at best.

Our offering was so limited that unfair calling cover was then one of our best sellers. At the same time, export credit insurance was exclusively in the hands of government export credit agencies (ECAs), and domestic credit insurance was the preserve of isolated domestic monopolies or semi-monopolies.

We have indeed come a long way.

Remarkably, this development has come against that backdrop of the Lloyd's crisis, which began in 1988 with the Piper Alpha oil rig explosion and continued until Lloyd's reconstruction and renewal in 1996.

During this time, it was the Lloyd's market – not the bankers – who were the press whipping boys and it is fair to say that the London insurance market peered into the abyss. Yet it emerged very much changed for the better – transitioning from, in some people's view, a club run principally for the benefit of its insiders to a modern, professional specialty market run for the benefit of its clients and capital providers.

Anniversaries are often a time for reflection and as BPL Global passes its own 30-year landmark, it seems apt to reflect on the growth of the private PRI market as reflecting the outside world. A world where privatisation and globalisation have, and will continue to be, the great drivers of change.

## Drivers of change

Clearly, we live in a very different world from the one in which BPL was established in the early 1980s. Then the Cold War and the Berlin Wall still loomed large, we had centrally planned economies in Eastern Europe and in many other parts of the world, and, for many, the Thatcher revolution was still a temporary aberration in a steady drift towards socialism and decline.

## End of the Cold War

Yet, within a decade, the Berlin Wall had fallen and economies around the globe were being liberalised. Indeed, the proliferation of western liberal democracy and free market economics even famously led Francis Fukuyama to proclaim the "end of history" in the early 1990s, a worry to those of us in the PRI market who have always regarded political risk as history in the making.

As it turned out, the 1990s proved to be a somewhat fallow period for the PRI business in terms of demand. We made good use of the time, however, developing credit cover, lengthening periods, adding capacity – enhancing the market's offering.

## Political violence

"History" had not ended, however, and if anyone really thought it had, the attack on the World Trade Center in 2001 certainly put paid to that idea. The event was not only a significant one for history, but also for the general insurance market, which realised that terrorism, like other forms of political violence, now presented an unacceptable aggregation of risk.

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Accordingly, general property insurers introduced terrorism exclusions into property coverage. With policyholders reluctant to lose the terrorism coverage they had previously enjoyed, momentum was given to the rapid growth of the market for stand-alone terrorism coverage. This has been a huge success.

This market has not limited itself to simply replacing terrorism coverage, however. Spurred on by those who saw the need for broader, property-based political violence cover, the stand-alone market has pushed on into previously forbidden areas of the political violence spectrum.

We are well under way in developing a proper market for "war risks on land". And while there is still much work to be done with the development of the product, the underwriting market and client demand, the capabilities of the political violence insurance market today have nonetheless progressed remarkably since 9/11.

## Global financial crisis

After the sharp shock of 9/11 came the sprawling, slow motion train crash of the global financial crisis, the aftermath of which continues to influence all our lives. Unlike the banking industry, however, the insurance industry had already been through its "casino" phase in the run-up to the Lloyd's crisis.

The London insurance market's overheated secondary trading market, the LMX spiral, was in many ways a forerunner of the subprime fiasco: in both cases, the apparent ability to trade away unsound, underpriced business into the secondary market undermined discipline at the point of origination, allowing fundamentally unsound business into the system. So the sound basis on which the specialist insurance industry rebuilt itself after the Lloyd's crisis stood it in good stead during the banking crisis, allowing business to continue, more or less, as normal.

The PRI market has reflected the stability of the wider general insurance market. Unlike the monoline financial guarantee insurers who, in many ways, became creatures of the excesses of the banking world, and consequently victims of the crisis – the PRI insurers stayed with their core business of supporting real economic activity in the form of trade and investment in emerging markets.

The underlying integrity of their business has meant that the PRI market has paid its claims, increased its capacity by over 50% in the last five years in response to demand, and traded on. Like the ECAs, the PRI market has had a good crisis.

## A new engine

As the financial crisis has transitioned into the eurozone crisis, a new engine of change in our industry has emerged: declining credit risk ratings of many European ECAs, some of which now have ratings below those of the PRI market insurers. Exporters and bankers have been slow to wake up to this new dynamic, and the fact that private insurers have the appetite, capacity and credit rating to offer an alternative to traditional ECA cover in the medium-to-long-term (MLT) export credit business. MLT export credit should now be seen as a mixed market of private PRI insurers and ECAs both operating in the same level of the market in competition or in client-led cooperation.

It is not surprising that the private PRI insurers want to become more involved in the type of business over which the government ECAs had previously enjoyed a near monopoly – the ECAs have been earning returns fitting for a monopoly.

Of course we recognise that the ECAs lost money in the 1980s and early 1990s. Indeed, the Berne Union membership collectively lost about US$5bn during this era. However, in the aftermath of the Thatcher/Reagan revolution, their governments demanded that the ECAs pulled their socks up. Breaking even over time became the new mantra – but in reality, they have done much better than that.

In the past 15 years the Berne Union has had a positive cash flow of a staggering US$165bn – nearly US$1bn a month – and the 30-year loss ratio (the ratio that paid claims net of received recoveries bears to premium income) has improved to just under 10%. Given that this figure is a combined ratio including that of the Berne Union's private sector members, which typically run 40–50% loss ratios, it is clear that the ECAs must be lowering the average. In short, they are much more profitable than their private sector counterparties.

## Privatisation and global globalisation

So the stage is set for more change. Yet with the ECAs ripe for further competition from the private sector, and with the private PRI market's client base still heavily focussed on European and North American-based multinational companies and financial institutions, the key themes are familiar: privatisation and globalisation.

The stability and continuity of what we started 30 years ago in the middle of so much change is something I see as synonymous with the development of the PRI market. We planned BPL as an independent, employee-owned, specialist broker and have added the ambition of being a global player. However, just because we are 30 years old, it does not mean the plan is changing. We see great growth and opportunity for the PRI market for the next 30 years and beyond. History has not ended. In fact, there is more history in front of us than behind. TFR

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