

# political risk insurance newsletter

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## The Challenge of PRI Wordings: Saying What We Mean

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Over the last two decades the political risk insurance marketplace has experienced remarkable growth and has demonstrated an ability to respond ably to evolving buyer needs. In recent years, however, PRI claims experience has yielded outcomes that have disappointed both policyholders and underwriters.

Most PRI transactions are confidential, so there tends to be little appreciation among buyers regarding PRI payouts but a much greater awareness of claims denials, because news or rumors about claims denied tend to seep out. Although underwriters are starting to report claims payments statistically or in cryptic accounts, the impression that the PRI claims process isn't working very well lingers in the marketplace.

Underwriters have had bad experiences too. In fact, insurers can lose even when they win because every "win" in a hotly contested claim may mean the loss of a client and damage to the insurer's reputation in the buyer community.

Better communication at the outset might help to avoid some of the problems. PRI coverages have often failed to respond to events of loss that buyers say they thought their policies were going to cover.

In some cases, buyers simply didn't understand what they were getting. Brokers and other intermediaries might give even greater attention to assisting buyers to understand the meanings and limitations of their policies. But if policies are fraught with pitfalls and ambiguities to begin with, better communication alone won't help much and may not even be possible.

Certainly buyers need to be aware of policy exclusions and limitations that bar compensation for a loss that otherwise meets the loss definition. Underwriters are under pressure to revisit some of these boundaries. Even so, a more fundamental problem remains.

### The challenge: making policies say what they mean

PRI policies depend on abstract notions and wordings that ultimately have to be applied to unruly facts and unknowable future developments. It is important that these policies mean what they say, but it is not always easy for underwriters to say what they mean. Clever wordsmithing can never make the problems go away completely, but surely underwriters can do better. We are going to suggest a few things that might be done. Two have to do with policy wordings, and another with the whole way we think about political risk coverage.

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## Interview with Richard Stern

*Richard Stern recently retired as General Counsel of EIC Corporation (Exporters), ending a 32-year career in the trade credit and political risk insurance industry. Prior to joining Exporters in 2001, he had been General Counsel of Citicorp International Trade Indemnity for over 14 years, and prior to that, Assistant General Counsel and Deputy General Counsel of the Overseas Private Investment Corporation. He thus has witnessed the evolution of the marketplace from several vantage points, and established himself as a preeminent legal authority in his field.*

**Q.1: Your career spans several decades and long stints with both public and private sector underwriters. What are the biggest changes you have seen?**

In my view, the most dramatic change has been the rise of the private market and the relative diminishing importance of the public sector. I think that this has resulted from two primary factors. First, as more individuals became familiar with the products and the risks through working in government institutions, they were able to convince the controllers of capital that

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## The Differing Flavours of Political Risk in Latin America

*We invited Carlos Caicedo, Head of the Latin America Division at Exclusive Analysis Ltd, to discuss the current political risk environment in Latin America. Exclusive Analysis is a strategic intelligence company based in London with a worldwide network of expert analysts and human sources. Exclusive Analysis provides decision-ready, evidence-based forecasts for violent and political risk worldwide.*

Within the past five years, underwriters have witnessed a significant increase in the political risk associated with several Latin American countries. Specifically, there is tremendous concern regarding the new left-leaning governments of Venezuela, Bolivia and Ecuador, which have moved away from their market-friendly policies in the 1990s to ones that greatly enhance the role of the state within the economy. This transformation is parallel with growing anti-US sentiment in the region, along with mounting disenchantment among impoverished millions who have seen few of the economic and social benefits promised to them by democratic governments. However, this leftward shift is by no means as widespread, or as pronounced, as is often proclaimed. Indeed, many countries have implemented sound macroeconomic policies that have brought stability and increased economic growth to their populations.

By way of simplification, it is possible to outline three different political risk profiles in South America: the populist left comprised of Venezuela, Bolivia and Ecuador; the pragmatic nationalist—Argentina; and the rest. This last category contains centre left governments such as Brazil and Chile and pro-business governments such as Colombia. Most of Central America, with the notable exception of Nicaragua, also falls into the last group. As does Mexico, where the Calderon government has been pursuing market friendly policies since it came to power.

Indeed, the majority of Latin American countries continue to welcome foreign investment and there are few signs of an impending backlash. Accordingly, this article departs from the sensationalist headlines dominating coverage of Latin America to provide the reader objective regional political risk analysis.

### Venezuela

Leading the populist bunch is Venezuela, where election victories have left President Hugo Chavez in virtually total control of Venezuela's main institutions, including Congress, the Supreme Court, the Army and crucially, PDVSA, the state-run oil company.

Chavez is openly anti-US and aspires to assemble a coalition of like-minded governments in the region. In concrete terms, he has sought to gain more state control over the oil industry by means that include unilateral changes in contractual terms, with threats of expropriation against companies refusing to go along. Chavez is also moving to increase state control in other economic sectors, including media and telecommunications, heavy industry and food processing. This does not mean the end of private enterprise in Venezuela, but uncertainty about what sector will be next is causing private investors to either leave or delay expansion. Large property owners are at particular risk, as land reform is one of Chavez's flagship programmes. Media outlets and US companies, if perceived as anti-government, are also at risk. Also, labour unrest in large companies may quickly escalate into government intervention, as seen with Coca Cola in late 2006. There is no prospect of a major change in Venezuela's political landscape in the

three-to-five year outlook, with Chavez' grip on power becoming, if anything, more solid.

### Bolivia

Since coming to power in January 2006, Evo Morales has adopted a policy of nationalising private industry. In May 2006 the military took control of natural gas installations as part of Bolivia's hydrocarbons "nationalisation". Mandatory new contracts, including an increase in government take from 18% up to an 82% ceiling and controlling stakes for state hydrocarbons firm YPF, were later signed with 12 multinationals, including Brazilian state firm Petrobras, Spain's Repsol and France's Total.

Other industries affected by the new policies include mining and telecommunications. In May 2007 the government announced that all mining activity in Bolivia will now be centrally controlled by the recently-revived state mining company, Comibol, and taxes for companies would be hiked. A five-year survey will be conducted to determine which concessions are considered "idle" to then return these to state control. In April 2007, the government said it would re-nationalise the country's main telecoms company, Entel, run by Italian firm Telecom Italia, which has threatened arbitration.

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*"[Morales'] capacity to implement structural changes is smaller than that enjoyed by Chavez and Bolivia badly needs foreign capital to develop its gas industry."*

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Looking ahead, the government has said it will scrutinise any projects deemed not to be continually investing and creating local wealth and jobs. Furthermore, Morales wants the new Bolivian constitution, due late 2007, to include quotas to ensure indigenous participation in the economy and taxes or caps on extraordinary profits

Still, his capacity to implement structural changes is smaller than that enjoyed by Chavez and Bolivia badly needs foreign capital to develop its gas industry. He faces strong political opposition from traditional political parties, which enjoy substantial parliamentary representation, including a contingent in the Constitutional Assembly.

### Ecuador

President Rafael Correa faces a similar situation in that he has limited capacity to implement his left-leaning agenda. He reached power as an outsider, blaming Ecuador's traditional political parties for the corruption and poverty affecting the country, while claiming that multinationals should also renegotiate the terms under which they exploit the country's oil riches. He suggested the country reduce payments on foreign debt and was quick to align himself politically with Hugo Chavez.

Yet, with no formal representation in the country's legislature his impact has been limited. He hopes eventually to coalesce his power through reforming the constitution. However, his efforts have led to serious institutional clashes with congress and the courts.

Correa has shied away from total confrontation with foreign investors. The government has not yet defaulted on debt as some worried. And,

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## The Challenge of PRI Wordings: Saying What We Mean (continued)

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### The uses of manuscripting

Manuscripting a PRI policy lets policyholders and insurers tailor coverage to fit a specific project and its particular risk profile. Policy language can be crafted or sharpened to address particular concerns. For this to work for policyholders, they or their specialist advisers need to have a sound understanding of the relevant sector and its risk vulnerabilities – a particular necessity for infrastructure projects.

Nonetheless, there are perils in the manuscripting process. A wording problem that keeps cropping up is often the result of what is commonly called “heavily negotiated” coverage. Unfortunately, what sometimes results from these negotiations is a clause or a paragraph that fits poorly with the rest of the policy, confronting the parties with contradictions or confusing policy terms that may have to be settled by arbitrators, who in the presence of ambiguity or uncertainty are empowered to cut themselves adrift from the policy and go sailing off into uncharted waters of “intent” and “reasonable expectations.” The results will probably outrage and astonish one of the parties, most likely the insurer. A simple solution is to stay the rush to closure long enough to have the entire policy read by a professional who has not been immersed in the negotiations and comes to it with a fresh eye.

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*“... wordings tend to be regarded as sacrosanct when they are merely familiar, and gaining acceptance for alternative language meets formidable obstacles.”*

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### Boilerplate problems too

In any case, curing problems in standard policy wordings should not be left to the manuscripting process any more than basic manufacturing flaws should be left to the repairman to deal with. It is important to have good boilerplate wordings from the start. In a business as conservative (in its own way) as PRI is, wordings tend to be regarded as sacrosanct when they are merely familiar, and gaining acceptance for alternative language meets formidable obstacles. Coming up with new wordings whose meaning is clear and unequivocal is no small challenge. Still, it does not follow that those wordings should stay as they are if their meaning proves elusive or highly debatable when it comes to applying them in claims situations.

Let us give an example. Many policies require that to be expropriatory, a government’s act must “expressly and permanently” deprive the insured of its interests. “Permanently” suggests that the mere passage of time provided for in the “waiting period” isn’t enough, but what is? Surely there is some finite limit at which an unresolved expropriation should become “permanent” for purposes of the coverage.

A greater problem is presented by “expressly.” What does that mean? Does it mean that the government must formally announce that it is taking your property and has no intention of paying you for it? That may happen, but most governments nowadays are more subtle, and policyholders probably do not expect to have to meet such a high standard.

But if the standard is lower, what is it? Is it just that the taking not be inadvertent?

### “This is the way we have always done it”

It is becoming increasingly difficult to fob off investors and lenders with assertions that standard wordings have meanings that are well understood in the marketplace (if so, would there be so many disputes?), or that “this is the way we have always done it.”

Two other objections to new standard wordings are commonly raised. One is that broad language benefits the policyholder because too much precision may force a narrower interpretation of coverage than would otherwise apply. Maybe, but how often do we hear of an insurer stretching the meaning of a PRI policy to yield coverage in a threshold situation?

The other objection is that instead of better language, you will just get more of it, with those pesky (American) lawyers piling word upon word without really improving anything, a view commonly encountered in the United Kingdom. But in the hands of seasoned and knowledgeable professionals, improvements are possible without monumental growth of the policy form. Underwriters and buyers alike have an interest in exploring them.

### Yet another possibility

An alternative to the tough task of developing better wordings and getting them accepted by the interested parties might be to borrow from the derivatives market approach, and to let proxy events and indicia (alongside an actual loss) be the triggering basis for PRI compensation. Our firm came very close to achieving this in negotiating a political violence policy whose payout depended on a severe depression of a project’s revenues, concurrent with general industry downturns connected to certain political violence occurrences, in the absence of statistically determinable exogenous factors. The effort was eventually abandoned because of external commercial events, but not because the prospect of such coverage was remote. The benefit of this approach, of course, is that if the loss is ascertainable and the other factors independently verifiable, you have less room, if any at all, for debating whether the loss is covered. And that would be a very good thing.

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*“An alternative to the tough task of developing better wordings ... might be... to let proxy events and indicia (alongside an actual loss) be the triggering basis for PRI compensation.”*

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### Conclusion

Political risk insurers offer important and needed support for investment. The experience of PRI underwriters overall has been very good, and many claims have been paid. But too often the claims process doesn’t yield the results that one of the parties expected. The underlying problem frequently lies in wordings that are ambiguous or that fail to clearly state what the parties intended. Absolute clarity is an elusive goal, but there is ample room for policies to state more clearly what they mean. ■

## Meeting The Challenge of Syndicated PRI Placements

*We invited Julie Martin, a Senior Vice President at Marsh Inc. and veteran of many multiple-insurer PRI placements, to discuss how the difficulties that syndications pose can be overcome.*

Syndicating an insurance placement is often necessary, particularly to obtain adequate amounts of coverage. The goal in any syndication is to have all underwriters write on the same clear policy wording with pricing and terms to satisfy both the insured and the underwriters. While syndications are fairly common in most lines of insurance, they can be particularly challenging in the political risk insurance (PRI) market.

In some instances, underwriters have competed aggressively to provide cover. However, these circumstances are rare in the PRI market. With that reality in mind, let's examine some of the key challenges typically associated with syndicated political risk insurance placements.

**Policy Wording:** In difficult placements, the final policy wording often reflects the lowest common denominator. The reason for this is that underwriters want to cover risks on the same terms and conditions as others in the syndicate whether they are on a quota share coinsurance, layered so that some insurers pay after losses exceed the limits first absorbed by other insurers, or on a reinsurance basis. Insureds benefit if underwriters have a unified and coherent approach to claims, claims-cooperation, and recoveries. In pursuit of these objectives, the most conservative wordings generally prevail. In addition, while some underwriters are flexible regarding policy wordings, most prefer to start with their own. This is particularly true of official agencies such as OPIC or MIGA. When combining underwriters, many of their varying policy wordings have to be reconciled. For example, is the measure of compensation the book value of the foreign enterprise or the insured's net investment value? What is the standard for expropriation cover? Is it violation of international law or is it an action that expressly and permanently deprives the insured of assets or interests? Other limitations on flexibility in wording result from exclusions in individual underwriters' reinsurance agreements, such as losses arising from devaluation; from differences in underwriting standards (e.g. environmental conditions exclusion); or from statutory limitations, such as insured's eligibility. All of these, and other issues, must be debated and resolved.

*“In difficult placements, the final policy wording often reflects the lowest common denominator.”*

**Eligibility:** Underwriters have different approaches to eligibility, but official agencies impose the greatest constraints. In general, most underwriters require that there be a cross-border investment. Some will require that the recipient country be an emerging market nation. Others may be willing to look at developed countries or perhaps a combination of developed and developing country exposures. For US-based underwriters, the recipient country cannot be subject to US sanctions, such as those imposed upon Iran, while certain Lloyd's syndicates can cover such countries. For many public agency underwriters, the transaction must meet particular guidelines: MIGA and OPIC require it to be a new investment; most ECAs require the transaction be an export from the underwriter's country. Some recipient countries, such as Iraq, Vene-

zuela, Bolivia, Ecuador, may be barred by one underwriter's reinsurance terms while capacity considerations may limit another underwriter's interest. The public underwriters vary in their requirements regarding social, environmental and other public policy matters. All must be accommodated in a multi-party syndication. There is also a spectrum of approaches for covering equity where the shares are pledged to lenders, ranging from there being no issue, to charging a premium for potentially impaired insurer security, to refusing to compensate if the insurer is not assigned free and clear title to the shares. It takes experience and market knowledge to reconcile all of these issues.

**Pricing:** When substantial capacity is required in a country regarded as particularly risky, the challenge is to bring pricing down. This often requires layering the coverage so that some underwriters are farther from the first-loss risk. Some underwriters would prefer to earn the higher premium and/or enjoy the leadership status associated with primary layers while others would rather participate on a limited basis as far away from the risk as possible. Some underwriters prefer to use their entire per-project capacity, and others prefer to participate in multiple risks for smaller amounts. Underwriters on bottom layers expect to earn more than those on higher layers, and it has occasionally been a challenge not to allow the top layers to drive pricing.

How the pricing is calculated is often more complex than would be expected. One attorney, whose practice includes a number of political risk underwriters, claims that his clients fight more frequently over pricing calculations than many other issues and often ask him to draft this wording relating to issues such as day count, estimated premium, etc. After legal input, pricing calculation is often the most complicated provision.

**Timing:** Projects move only as fast as the slowest participant moves—whether it be the project lenders, underwriters, or sponsors. In political risk insurance, it is generally the public agencies whose processes cause the most delay to the detriment of investors who require coverage to move forward. For the London markets, a committed, respected lead underwriter is critical to placing coverage efficiently as many underwriters in that market may defer commitment until such a lead is in place.

**Tenor:** The political risk market policy term ranges from approximately one year to a maximum of 15 years for a few private underwriters, or 20 years for some public agencies. There is a tradeoff between price and policy tenor for the private market that public markets are less likely to make. For long-term projects, weaving together varying terms and finding the “sweet spot” between pricing and tenor presents a challenge.

**Claims:** Claims cooperation among underwriters has sometimes been an issue. Although the insured may have to allow coinsurers to make independent determinations, it is important that with respect to loss mitigation, recoveries and other matters, the insured not be confronted with conflicting guidance and obligations. This must be sorted out in advance. Another problem is that public agencies have been unwilling to share their “preferred insurer” status which is their presumptive rights

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to preferential status among creditors, or to favorable treatment in investment dispute matters, unless they are rewarded.

**Approach:** Bringing together multiple parties in a timely way always has its challenges, particularly when underwriters in a syndicate do not have comparable levels of sophistication, temperament, and experience. Differing negotiation styles must also be navigated. Some brokers prefer to settle structure and pricing first, followed by wording. Others believe that wording affects pricing and may prefer to do both at once -- but this can complicate timing and approach. Not all underwriters require the same information about a transaction, but every underwriter wants to see as much information as any other underwriter. Managing the flow of information, responding to questions, and negotiating with underwriters with different styles and with the insured can be an exercise in diplomacy as well as in technical capability.

Practitioners have often said that political risk insurance underwriting is more of an art than a science. While they are probably referring to the lack of actuarial foundation for underwriting political risks, it is equally true that solving the problems outlined above calls for case-by-case craftsmanship. In the real-world examples that follow, there were no handbook solutions — each case called for a tailored solution.

#### Greenfield Project in an African Country

**Challenges:** The insured wanted to obtain cover from a public agency to benefit from the agency's "deterrent" capabilities, however, it would likely take a year to secure that agency's commitment, while the insured's exposure would begin sooner and would vary over time. Also, given the country risk, pricing was a concern, as was the need to achieve policy wording acceptable to both the public and private markets.

**Solution:** The timing issue was solved by placing shorter-term bridge coverage from the private market with the full expectation of the public agency's participation at a later date. The wording issue was addressed by utilizing a public-agency wording that had been accepted by underwriters for a similar transaction. They managed pricing by utilizing a quota-share coinsurance structure for expropriation coverage, and a layered structure for political violence coverage. They addressed anticipated variations in the policyholder's exposure over time through a monthly calculation of premium and anticipation of the fluctuations up front.

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*“...it is important that with respect to loss mitigation, recoveries and other matters, the insured not be confronted with conflicting guidance and obligations.”*

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#### Expansion in a South American Country

**Challenges:** A company's existing public-agency coverage could not, for policy reasons, be increased to cover additional investment. A supplementary private market program was placed at a very competitive rate, but it did not have the same perils, definitions, compensation calculation, etc. The new program did not drop down to fill gaps in the agency's coverage (e.g. the underlying policy did not cover Forced

Abandonment) and was inadequate for the expansion.

**Solution:** The public agency's policy issues were tackled and overcome, allowing it to increase its participation. Since it had the least flexible approach to wording, its policy was used as the basis for negotiation among the parties. The program was completely restructured as a public/private market coinsurance but with the private market participation layered. For the highest coverage limit that required multiple insurers, coverage was layered to achieve optimal pricing. The longer tenor participants were on the bottom layer and received the highest premium, with the shorter tenor participants at the top layers. For other coverages with lower limits, a single, competitively priced placement sufficed. The wording was essentially the same for all 11 markets, including the United States, Bermuda, London and the public agency, but there were some minor differences in various layers to reflect the requirements of individual market or reinsurance agreements. This was the first time that many of the participants had written on this public agency wording and it was key to educate the private market about the agency's language.

#### Transaction in a South Asian Country

**Challenges:** The transaction outpaced the readiness of some underwriters to commit coverage. It also involved two public agencies, each with its own eligibility and other criteria. One agency would have been required to obtain certain additional internal approvals which would have further delayed its participation. Another agency could write on a different underwriter's policy wording only if the agency were reinsuring rather than coinsuring.

**Solution:** As the exposure was incurred over a period of time rather than all at once, the first agency provided coverage for the full amount of the early exposure. Once the policy wording was negotiated, the private market agreed to take half of the ultimate exposure amount on essentially the same wording, on a coinsurance basis. The strategy then was to bring in the second agency, using the same wording. As a reinsurer, the second agency was able to accept the first agency's wording, which it could not have done as a co-insurer. This was its first time working in this capacity and while it was efficient in obtaining internal approvals, it still had to address some details. The first agency could not take the credit risk of the reinsurer without additional approval, so it structured an agreement to give the insured direct recourse to the reinsurer.

#### Multi-country Placement

**Challenges:** This project involved multiple countries and several public agencies. Each agency had different eligibility requirements and policy approaches. The slowest of the agency processes drove the timing.

**Solutions:** Because the coverage was relatively straightforward, the project carefully structured, and the underlying documents clear, the policy language even from the most inflexible participant was acceptable. Still, it was necessary to structure the investment in separately insured tranches to avoid the impairment of coverage that one participating insurer's coinsurance policy otherwise would have imposed. Timing became an issue and the line size of one of the leading potential underwriters was reduced when it proved unable to obtain all

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## The Differing Flavours of Political Risk in Latin America (continued)

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wary of expensive litigation, it has grudgingly accepted international arbitration with US oil firm Occidental Petroleum.

For the three year outlook, the threat of political risk resulting from nationalisation is tempered by the reality of limits on state capacity. Correa is likely to focus on a few high profile confrontations with energy multinationals, rather than attempting an all-out assault against private enterprise.

### Colombia

Not all countries in the region share this shift to the left. The most obvious example is Colombia. President Alvaro Uribe was re-elected in 2006 for another four-year term on an orthodox platform that includes market friendly economic policies, close alignment with the US and a strong mandate to fight communist FARC guerrillas. Colombia is enjoying renewed growth and Uribe still enjoys 60% plus popularity, despite recent scandals linking the government to right wing paramilitary groups. Accordingly, Colombia should enjoy relatively low political risk in the next three years. Colombia is institutionally strong, the economy is well run and its record of always meeting its credit obligations is unmatched by any other country in Latin America. The main issue for investors and underwriters in Colombia is security and the threat of terrorism. It appears that foreign investors are mindful that violent threats in Colombia are manageable as long as they implement contingency plans. This perception has been strengthened by the major inroads made by President Uribe's security policy. As a reflection, foreign investment in Colombia has tripled over the last two years.

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*“Overall, the region seems better prepared this time to deal with external shocks, and the appeal of economic nationalism a la Chavez is limited.”*

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### Mexico

As could be expected, Mexico has a very close economic association with the US by virtue of its proximity and free trade agreement. The election of Felipe Calderon, a pro-business conservative, will likely keep political risk low in the three year outlook. Mexico experienced significant political volatility around the 2006 elections on account of the extremely close results, which were not recognised by the PRD candidate Lopez Obrador. Since Calderon's election, there has been a gradual improvement in the country's governability. Aware that nearly 50% of the electorate did not endorse him, he has chosen pragmatism over ideology and has sought to bring on board the opposition, particularly the PRI, the largest opposition party in Congress. This is paying off in terms of a cooperative Congress that has so far backed Calderon's important policies such as the pension reform. This support has proven lasting, as the PRI has announced it will vote with the government on a crucial tax reform that will see state revenue increasing by 3% of GDP. Also, Calderon appears committed to introduce policies that will open the door of Pemex, the state-run oil company, to foreign investors. Calderon is also tackling corruption in the police force and drug trafficking head on. Calderon's drive to increase security, if achieved, will result in a significant improvement in the country's business environment. On the macro-

economic front, Mexico appears solid both on fiscal and monetary policy, in addition to having a sound debt outlook.

### Brazil and Chile

Brazil and Chile occupy what could be described as the moderate centre in this debate. Presidents Lula and Bachelet remain committed to moderate economic policies which combine increased levels of social spending with respect for foreign investment. This is significant given Brazil's position as the largest country, and Chile's status as the widely-recognised best economic performer in the region. Chile, given its political stability and proved sound macroeconomic record, faces limited political risk, with very few signs that its liberal economic policies and legal stability may be at risk. Brazil has made major strides in gaining the confidence of the markets for its macroeconomic policies. President Lula, despite his left-wing leanings, has maintained the sound macroeconomic policies he inherited from the Cardoso administration. As a result, the Central Bank has been allowed to set monetary policy without central government interference, the Lula administration has kept a primary fiscal surplus since 2003 and the country has greatly reduced its foreign debt burden. This, together with a commodity boom and a resilient world economy has helped Brazil to register a large trade surplus and accumulate record foreign reserves. Even so, the country has lagged behind on institutional reforms. For example, corruption, particularly political bribery is rife, the judiciary is inefficient, and sub-sovereign risk is a concern, as provinces have autonomy to contract debt. Also, investors are often put off by an excessive tax burden and an inflexible labour market, not to mention that real interest rates continue to be among the highest in the developing world. Even so, changes in Brazil tend to be gradual rather than revolutionary and most indicators suggest the political and business environment will gradually improve in the next few years.

### Argentina

President Kirchner is a pragmatic politician with nationalist leanings, but less brazen than Chavez and Morales. He has faced the same dilemma of keeping business confidence while appeasing the radical sectors both within his party, the Peronists, and a large base of social and labour groups who have applauded his uncompromising stance against foreign creditors and the IMF. Kirchner has reacted with populist measures including price controls on utilities, which have led to litigation with foreign multinationals. The main threat to Kirchner is soaring inflation, a result of his populist economic policies, and an impending energy crisis. Both threaten Argentina's stellar economic performance of more than 8% growth over the last four years. His wife, Cristina Fernandez, current frontrunner in opinion polls, is likely to follow a similar route if elected, combining populist displays with pragmatism towards business. However, Cristina appears aware of the threat posed by inflation and the energy crisis and it is expected that she will be more willing to consider unpopular measures such as gradual liberalisation of utility rates. Similarly, the phasing out of price controls will be a gradual process.

### The prospects

Latin America's "pink tide" is not a hegemonic force. Some countries have moved from market oriented policies towards heterodox

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## Interview with Richard Stern (continued)

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the risks in both political risk insurance (PRI) and trade credit insurance (TCI) could be prudently and profitably underwritten. Second, in recent years, the risk of purposeful adverse government action, such as expropriation or unreasonable foreign exchange restrictions, has decreased in relative importance, making the authoritative weight of a government insurer less important in avoiding problems and working through claims matters.

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*“The trend of insureds to opt for comprehensive coverage could reverse with a firming of rates, but I suspect that insureds will remain inclined to seek the broader insurance.”*

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**Q.2: How did you find the claims process differed when you went from OPIC to Citibank and to Exporters?**

At OPIC, we could make effective use of the US Government for dealings with foreign governments. The State Department was particularly supportive with respect to expropriation claims, and the special currency arrangements permitting OPIC to sell foreign exchange acquired from inconvertibility claims to the Treasury Department was extremely beneficial. At times, information obtained from the CIA, not available to the general public, was also quite helpful. Working in the private sector, I have also been able to utilize US Government services from time to time, but not in the same authoritative manner as when the Government is speaking for one of its own agencies.

**Q.3: Is the boundary between PRI and TCI disappearing?**

There has always been a substantial overlap in the two in insuring governmental entities against contract default, particularly as “government entity” has been broadly defined by the private PRI market to include parastatals. The pure political risks – such as expropriation, currency nontransfer/inconvertibility, government interference in contracts, political violence, etc., remain viable, separate products. What is changing is (1) the tendency of insureds to simply purchase comprehensive coverage on their exposures and not limit the coverage to PRI risks, and (2) the tendency of insurers to offer both products. The trend of insureds to opt for comprehensive coverage could reverse with a firming of rates, but I suspect that insureds will remain inclined to seek the broader insurance.

**Q.4: As non-honoring and non-payment coverages assume a greater role in “PRI” portfolios and traditional currency inconvertibility, expropriation and political violence coverages assume an apparently diminishing one, what are the implications?**

In general, I think that the political violence coverages are continuing to be of great interest and that there will be some refining of definitions and a great deal of negotiating of terms of coverage. Both insurers and reinsurers will be examining their underwriting attitudes toward this class of business. Expropriation and currency inconvertibility will continue to be of diminished interest.

**Q.5: What are the biggest challenges confronting the PRI marketplace today?**

Low rates of return. Even if the risk of loss is low enough to justify the rates on exposure, the other factors affecting the capital that must be placed against the exposure make it difficult to earn a sufficient return.

**Q.6: Are currently low premiums sustainable? Is there too much capacity in the marketplace?**

Given the dearth of solid public information in this area, these are difficult questions to answer, except by intuition. Judging by the day-to-day bidding on risks coming into the market and the number of players in the process, there may be too much capital chasing the risks. I suspect that we will eventually see some consolidation in the number of participants and a firming of rates. I also think that we are at a low point on the perception cycle, and that there will be an event or events that cause a general increase in risk perception and rating.

**Q.7: In a default situation, to what extent are the interests of insured banks likely to coincide (or not) with those of the insurer? Are there areas of potential conflict?**

In general, the banks tend to take a no-nonsense approach toward debt recovery and are less likely to be interested in preserving continuing relations with debtors than are other creditors, who may have prospects for future business in mind. In that sense, the banks are usually well aligned with insurers. On the other hand, the banks are often more concerned about the use of their names in public litigation and exposure to lender liability. That can somewhat complicate the recovery process. Also, because of concern for overall government relations or public relations, where a bank has a large presence in country, bank interests may diverge from those of the insurer if the loss in question is relatively small. Overall, however, I do not think that these are major concerns for insurers.

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*“I suspect that we will eventually see some consolidation in the number of participants and a firming of rates.”*

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**Q.8: What’s ahead for Exporters, especially in PRI?**

Exporters has always been in the PRI market in providing comprehensive coverage on government entities. PRI, however, was never emphasized, and we did not focus on the pure political risk products. Exporters recently decided to make a concerted thrust into PRI and has engaged staff in London and the US to oversee the initiative. The initial response to this initiative has been very favorable. Even though the PRI market is currently soft and there are many players, Exporters is confident that it will be seen as a very viable market for the PRI line.

Over the past couple of years, Exporters has been engaged in an expansion of its geographical presence. A full UK license was obtained in January of 2006, followed by an EU “insurance passport” in 13 other countries. Rep offices were established in Hong Kong and Singapore, and Exporters is in the process of applying for a full license in Singapore. A commission agent was retained in Mexico. Concurrently, the Exporters staff has been greatly expanded. All in all, the company has been very expansion minded since control shifted at the end of 2004 ■

## Syndicated PRI Placements (continued)

(continued from page 5)

approvals in time. To meet one agency's eligibility requirements it was also necessary to bring in an insurer from the private market as primary with the agency as reinsurer. Navigating the approval procedures, policy issues, and wording constraints to successfully place cover for this challenging project required strong cooperation between the project team and underwriters.

**Conclusion:** Bringing multiple parties to a placement can have substantial advantages including combining the benefits of public agency deterrence with the greater flexibility of the private market. Involving multiple insurers is often the only way to achieve the level of capacity required for large projects. The political risk market has made dramatic strides in working together to achieve these goals but still is not as commoditized as other insurance markets. Careful structuring around various hurdles is required to achieve an outcome that satisfies and delights all parties. ■

## Political Risk in Latin America (continued)

(continued from page 6)

positions but many others have stuck with moderate policies. Latin America has been experiencing a so-called shift to the left over the last five years and yet countries like Colombia, Peru, Mexico, Brazil and Chile, as well as Uruguay and most of Central America remain open for business, continuing to embrace foreign investment as a necessary contributor to economic development. The countries that have radically shifted to the left, namely Venezuela, Bolivia and Ecuador, have been institutionally weak, which has facilitated the emergence of radical nationalist leaders. In particular, the crisis of the traditional political parties in these three countries has facilitated the rapid rise of 'caudillos' (strong men) such as Chavez, Morales and Correa. It appears that the key for investors these days in Latin America is to avoid generalisation and look at each country on an individual basis. Overall, the region seems better prepared this time to deal with external shocks, and the appeal of economic nationalism a la Chavez is limited. ■

## People and Organizations

**MIGA:** Edie Quintrell is leaving OPIC to become MIGA's Director of Guarantees as of October 15, 2007.

**Zurich:** Joe Martin has joined the Washington DC office as Senior Underwriter for political risk and trade credit insurance

**Marsh:** Chris Kirby, formerly with Aon, is a Vice President handling PRI matters in the company's New York and Hartford offices.

**Exporters International Group:** Vincent D. Salvatore, Jr. succeeded Richard Stern as General Counsel. Stuart L. Barrowcliff has joined the

New York office as Vice President – Underwriting and Charles Keville has joined Exporters Insurance Company (Europe) as Director – Political Risk Underwriting.

**HSBC Insurance Brokers Limited:** Andrew Bickmore has joined the broking team at HSBC Asset Finance & Political Risks Division.

**Berne Union:** Csaba Simon, Director of Sales at MEHIB Hungarian Export Credit Insurance, was elected chairman of the Berne Union Prague Club, the network of export credit agencies in emerging and transition countries.

## about this newsletter

This is the sixth edition of the *robert wray* PLLC Political Risk Insurance Newsletter. Our intention is to provide a forum for the exchange of information and opinions relating to topics that will be of interest to political risk insurers, buyers, brokers, attorneys and others. We invite contributions and suggestions from professionals in the field.

We also encourage readers to submit information about notable transactions, personnel changes and other important developments in the political risk insurance sector.

If you would like to receive future editions of the PRI Newsletter electronically, or if you have friends or colleagues who would be interested in joining our distribution list, please e-mail us at [info@robertwraypllc.com](mailto:info@robertwraypllc.com). This and previous editions of the newsletter are available at [www.robertwraypllc.com](http://www.robertwraypllc.com)

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## about robert wray PLLC

*robert wray* PLLC is a specialized law firm focused on analyzing complex issues and providing innovative solutions in the areas of political risk insurance, project finance, transportation infrastructure, privatization, aircraft finance and microfinance. The firm's political risk insurance practice, led by Robert T. Wray and Felton (Mac) Johnston, offers comprehensive advice related to the mitigation of risks and selection and acquisition of political risk insurance associated with international investments.

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