POLITICAL RISK INSURANCE: IMPLICATIONS OF INSTABILITY IN UKRAINE AND RUSSIA

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Concern over the political unrest and country credit rating in Ukraine and potential sanctions against Russia have caused some insurers to effectively stop underwriting political risk policies in those two countries, according to political risk experts at Marsh. Current policyholders with exposure in those countries may experience premium rate increases upon policy renewals. Companies looking to conduct new business in Russia may encounter difficulties obtaining coverage; insurers have effectively stopped offering coverage for any new credit or political risk exposures in Ukraine.

The turmoil in Ukraine and Russia is not expected to cause a large-scale impact to political risk, structured credit, and trade credit insurers. In the last several years, new insurers and reinsurers have expanded into those coverage lines, increasing capacity and putting downward pressure on rates. Insurers' exposure in Ukraine is relatively modest. But because Russia is the political risk and structured credit insurance market's largest country exposure, global premiums and insurance capacity for those coverages may be adversely affected if the current conflict causes major insurable losses.

The overthrow of the Ukrainian government and subsequent movement of Russian military forces in February has resulted in a standoff between Russian and Ukrainian troops. Political tensions escalated in early March as Russian military reinforced their positions in the Crimea region of Ukraine. Leaders of Russia's Parliament indicated that they would support a vote by Crimeans to annex the region to Russia despite warnings and sanction threats from the US and other countries.

The situation remains volatile. Companies with interests in the region face the potential for damage to assets through political violence and possible broader expropriation measures or sanctions against foreign interests in Russia should more sanctions be imposed against Russia. This is in addition to actions that could jeopardize the safety and security of a firm's people, assets, and supply chains. The withdrawal of aid packages to Ukraine from Russia and other economic issues could lead to a downgrade of the country rating by ratings agencies and possible payment difficulties for creditors of Ukrainian companies.

INSURER REACTION TO THE UNREST

Some insurers appear willing to consider deals involving large Russian corporations or banks and may honor non-binding quotes on new business — referred to as non-binding indications (NBIs) — but are being extremely careful and are analyzing each risk thoroughly, taking time to respond as they monitor the unfolding political events. Insurers are favoring commercial banks, commodity traders, and large exporters with extensive experience trading in difficult markets presumably because of their ability to recover a reasonable amount of losses after claim payments. Most insurers had stopped underwriting political risk, structured credit, and trade credit insurance for Ukraine, and are unlikely to honor a non-binding indication. The following summaries of insurers' outlooks on these coverage areas are as of March 10 and are subject to change with the fast-moving events.

Political risk insurance: Political risk insurance provides coverage for government actions or inactions, including war and political violence, which affect an organization's assets, investments, and contracts. In Russia, most insurers have effectively stopped underwriting political risk insurance. However, some insurers are willing to help existing clients or support deals involving the largest Russian corporations or banks. Generally, insurers are most concerned with potential sanctions that could be imposed against Russia and are proceeding cautiously with deals one at a time. While some insurers prefer new deals with good risks, others are only willing to support existing programs. Multi-country policy requests continue to be considered by some insurers, contingent upon how the situation evolves. By and large, if a political risk insurance policy is quoted, it is likely that organizations will experience significant delays and it is doubtful that coverage can be bound immediately. Most insurers seem willing to honor existing NBIs, but organizations likely will face more underwriting due diligence, resulting in a longer than usual period to bind coverage.

Structured credit insurance: Structured credit insurance protects nonpayment of bank loans, mainly to obligors in emerging markets. Similar to political risk coverage, insurers have effectively stopped underwriting coverage in the current situation, but appear willing to look cautiously at specific deals in Russia. Sanctions against Russia are the main concern for most insurers as they closely monitor the political situation. Although some insurers are evaluating risks in Russia on a case-by-case basis, at present most appear willing to honor NBIs, but organizations may face delays.

Trade credit insurance: Trade credit insurance provides coverage for the nonpayment of accounts receivables that arise from the sales of goods or services under two types of policies, non-cancelable and cancelable. Non-cancelable policies typically lock in endorsed credit limits on a policyholder's customers for a one-year period. Cancelable policies allow insurers to reduce or cancel the credit limits throughout the policy period.

Non-cancelable credit limit policies: Ukraine was considered a high-risk country by some insurers prior to the recent turmoil. As a result, insurers' exposures there are modest and typically below the aggregate deductible levels of their global programs. Insurers are holding discussions with policyholders with coverage in Ukraine, and most are supporting individual strategies regarding new deliveries and payment delays. Generally, insurers indicated that they will continue to support existing insureds throughout the crisis, but most will not consider new exposures on any product lines at this time.

The degree and severity of the potential sanctions against Russia are a concern for insurers offering non-cancelable trade credit insurance policies in the country. Insurers covering considerable commercial and political perils in Russia seem prepared to continue supporting existing policyholders but unwilling to take on significant new exposures in the country at this time. However, some insurers will consider exposures from large companies with high-quality risks.

Cancelable credit limit policies: Insurers indicate they will continue to provide coverage for new shipments in Ukraine but will approach each risk with extreme caution and are unlikely to approve new coverage for poorly rated customers. Most insurers have implemented risk action plans to reduce or cancel buyer credit limits in all sectors. Insurers are likely to review their underwriting stance on difficult risks and may reduce exposures by a minimum of 50% or more. Limits supported by guarantees and collateral will be reviewed and assessed by the strength of the guarantors. In the current circumstances, it appears that most insurers will be providing coverage for future business in Ukraine for only the highest rated customer risks. Typically, domestic sales are viewed favorably by insurers since obtaining hard currency to pay a foreign supplier is not needed.

Insurers continue to provide cancelable limit trade credit policies in Russia without distinguishing between new and existing coverage. Insurers continue to monitor the situation in Ukraine and Russia daily and may take additional action in the short term.

MANAGING INSURANCE PROGAMS

As the crisis in Ukraine and Russia unfolds, organizations should review all insurance policies and clearly understand their limits and sublimits, deductibles, loss-reporting requirements, covered perils, and other restrictions. For trade credit insurance specifically, organizations should maintain an open dialogue with their insurers regarding their customers' ability to pay as well as the insurers' underwriting strategies. Companies should:

- Be prepared to provide insurers with compelling information that may be necessary to maintain buyer credit limits.
- Obtain insurer approval, if necessary, before changing payment terms or agreeing to payment rescheduling.
- Consider the impact that a change in payment terms could have on claim recoveries in the event of a loss when moving from an open account to more secured terms such as cash in advance.

In the event of a loss, organizations should, among other things:

- Gather data for a claim filing. For political risk, capture potential loss information and additional costs associated with the claim, including temporary repairs, extra expenses, and business interruption and loss of income costs. For trade credit risk, include evidence of product shipment/delivery, customer payment obligations, collection efforts, and potential plans to minimize loss.
- Record photographic and/or video evidence of property damage and maintain open lines of communication between employees, insurers, and claims advisors to support policy loss mitigation and notification terms.

Finally, it is important to note that the current situation in Russia and Ukraine is extremely fluid. Insureds with interests in the region should monitor events closely, and contact their brokers, counsel, and other advisors regarding insurance and risk management questions.

MULTI-COUNTRY POLICIES

In recent years, many businesses have turned to a broader approach to political risk management through the purchase of multi-country insurance policies. Such policies can help organizations take a more holistic approach to managing risk. Instead of attempting to cover unpredictable risks through a patchwork of policies for individual nations, a multi-country policy typically covers 15 to 20 countries, and potentially more. Most underwriters prefer the multi-country approach as it allows them to spread their political risks across several countries. The terms available in such policies can often be more favorable than single-country policies, and multi-country policies also make it more likely for organizations to be able to obtain coverage for exposures in higher risk countries. Currently, most insurers seem likely to favor multi-country programs when allocating scarce capacity to risks in Russia.

Trade credit insurance policies have historically been purchased on a multi-country basis. As a result, many organizations already recognize the benefit of spreading the risk. Larger global programs with experienced policyholders tend to benefit from more favorable terms such as "delayed effect of cancellation" on customer credit limits, which gives the policyholder more time to work down exposures while still maintaining coverage in the event of a credit limit cancellation by the insurer.

There is a robust market for single obligor policies for trade credit and structured credit products. In Ukraine, the single-risk trade credit and structured credit market incurred significant losses following the 2008/2009 financial crisis. Therefore, the insurance market's credit exposure in Ukraine is fairly low.

ABOUT THIS BRIEFING

This report was prepared by Marsh's Credit & Political Risk Group, which helps businesses to manage risks related to political violence, government breach of contract, sovereign or commercial default, expropriation of investments or assets, currency inconvertibility, and more.

ABOUT MARSH

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