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political risk insurance newsletter

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Inside this Issue

Recovery Ratings for Structured and Project Finance Transactions: Opportunities for PRI

By Robert T. Wray

Recovery ratings provided by agencies such as Standard & Poor's (S&P) and Fitch can help lenders and borrowers assess the prospects of recovery once a default has occurred, open access to particular investors and lenders, as well as to calculate capital requirements, and to price issues. We believe that political risk insurance (PRI) can prove to be an increasingly important factor in recovery ratings for structured and project finance.

Both S&P and Fitch have recently established recovery ratings and methodologies for rating the recovery prospects of project or structured financed instruments.

S&P first looks at possible circumstances of default and then at post-default recovery prospects. Its recovery ratings take into account both legal structure and collateral. S&P does a project value analysis, but if viability is doubtful, it performs a liquidation analysis. S&P then ranks the issue numerically from 1+ to 5, based on descending levels of likely recovery of principal (see Table 1, page 4).

PRI could be viewed as an element of either a going concern or a liquidation analysis. In post-default circumstances, PRI may keep the project performing by keeping the cash flowing, for example with convertibility and transfer coverage, or, as a form of collateral, may yield values for lenders in the form of insurance proceeds.

Fitch's recovery ratings are based on a relative scale measuring potential recoveries in bankruptcy, liquidation, or some other form of restructuring. It notches down and up from the issuer rating (see Table 2, page 4). For its corporate analysis, Fitch will focus primarily on ultimate recoveries, although the recovery analysis will use stressed cash flow scenarios and realistic enterprise valuations. For structured finance, Fitch concludes from market feedback that prospective users concur with Fitch's view that cash flow streams are more predictable and easier to model, making a present value approach more appropriate for some, if not all, asset classes and structures. Sector-specific recovery methodologies will be published in concert with the incorporation of this methodology and recovery scale.

Fitch believes that the adoption of recovery ratings and issuer default ratings (IDRs) globally will enhance the informational content of Fitch's ratings by separating the two main components of credit risk: probability of default and loss given default (LGD). This type of information is increasingly valuable in a post Basel-II world of sophisticated credit risk management. They see an overwhelmingly positive response from the market to Fitch's rollout of recovery ratings and IDRs, which reinforces this view.

A case in point is the recent assignment by Fitch of a "B"

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Interview with Charles Berry

Charles Berry is Chairman of BPL Global, a founding member of the global network of independent political risk and trade credit insurance brokers. He co-founded Berry, Palmer & Lyle in 1983. With over thirty years as a London-based political risk broker, he is widely recognized as a pioneer and innovator in the fields of political risk and trade credit insurance.

You specialize in syndicating placements. What are the benefits of PRI syndication?
I am a great fan of the syndicated market, partly because I believe the PRI market has to accept the inevitability of real losses, ones that won't necessarily be recoverable over time, like war risks and terrorism risks. Therefore it is important to adhere to the core principle that insurance spreads losses so they "fall lightly on the many rather than heavily on the few."

Syndication is clearly good for the client as it delivers the capability of the whole market, rather than the single capability of one underwriter. And syndication also benefits insurers as it enables them to operate within their comfort level and better balance their portfolios. This is why even smaller transactions are often syndicated.

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Interview with Charles Berry (cont'd.)

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Is it harder to negotiate coverage with multiple insurers than with one?

We are so used to the practice when dealing with London, Europe, Bermuda, and the broader international markets, that we do not really see any major difficulties. One of the reasons that syndication works smoothly is because it is broker-led. This is not only true for the London based PRI placements but applies generally in the insurance market for large and complex risks. For example, when we recently syndicated a large risk, seven insurers wrote it on identical terms and conditions, but none of them at any stage talked to each other. This is not only efficient, it is good for the client. It means the client, through their agent the broker, controls the syndication process.

In the North American PRI market it has been more common for syndications to be led by the leading insurer. Personally, I always feel uncomfortable with the idea that insurers who are meant to be competing sit down together and talk about the same transaction. For larger risks there clearly needs to be an element of co-operation between insurers, but that co-operation is more efficient and more healthy if it is co-ordinated through the broker.

But the syndication process can be and is being improved: we are making better use of technology; there has been increased standardisation of the format of placement slips; the relationship between different insurers on the same placement is being codified, rather than being simply based on market practice; and there is a big initiative to improve contract certainty. All this does not change the principle though: syndication is an excellent way of spreading risk.

> "If history is anything to go by, the reaction to globalisation can be more powerful than globalisation itself."

Some traditional PRI covers - CEN and CI - seem to be in diminished favor with buyers these days. What are the mains reasons and what does the market have to do to regain buyer confidence?

The main problem with currency inconvertibility (CI) cover is that the world has largely moved to floating exchange rates. CI cover was designed for a fixed exchange rate environment. Currency inconvertibility coverage was never designed to deal with devaluation risk. I do not believe the insurance market will ever produce an effective solution for this. Devaluation is a price risk, and we do not do price risk. When lending to emerging markets in hard currency you need to address devaluation risk first. When that is dealt with, then lenders PRI policies can still provide a lot of value, and CI cover is an essential part of that cover.

Classic confiscation, expropriation and nationalisation (CEN) coverage has been out of fashion. However you would be wrong to forget about it: look at South America. Chavez in Venezuela, Morales in Bolivia, and Humala in Peru are all feeding off a nationalistic and leftist reaction against the West and against globalisation.

If history is anything to go by, the reaction to globalisation can be more powerful than globalisation itself. Elsewhere in the world radical Islamists are feeding off the same reaction. The Bush doctrine, globalisation, even development: like it or not, they are not popular with everyone. So the full range of political risk is out there, including classic expropriation.

I believe global businesses generally sense the risk, but the insurance demand is currently more for terrorism and political violence (PV) cover. PRI insurers should focus on meeting and channelling that demand, particularly because only PRI insurers can provide a proper solution to terrorism and PV risks in emerging markets.

What are the biggest opportunities and challenges facing the PRI market today?

I have to distinguish here between the traditional investment insurance products (by which I mean policies covering specified political risk perils such as CEN, Currency Inconvertibility, Political Violence and War risks, whether for equity, loans or tangible assets) and comprehensive "failure to pay" insurance policies. Of course a great deal of the activity of the private PRI insurers is in this area of Non-Payment Insurance.

For these Non-Payment Insurance Policies, the future looks pretty good, because even though the number of government-owned obligors is diminishing, the product is being applied beyond strictly trade-related transactions, and, for example to local currency loans to government obligors. Additionally of course, many of the so-called PRI insurers underwrite single situation and medium term comprehensive Non-Payment Insurance on private sector obligors in emerging markets, further eroding the line between the PRI market and traditional export credit insurance.

I believe that Non-Payment Insurance is a great product whose market will expand, particularly with banks for their emerging market exposures, driven by the pressures of Basel II which will require high regulatory capital allocations for emerging market exposure. In this regard I am quite satisfied that Non-Payment Insurance from the private insurers suitably amended can be and will be recognised as qualifying Credit Risk Mitigation under Basel II, thereby allowing the banks to gain regulatory capital relief.

Unfortunately I do not believe the investment insurers will get the same boost from Basel II. And the traditional investment insurance market is somewhat in the doldrums. To some extent the slack has been taken up by covers for Breach of Contract, Denial of Justice, and so on. While these areas are important, the PRI market should not just be about the good faith and good credit of the current host government. At root, the PRI market should be there for unexpected, and often violent political change. Historically (if not recently) it has been war, revolution and conflict that have produced most political risk losses – including most CEN losses.

The risk of an attempted revolution somewhere in the world is quite high at the moment. While nearly all governments have signed up for the "war on terror", for many this has a political cost at home. This is why leaders like Musharraf in Pakistan and even Mubarak in Egypt needed the Danish cartoons, like they needed a hole in the head. I think it is a pity that many investment insurers haven't responded quicker to the demand for specialist and stand-along terrorism and political violence coverages following 9/11. The initial reaction was to leave even the emerging market risks to the terrorism insurance market which, strangely, has become a separate silo in the insurance industry.

What has been the growth of the terrorism insurance market and why do you see it as an opportunity for the traditional investment insurers?

Since 9/11 the stand-alone terrorism insurance market has grown from a premium base of about USD30million per annum to an annual premium income in round terms of USD500million. This is a testimony to how responsive some insurers can be – particularly the London underwriters who led this market immediately after 9/11. But having said that, the terrorism market has not got it right for emerging market risks.

The opportunity for the PRI insurers lies in the product sold by the terrorism

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Interview with Charles Berry (cont'd.)

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insurance market. The terrorism T3 wording and its variants was designed for the US or Western Europe. The T3 wording only gives "Lightweight Terrorism" insurance. In the context of emerging markets it covers some form of terrorism but excludes others. Terrorism in emerging markets has many faces. Some terrorists are also insurgents, rebels or guerrillas. So if you think the T3 wording covers all the types of terrorism found in places like Iraq, the Niger Delta, Sri Lanka, Colombia and elsewhere in emerging markets – dream on. The legal advice we have taken on the T3 wording supports this. In the context of emerging market terrorism, T3 is, in their words, a "dog's breakfast."

Effective insurance cover for emerging market terrorism can only be found in a PRI product. If you make the necessary amendments to the T3 wording to make it suitable for emerging market risks, the cover can only be provided by PRI insurers.

> "Effective insurance cover for emerging market terrorism can only be found in a PRI product."

Happily, many terrorism insurers are also PRI insurers, particularly in London and Bermuda. As and when the demand in respect of emerging market risks changes and buyers start asking for a better product, these insurers will simply take their terrorism underwriting hat off and put on their PRI hat. Meanwhile, PRI insurers who previously did not write stand alone terrorism and political violence covers are beginning to do so, focusing of course on emerging markets. So the supply is there. How rapidly things change now depends on how quickly policyholders take a closer look at the risk and the wordings. At the moment 95% plus of emerging market stand-alone terrorism insurance is still being purchased on the basis of an inadequate T3 based "Lightweight Terrorism" wording.

But won't better wider terrorism coverage using the PRI approach be more expensive?

No – not necessarily. We have seen significant premium savings achieved by moving a terrorism insurance renewal from the terrorism market to the PRI market. For these renewals, the PRI alternative was better and cheaper. There is no consistent pattern, however. It depends on the risk, and to get the best from the current market you need to be able to work seamlessly in both the terrorism insurance and PRI markets.

This is because – for emerging market risks – there is a convergence underway between the terrorist insurance market and the PRI market. It is really quite ridiculous that our market has been dealing with emerging market terrorism insurance and political risk insurance in separate "silos". It may suit the insurers, but in reality they are clearly part and parcel of the same risk. We are breaking down this silo mentality – and it means much better value for the policyholders. ■

Loss & Recovery Journal

On August 2, 2005, the **Overseas Private Investment Corporation (OPIC)** reached a determination that an expropriation claim filed by Ponderosa Assets, L.P. was valid and that compensation should be paid in the full amount of coverage ($50 million). The insurance covered Ponderosa's equity investment in the privatization, acquisition and operation of a gas pipeline company located in southern Argentina.

OPIC found that the actions of the Argentine government came within the scope of coverage of OPIC's insurance contract based on OPIC's determination that emergency legislation enacted by the Argentine government in 2002 constituted a repudiation of the government's contract with the investor, motivated by noncommercial considerations, and for which compensatory damages were not paid, in violation of the government's responsibilities to an investor under international law. It was not necessary for OPIC to determine whether enactment of the emergency legislation itself constituted a violation of international law or an event within the scope of OPIC expropriation coverage, and OPIC did not do so. The decisive factor in this case was the government's entering into a license that created a contractual obligation to allow tariff payments in dollars and PPI indexation of tariffs, and the government's subsequent repudiation of those contract rights by enactment of emergency legislation that required acceptance of "pesified" tariffs without indexation. These factors resulted in a decrease in the revenues of the pipeline company so great that, according to an independent accounting expert, it justified a total writedown by Ponderosa of its investment in the pipeline company.

Ordinarily, in connection with payment of an expropriation claim, the insured investor assigns to OPIC the shares evidencing the insured interest in the project company and the related claims against the foreign government. Under the intergovernmental agreement that relates to the OPIC programs, OPIC then negotiates a settlement with the foreign government. If negotiations fail, OPIC's claim may become the subject of an international arbitration between the two governments.

For a variety of reasons, the standard procedures were unattractive to both OPIC and the investor, and so an alternative arrangement was devised that permitted the investor to continue to pursue an ICSID arbitration (where recovery might exceed the limits of the investor's OPIC insurance contract) as well as the possibility of recovery from sales of shares in the pipeline company (which retained its assets, continued to operate, and had at least speculative investment value). From OPIC's perspective, the large number of pending investment disputes and arbitrations against the government of Argentina, as well as the Calvo compromises in the intergovernmental agreement with Argentina on which OPIC would have to rely, undermined OPIC's prospects of achieving the usual sort of negotiated settlement and made an innovative alternative recovery strategy attractive. If neither the ICSID arbitration nor the sale of shares resulted in recovery within an agreed period, OPIC retained the right to attempt recovery through the usual methods. Working out the details of the alternative arrangement required only a few weeks, and OPIC made full payment to the investor on September 12, 2005.

Through sharing in the proceeds of a sale of shares, OPIC recovered its claim payment with interest on January 27, 2006. Thus, OPIC compensated the investor in full and then achieved a full recovery in cooperation with the investor within about four months.

The full text of the Memorandum of Determinations may be found in OPIC's website (www.opic.gov) in the FOIA electronic reading room. The Ponderosa claim was the only claim that OPIC paid in 2005. ■

Recovery Ratings for Structured & Project Finance Transactions (cont'd.)

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rating to an Autopistas del Nordeste (AdN) issue of $163 million senior notes due in 2026, to finance a toll road project in the Dominican Republic. A very significant factor in the rating was a "partial political risk guarantee" (PPRG) provided by the Multilateral Investment Guarantee Agency (MIGA) that encompassed expropriation, inconvertibility, war and civil disturbance, and most significantly, breach of contract coverage that underpins a minimum revenue guarantee from the Government of the Dominican Republic. The PPRG covers 51% of the loss attributable to the covered risks, and in the event of a breach of contract claim, noteholders could receive a single accelerated payment rather than awaiting scheduled installment-by-installment compensation. In Fitch's view, MIGA's PPRG enhanced recovery prospects enabled the issue's rating to be notched up from "B-" to "B".

> "The adoption of recovery ratings and IDRs globally will enhance the informational content of Fitch's ratings by separating the two main components of credit risk: probability of default and loss given default."

Recovery ratings may not, as a matter of course, take political risk insurance into consideration, but in the right situations, the existence of PRI coverage with terms appropriate to the circumstances of default would deserve investigation and considerable weight in recovery calculations for project financings. For example, in 2004, the Overseas Private Investment Corporation (OPIC) made payments to Bank of America (as trustee for debt holders) in response to an expropriation claim involving the Dabhol project in India. The payments included defaulted installments and the outstanding loan principal.

PRI could be a factor in recovery rating analysis on a going concern basis if, for example, a project payment is in default on account of currency inconvertibility. That default and future defaults similarly caused could be redeemed or prevented by currency inconvertibility coverage. Further, PRI lender policies typically provide that if an expropriation or political violence claim is found to be valid, there is a presumption that subsequent consecutive defaults will be similarly caused. In either case, the existence of the PRI coverage could determine whether lenders will receive payments down the road.

On the other hand, the failure of a sovereign offtaker to meet its payment obligations, for example, might cause sponsors and lenders to discontinue normal project operations and fall back on contractual rights to arbitrate the matter against the sovereign or its agent, in effect liquidating the project. In the interval between the commencement of default and the arbitration's outcome, coverage against non-payment of the award and sovereign thwarting of the arbitration process would be a factor in assessing the prospect of recovering sums that would ultimately offset the lenders' loss.

In later editions, this Newsletter will explore further how PRI might play a role in recovery ratings for debt in project financings and in other cross-border lending situations. ■

Table 1: Standard & Poor's

Recovery Ratings Definitions

Recovery Rating	Recovery expectations	Indicative recovery expectations
1+	Highest expectation of full recovery of principal	100% of principal
1	High expectation of full recovery of principal	100% of principal
2	Substantial recovery of principal	80%-100% of principal
3	Meaningful recovery of principal	50%-80% of principal
4	Marginal recovery of principal	25%-50% of principal
5	Negligible recovery of principal	0%-25% of principal

Table 2: Fitch

Recovery Scale and Effect on Issue Ratings

	Scale	Investment Grade	Speculative Grade
RR1	Outstanding recovery prospects given default.	+2	+3
RR2	Superior recovery prospects given default.	+1	+2
RR3	Good recovery prospects given default.	+1	+1
RR4	Average recovery prospects given default.	0	0
RR5	Below-average recovery prospects given default.	-1	-1
RR6	Poor recovery prospects given default.	-1 / -2	-2 / -3

PRI Pricing; Understanding the Basics of a Nontraditional Market

We invited Julie Martin, Senior Vice President of Marsh & McLennan, to explain how political risk insurance is priced.

The Assistant Treasurers of two multinational companies, Powerco and Manuco meet at a conference and compare notes on their political risk programs. Powerco, which has invested in an investment grade rated emerging market is surprised to learn that its rates are almost twice as high as those of Manuco with investments in several large below investment grade rated countries. The Assistant Treasurer of Powerco returns home and wants an explanation. This is what I would tell her…

Pricing political risk insurance – particularly investment insurance - is unlike pricing for most "traditional" forms of coverage. Lack of an actuarial foundation, typically multi-year commitments, and vulnerability to aggregation risk and adverse selection by purchasers, make PRI pricing challenging and unique: more an art than a science. And each underwriter's approach may be a little different. But PRI pricing isn't just random or illogical: Here's why.

Broad Factors Affecting Pricing: Country Risk, Capacity, and Sector Risks

Country risk is the distinctive element in PRI pricing. But it is only a starting point. Two risks in the same country may have very different profiles, and will be priced accordingly.

Underwriters initiate country risk assessments not just as a means of setting rates, but to decide if they want to offer coverage at all. Very high rates send a simple message to the buyer: GO AWAY! Private market insurers' rates tend to go higher than those available in the public market, with private insurers offering lower pricing in low risk countries than the public market can muster but higher pricing in riskier countries. Some underwriters will go completely off-cover in a country where they have had to pay an expropriation claim and not yet recovered it from the host government. Such outstanding claims often prompt other underwriters to raise their pricing for exposures in that country, if not shun it altogether.

Underwriters carefully monitor their country aggregates – the sum of their per-country exposures - and may limit their country exposures based on risk perception. In any case, when there's high demand for coverage in any particular country, the law of supply and demand kick in and rates trend up. A few years ago, when demand was high in one large Latin American country, one underwriter actually held an auction for its remaining capacity. In another country, rates fell by almost 50% for similar projects due primarily to an easing in capacity.

> "Very high rates send a simple message to the buyer: GO AWAY!"

Some underwriters, such as OPIC, start with "base rates," for each coverage or a range or rates applied to a specific industry sector or type of exposure, based on their notions about which sectors pose a higher risk. While most insurers tend to start their rating process with country assessment, all take the industry sector and type of exposure into consideration at some point.

Projects generally believed to carry higher risks include natural resource projects, those involving concessions or special licenses from the host government, those that sell to or purchase from the government or its parastatals, and those that provide essential goods and services to the public, such as power and water.

Case Specifics Matter: The Project, the Insured, and the Policy Wording.

Political risk underwriters consider factors specific to the insured, the project, and the policy terms in pricing their coverage. The insured investor's staying power in the country, its conformity to local law and policy, its sophistication in dealing with foreign governments, and its approach to security are among the factors that help determine the likelihood of loss. So do the investor's relations with the local community, its approach to environmental concerns, and the project's developmental benefits. The investor's nationality may also affect the underwriter's perception of risk. In some countries, for example, US companies may be perceived as higher-risk than others.

The underwriter also considers the potential for salvage or recovery should a loss occur. Its pricing may take a favorable turn if it is coinsuring or reinsuring with a public agency and expects to share in that agency's superior recovery prospects. If insured equity shares are pledged to lenders, and the underwriter is willing to accept that impairment, that too will affect price.

Since political risk policies are typically manuscripted, meaning that the insurer tailors terms and conditions to the project and its risks, pricing may vary according to how "deluxe" the wording is. The more risk the underwriter perceives it is taking by offering broader or explicit language as a result of manuscripting, the higher the rate.

> "While PRI pricing does not move in lockstep with general property and casualty pricing, shifts in these areas do affect it."

Other Pricing Ingredients

The period for which coverage is committed at a fixed price also affects pricing. Shorter term commitments are generally cheaper. In a recent case where expropriation coverage was required, we saw the price increase by about 10 basis points for each two- to three-year period beyond the initial three-year tenor. Underwriters may offer some form of "standby" coverage at, for example, half the normal premium for exposure amounts that are expected to materialize only over a given period. Or they may not offer this break, and if country capacity is scarce, decline to cover more than the initial investment.

Just as the scarcity or abundance of capacity can have a profound effect on offered pricing, so can the availability of competing interest in the insured's business. Of course, the better risks are the ones that attract the most competition. Risk distribution is also important to underwriters: They may discount prices for an investor that offers them a well-spread book of business.

In large transactions, the investor can obtain some benefit from layering the insurance, so that underwriters in excess positions earn less than the primary

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PRI for the Nam Theun 2 Hydropower Project: Complex Collaboration Works

We invited Philippe Valahu, Acting Director of Operations, and Elena Palei, Senior Underwriter, at the Multilateral Investment Guarantee Agency (MIGA), to discuss the underwriting of investment in the complex Nam Theun 2 hydropower project, in which MIGA has played a major role.

Political risk insurance was a key element in launching the landmark $1.25 billion Nam Theun 2 hydropower project in Lao People's Democratic Republic (Lao PDR), the largest ever investment in that country. The project's power plant will export electricity to Thailand, which is expected to yield $1.9 billion of foreign exchange earnings for the country over a 25-year period, and will also serve domestic needs. Political risk guaranties from MIGA and the Asian Development Bank (ADB), and a partial risk guarantee from the World Bank's International Development Agency (IDA), made possible commercial bank financing for the project at attractive rates.

The Project

Nam Theun 2 (NT2) involves the development, construction and operation of a thousand megawatt hydropower plant on the Nam Theun river, a tributary of the Mekong, in central Laos. The project encompasses a 48-meter high gravity dam, a reservoir, a powerhouse, and two transmission lines: a 130 km double-circuit 500 kV line to deliver the bulk of the electrical output to the Thai power grid, and a 70 km single-circuit 115kV line to carry a small portion of the project's output which is dedicated to domestic use in Lao PDR.

> "The participation of commercial dollar lenders hinged on the availability of guarantees against political risks, and for a project of this size recourse to multilateral agencies was the only practical solution."

Structure and Funding

The project is structured as a BOOT (Build-Own-Operate-Transfer) arrangement, to be implemented by the Nam Theun Power Company Limited (NTPC), whose shareholders include Electricite de France International (EDFI), Italian-Thai Development Public Company Limited, Electricity Generating Public Company of Thailand (EGAT) and the Nam Theun 2 Power Investment Company (NTPI). NTPI will invest on behalf of Lao PDR's state-owned power company.

The project represents not only the largest investment ever made in Laos, but also the largest ever private sector financing of a hydroelectric project. The project is funded by equity (28%) and debt (72%) from multilateral and bilateral agencies, export credit agencies, and a consortium of international private commercial banks. The support of political risk guarantors was critical to securing a significant amount of commercial bank financing.

Risk Mitigation

The participation of commercial dollar lenders hinged on the availability of guarantees against political risks, and for a project of this size recourse to multilateral agencies was the only practical solution. Lender concerns included the traditional political risks of currency transfer restrictions and inconvertibility, expropriation, and war and civil disturbance, but also protection of the rights under the project agreements with the Government of Lao PDR and EGAT. These risks were covered by MIGA, ADB and IDA through a co-insurance agreement. It was also important to lenders to have coverage against political risks in both countries, despite the fact that the investment is located in Lao PDR.

"For MIGA, the main challenge was the cross-border nature of the transaction," says Elena Palei, the project's senior underwriter at MIGA. "Although the hydropower plant is being built in Lao, the real risk for the banks was the power purchase agreement between the project and Thailand."

The breach of contract insurance provided by all parties covers the Lao PDR government's contractual obligations for payment to both NTPC and the lenders, as well as its obligations under a direct agreement with the lenders recognizing their third-party rights under the concession agreement – including subrogation rights in the event of default. In addition, MIGA's and ADB's policies covered commercial lenders' rights under the power purchase agreement between EGAT and NTPC, as well as the various side agreements between EGAT and the lenders.

"It takes a village to build a project like this," says Palei. "This project was a great collaboration between public sector lenders, multilaterals, commercial banks, local financial institutions, the government, and the investor. This project simply would not have happened without this type of collaboration." ■

MARKET PROFILE:

ZURICH

Zurich Financial Services (Zurich) is one of the largest property and casualty insurance companies in the world with offices in more than 50 countries and 57,000 employees. Its international network supports customers in over 120 countries generating gross written premium and fees of approximately USD 49.3 billion in 2004.

Zurich provides political risk insurance (PRI) and trade credit insurance (TCI) through its Emerging Markets Solutions unit based in Washington, DC with offices in London, Barcelona, Hong Kong, Tokyo and Sydney (2Q 2006).

Products
Confiscation, Expropriation, Nationalization; Inability to Convert/Exchange Currency; Political Violence, Sovereign and Sub-Sovereign Non-Payment; Wrongful Calling of Bonds; Private Buyer Non-Payment; and Other Tailored Policies

Capacity
Political Risk Insurance: up to $80 million per transaction for up to 15 years
Trade Credit Insurance: up to $35 million per transaction for up to 7 years

Credit Rating
Zurich is rated "A+" by S&P and Fitch, "A1" by Moodys, and "A" by AM Best. Policies may be underwritten using either Steadfast Insurance Company or Zurich Insurance Ireland, Ltd. paper which both share Zurich's "A+" rating.

Claims Experience
Zurich has paid PRI and TCI claims in Argentina, Venezuela and most recently, the Dominican Republic where it has paid approximately $20 million for policies covering the timely payment of sovereign debt. Up-to-date information on Zurich's claims experience is available on its website (www.zurichna.com/politicalrisk).

Company Comment
Zurich is extremely service-oriented and can typically respond to coverage inquiries from brokers and customers within 24 hours of receiving a submission. Its experienced team of underwriters can respond to both political risk insurance and trade credit insurance inquiries and craft policies to accommodate even the most complex transactions.

Zurich works proactively with Insureds throughout every stage of the claims process to secure a successful outcome. Due to the nature of political risk claims, the advocacy and loss minimization assistance it provides is an important component of its overall claims service.

Zurich has been voted the "Best Private Insurer" by Trade Finance Magazine between 2002 and 2005 and is one of only four private sector members of the Berne Union.

Key People:
Daniel Riordan, *EVP and Managing Director*
Michael Bond, *SVP and Director, Political Risk Insurance*
Frederic Louat, *SVP and Director, Trade Credit Insurance*
Edward Coppola, *Chief Underwriting Officer*
Sean Cassidy, *Manager, Business Development*

Contact information:
Political Risk Insurance inquiries, please contact Mr. Michael Bond at (202) 585- 3106. Trade Credit Insurance inquiries, please contact Mr. Frederic Louat at (202) 585-3111.

Please visit Zurich's website at www.zurichna.com/politicalrisk for detailed information about its products, claims payment history, and contact information.

■

People and Organizations

■ Effective February 1, 2006 **ACE Bermuda Insurance Ltd**. ("**ACE**") assumed 100% ownership of **Sovereign Risk Insurance Ltd.** ("**Sovereign**"), the Bermuda-based insurer of political risk and sovereign non-payment insurance. Sovereign, formerly a joint venture between ACE and XL Insurance (Bermuda) Ltd., will now write business solely for ACE.

■ John Simon is the new Executive Vice President of the **Overseas Private Investment Corporation (OPIC).**

■ Veteran OPIC insurance underwriter/manager Edie Quintrell has been named OPIC's Vice President for Insurance.

■ Peter Jones, formerly Head of Syndications at the Multilateral Investment Guarantee Agency (MIGA), is now Chief Executive Officer of the **African Trade Insurance Agency (ATI)** in Nairobi.

■ David Anderson, Assistant Vice President of **Zurich's Emerging Markets Solutions** unit will begin underwriting political risk insurance and trade credit insurance in Sydney, Australia beginning April 1, 2006. David will be collocated with Zurich Australia and work with brokers and customers in Australia and nearby countries.

■ Separately, Zurich's Emerging Markets Solutions can now issue political risk insurance and trade credit insurance policies for Japanese insureds using Zurich Japan, which recently received regulatory approval to do so.

■ Vadim Vorobyov has joined **Exporters Insurance Company** as Vice Presidnet – Underwriting in their New York office. Vadim was most recently an Assistant Vice President in Citigroup's Global Project & Structured Trade Finance Group.

PRI Pricing: Understanding the Basics of a Nontraditional Market (cont'd.)

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(first loss) layers. Layering makes most sense for risks vulnerable to partial-losses, like political violence, and less for catastrophic risks like expropriation.

PRI is affected by market cycles: Pricing broadly responds to the ebb and flow of capital into the insurance marketplace. While PRI pricing does not move in lockstep with general property and casualty pricing, shifts in these areas do affect it.

One such external force is the lending business. Bank loans and capital issues have become an important area of coverage for investment insurers. As bank liquidity has grown in the last couple of years, spreads, out of which PRI coverage costs must come, have diminished. Underwriters, eager to retain this business, have lowered their pricing accordingly.

Cost Versus Price and the Role of Intermediaries

Policy pricing is not the whole story. The total cost of supplying the policy is affected by such additional elements as deductibles, minimum coverage periods, no-claims bonuses, cancellation fees, and fee reopener provisions. These non-premium costs can sometimes be considerable. Involvement by public agencies may impose additional expenses to satisfy public concerns related to the environment, workers' and human rights. In one recent and extreme case, the involvement of a multilateral agency cost the investor $1 million in addition to the premium.

Many companies use brokers to place cover, or may engage other advisors. Expert assistance in this very specialized insurance line can be the key to obtaining the best coverage at the lowest cost, and in many cases will spare the investor - and the underwriter - much time and effort.

Conclusion

PRI pricing is not formulaic or static, and varies with the underwriter. In some transactions, we have seen rates vary by more than 100% between two underwriters. Once the investor has obtained quotes from many sources, it can make a business and risk case to underwriters. The investor and its broker or advisor may find that presenting the risk in a different way or providing additional information will yield a better rate. Other things being equal, well presented and documented projects that address important issues get the best reception from the marketplace. ■

about this newsletter

This is the third 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*. This and previous editions of the newsletter are available at *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 and aircraft finance. 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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