

The Willis logo is displayed in white, sans-serif font on a dark blue rectangular background. The background of the entire page is a photograph of a protest with people holding signs and buildings in the background.

Willis

# CLIENT ALERT

**POLITICAL RISK INSURANCE:  
MIND THE GAP**

**APRIL 2011**



# CONTENTS

<b>INSTILLING A RISK MANAGEMENT CULTURE .....</b>	<b>3</b>
<b>THREE TYPES OF INSURANCE AGAINST POLITICAL UNREST.....</b>	<b>3</b>
<b>INSURERS' RESPONSE TO RECENT POLITICAL UNREST .....</b>	<b>5</b>
<b>GETTING YOUR PEOPLE OUT.....</b>	<b>5</b>
<b>THE RISKS OF GOING GLOBAL .....</b>	<b>6</b>
<b>THE RISE OF RESOURCE NATIONALISM AND CREEPING EXPROPRIATION .....</b>	<b>6</b>
<b>SUPPLY CHAIN VULNERABILITY .....</b>	<b>7</b>
<b>TAKE THE FIRST STEP.....</b>	<b>7</b>



**VIOLENT CIVIL UNREST IN LIBYA, REVOLTS IN TUNISIA AND EGYPT, RIOTS IN BAHRAIN, UPRISINGS IN THAILAND - AS A CLIMATE OF POLITICAL DISCONTENT THREATENS TO SPREAD TO OTHER PARTS OF THE WORLD, BUSINESS LEADERS CAN'T AFFORD TO HAVE ANY GAPS IN THEIR INSURANCE COVERAGE WHEN IT COMES TO PROTECTING THEIR HUMAN AND PHYSICAL ASSETS.**

**WILLIS EXPERTS IN POLITICAL RISK, POLITICAL VIOLENCE, TERRORISM AND KIDNAP & RANSOM OUTLINE IMPORTANT CONSIDERATIONS WHEN IT COMES TO MAXIMISING BUSINESS INSURANCE PROTECTION IN THE EVENT OF A LOSS.**

While the events unfolding in the Middle East, North Africa and Asia have heightened the general public's awareness of political risk, they have also elevated the topic to the top of the agenda of Risk Managers and Boards in the business community.

Companies with operations or staff in the troubled regions have had to rapidly dust off and implement their Business Continuity Plans and, in some cases, improvise a whole series of actions in order to protect and evacuate their employees while at the same time safeguarding their assets.

Business leaders in all countries, no matter what the political risk temperature of their locations, will also undoubtedly be reviewing their insurance protection to see if they have the right coverage in place should the unthinkable happen.

Whilst companies may be able to assess and manage technical and even commercial risks, it is extremely difficult to deal with or indeed predict political events. If insurers had mounted a campaign in, say, October 2010 to sell Political Violence coverage in a 'safe' country like Bahrain, they would not have had much success, but if recent events have taught us anything it is that today's stable or 'investor friendly' regime can very easily become tomorrow's hot spot.

Insurers too will be looking at their own exposures and aggregations and as a result will be seeking to impose tighter wordings and rate increases and even, in some cases, withdrawing from certain areas and lines of business.

In this Client Alert, Willis experts:

- Look at the importance of developing a risk management culture.
- Contrast the main kinds of insurance available for political unrest.
- Report on how the insurance market is responding to recent events.
- Shine a light on a lesser known Kidnap & Ransom insurance evacuation extension.
- Explore the political and supply chain risks brought about by globalisation.

## INSTILLING A RISK MANAGEMENT CULTURE

As global business continues to expand and explore new market opportunities, companies' physical assets and employees are increasingly exposed to high-risk territories, hostile situations and new threats like resource nationalism and creeping expropriation. Increased globalisation also brings with it more potential for supply chain vulnerability. Against this backdrop, can a company afford not to have the right insurances in place?

When investing in or trading with emerging markets, companies need to be able to identify the risks and assess how they might impact upon their business. The next step is to be able to monitor these risks by devising a comprehensive risk management strategy. It is a truism that if you can't monitor these risks you can't manage them.

The third step is to take the necessary measures to adequately mitigate these exposures, including the purchase of appropriate insurance. Taking this one step further, there is a need to ensure that the insurance protection companies' have purchased will respond in the event of a loss.

## THREE TYPES OF INSURANCE AGAINST POLITICAL UNREST

There are three main types of coverage that companies concerned with political unrest could consider: Strikes, Riots and Civil Commotions (SRCC) insurance, Terrorism cover (known as the Lloyd's Sabotage & Terrorism Only Form) and full Political Violence cover.

In the past, it has been wide-spread practice for companies to purchase Strikes, Riots and Civil Commotions (SRCC) coverage as an extension to Property and Marine Cargo insurances. But as our table on the next page shows, this extension would not necessarily respond to the type of events we have recently witnessed in North Africa, the Middle East and Thailand.

Over the past 10 years since the events of 9/11, the purchase of Terrorism insurance, whether through commercial insurance policies or through government sponsored schemes, has become more commonplace and this is to cover risks which were being excluded under Property and other insurance policies.

Like many things, purchasing habits change in response to circumstances but it is clear that populous violence to overthrow unpopular regimes has little or nothing to do with what is currently defined within the stand-alone Terrorism insurance policy. There is a very great risk that this coverage, in its traditional format, will not respond to the type of losses that we have seen being incurred in the Middle East and North Africa as well as in Thailand. This is because an Act of Terrorism is narrowly defined as being:

**'An act, including the use of force or violence, of any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organisation(s), committed for political, religious or ideological purposes including the intention to influence any government and/or put the public in fear for such purposes.'**

It is this requirement that the terrorist act must influence or overthrow the government that can cause a potential gap in coverage. Other restrictions include the requirement to rebuild or reinstate after damage and the policies are usually cancellable.

Furthermore, the standard LMA 3030 Form (Lloyd's Sabotage & Terrorism Only Form) formerly known as the T3 Form, does not insure against:

**'Loss or damage occasioned directly or indirectly by war, invasion or warlike operations (whether war be declared or not), hostile acts of sovereign or government entities, civil war, rebellion, revolution, insurrection, civil commotion assuming that the proportions of or amounting to an uprising, military or usurped power or martial law or confiscation by order of any Government of public authority.'**



The following table provides a comparison between the Political Violence, Terrorism and SRCC coverages:

	<b>FULL POLITICAL VIOLENCE COVER</b>	<b>TERRORISM LMA3030</b>	<b>SRCC</b>
Cover	Physical loss or damage arising from Strikes (including lock-outs), Riots, Civil Commotion, Looting and Malicious Damage, Mutiny, Terrorism and/or Sabotage, Uprisings, Rebellions, Coup D'état, Insurrection and Revolution, War and Civil War: (Coverage can occasionally be extended to include seizure and capture of goods by persons engaged in Political Violence with or without physical damage to the goods)	Terrorism only and often requires terrorist organisation to 'influence' or 'overthrow' government	Physical loss or damage arising directly from Strikes (including lock-outs), Riots, Civil Commotion
Cancellable	No	Normally	Normally
Premium	Fixed at inception	Reviewable	Reviewable
Abandonment	Covered without requirement for physical damage	Not covered	Material Damage Only
Reinstatement/ Rebuilding	Not required	Required	Not Applicable
Relationship with Property Damage Policy	Tailored to exclusions of property damage policy. Business Interruption can be included	Not tailor made	Extension of stand-alone
Exclusions	Limited: War between five Great Powers/Chem-Bio Attack (although can be included)/ Expropriation/Theft	Several	Numerous and include: Business interruption, Confiscation, War, Civil war, Insurrection, Revolution, Terrorism, Mutiny; Civil Commotion can be excluded where it is the result of a popular rising or military rising
Period	Up to five years (if part of a Political Risks policy)	Usually one year	Usually one year

Looking at the table, full Political Violence insurance, under the Hiscox and Beazley policy forms, is much broader in its offerings than Terrorism or SRCC insurance. Aside from being non-cancellable, there is no requirement for rebuilding or reinstatement in Political Violence coverage.

Political Violence insurance also has fewer exclusions, although war between the five major powers is still a paramount exclusion as is damage occasioned by Nuclear, Biological and Chemical attacks. It is, however, possible to buy back the Biological and Chemical Exclusion in some cases.

## INSURERS' RESPONSE TO RECENT POLITICAL UNREST

With the wave of political unrest sweeping through countries from Algeria to Iran, all in the first few months of 2011, the insurance markets have reacted in a number of different ways.

Some insurers, particularly in territories where the situation has become more unstable, are already reviewing their ability and even desire to continue offering even the more basic form of SRCC – their policy conditions give them the right to issue Notice of Cancellation in order to review, re-rate or simply withdraw this element of coverage. Others are making it abundantly clear to their policyholders that the events which are currently taking place all across North Africa are not addressed by the SRCC extension.

Specialist insurance markets, particularly Lloyd's of London, continue to offer both Terrorism and full Political Violence coverage. Such insurers are undoubtedly reviewing their own exposures and aggregations and the rating structure has become harsher to reflect the perceived increase in risk in each territory.

Marine Cargo insurance can typically be extended to cover the risks of SRCC. While the Marine definition does extend to include Terrorism (as defined), the Marine Cargo market, following the World Trade Centre loss, moved to restrict these perils to goods in transit only; in other words, when you revisit your policy, you will find that, once the Cargo becomes a 'static' risk (eg in Storage), the Terrorism coverage ceases (although Governments in countries such as Australia, France and the USA have made it compulsory for some coverage to be offered).

In the case of 'static' Cargo, therefore, the short-fall in coverage can only effectively be made up by resorting again to the Political Violence insurance market.

## GETTING YOUR PEOPLE OUT

During recent events in North Africa, the Middle East and Thailand, some corporations will have had the foresight to provide Kidnap & Ransom (K&R) insurance for their key employees working in or traveling to 'unstable' territories.

For those corporations with K&R programmes in place, many would have historically had an infrequently-used extension to their corporate K&R programme, the Emergency Political Evacuation and Relocation extension. This extension, which was generally included at no additional premium by insurers, provided assistance and costs to evacuate staff from territories when political unrest arose.

Previous incidents which triggered the coverage included Kuwait in 1991 and Lebanon in 2006. Insurers attempted to include some territorial exclusions, but most multinationals retained global coverage and the territories currently experiencing unrest would not have featured on the exclusion list. Many clients were unaware that they had this type of coverage under their K&R policy until it was drawn to their attention.

Some of the lessons learned from the last few months have included the effectiveness of the trigger for coverage, generally an instruction from a government to evacuate their citizens. The political nature of this type of advice and the diversity of multinational clients' employee base created a delayed and, in some cases, a confused trigger. It was also clear that many multinationals were unprepared for such a mass evacuation and were forced to rely on extremely stretched and scarce third party resources.

Some basic planning and preparation could have ensured a smoother decision making and implementation process. The emphasis of many clients was towards preparation and assistance rather than financial protection. Going forward we expect to see increased focus on this extension, including possible exclusion, reductions in limits and significant pricing implications.

Some coverage is also afforded under group Personal Accident and Business Travel policies, with the scope of coverage varying considerably and focused on Business travellers versus expatriate staff. These insurers often provided different assistance companies, predominantly from a medical evacuation background.



What is also clear, however, is that any such corporate K&R coverage will almost certainly not have extended to include blue-collar workers, many of whom will originate from emerging market countries. The cost and complexity of evacuating and repatriating hundreds of such workers can be simply ruinous and we are now seeing a considerable client appetite to develop a stand-alone Evacuation product to draw together the coverages offered across products, with a single provider of assistance. However, whether there is sufficient appetite from insurers does remain to be seen in light of recent events.

## **THE RISKS OF GOING GLOBAL**

With commodity prices remaining relatively robust for the foreseeable future, there is vast potential for investors in emerging markets, but while these resource-rich countries present significant opportunities for foreign direct investment, there are also very real and inherent risks.

Precarious political or socio-economic issues in these countries are also often compounded by weak macroeconomic frameworks and inadequate legal and regulatory regimes which can hamper development. However, it's not only in emerging markets where companies can be exposed to unrest. Political demonstrations across Europe have been seen to rapidly deteriorate into extreme violence during which the articulation of a desire to overthrow the incumbent government is evident.

Traditionally, 'political risk' has meant some form of governmental interference such as expropriation. However, national governments are no longer the only source of political risk. Political risk can also stem from local governments, international and local NGO's, community groups, local competitors or any other group advancing political objectives. Additionally, more 'soft risks' such as poverty, human rights, labour disputes and growing income disparities can also fuel civil disturbances and conflict.

The situation in the Middle East and North Africa is a prime example of where the original touch point was not due to any direct intervention on the part of the government, but was ostensibly a populous movement driven by high food prices.

## **THE RISE OF RESOURCE NATIONALISM AND CREEPING EXPROPRIATION**

As natural resources become scarcer and global demand for energy and minerals continues to increase, substantial investment will be required in the coming decades. Due to their importance to host economies, extractive industries and power projects, amongst others, are often highly politicized and are therefore at particular risk from governmental interference.

A change in government policy or regime can easily lead to expropriations, license cancellations, the abrogation of concession agreements and contract 'reviews' as governments seek a larger share of the profits or try to claim socio-economic capital by blaming foreign companies as the source of their problems.

Furthermore, tensions can develop between central and local governments over the distribution of royalties and taxes. In addition, any failure to address social and environmental concerns properly can exacerbate tensions with local communities, damage the reputation of project sponsors and lenders and result in huge losses.

Moreover, lenders have portfolio or country risk limits and the financing of such projects can often hinge on the ability of the investors to mitigate political risk.

The rise of what is often termed ‘resource nationalism’, as witnessed in Venezuela has meant that risk-facing investors will become ever more prevalent and need to be adequately mitigated.

However, rather than an outright confiscation of a foreign investor’s assets, companies are more likely to witness a more indirect or insidious form of government intervention known as ‘creeping expropriation’. This refers to state conduct that substantially deprives a foreign investor of the use or benefit of their investments, even though formal legal title may continue to vest with the investor. For example, such expropriation could take the form of the imposition of a punitive tax regime that is applied selectively against the foreign enterprise and which is not applied to local companies.

Political Violence coverage is not restricted to an investors’ equity in the foreign enterprise but can apply equally to other fixed as well as mobile assets.

## **SUPPLY CHAIN VULNERABILITY**

Global outsourcing has led to significant increases in the length and complexity of supply chains and any delay or interruption can often have a catastrophic effect on a company’s bottom line.

The advent of just-in-time manufacturing processes means that supply chains are often very stretched. Furthermore, should there be a lack of alternative suppliers for a particular type of goods or commodity or if long-term fixed priced contracts are in place, an interruption to the supply chain could result in the company failing to honour its contractual obligations. Whilst companies may carry a global Property and Marine Cargo or Stock Through-Put policy there may very well be gaps in coverage.

Trade Disruption Insurance, which can dovetail with these programmes, can effectively cover importers’ loss of profits or revenue consequent upon an import embargo, war, port blockage, supplier insolvency or confiscation of goods etc.

Similarly exporters can protect themselves against the introduction of any law, order or decree that would prevent or delay the export of goods into the host country or as a result of the non-renewal of any valid export or transit licence or as a consequence of war, civil war, revolution, hostilities, rebellion and/or insurrection and exchange transfer embargo.

## **TAKE THE FIRST STEP**

All the potential issues outlined in this document raise a number of questions and we consider the subject-matter to be so important as to merit specific study in company with your corporation’s insurance advisor.

At Willis, we have mobilised our Client Advocates to contact our clients and to meet with them in order to revisit all these issues and to ensure that our clients have the most appropriate coverage in place in order to reflect their risk exposures.

## Contact us

### Financial Solutions (Political Risks)

Paul Davidson  
Tel: +44 (0)20 3124 6051  
Email: davidsonp@willis.com

### US Terrorism Practice

Wendy Peters  
Tel: +1 610 254 7288  
Email: peters\_wa@willis.com

### International Terrorism Practice

Alex Clayton  
Tel: +44 (0)20 3124 6029  
Email: claytona@willis.com

### Special Contingency Risks (K&R)

Doug Milne  
Tel: +44 (0)20 7088 9100  
Email: contactus@scr-ltd.co.uk

### Willis Limited

The Willis Building  
51 Lime Street  
London, EC3M 7DQ  
United Kingdom  
Tel: +44 (0)20 3124 6000  
Fax: +44 (0)20 3124 8223

### [www.willis.com](http://www.willis.com)

Willis Group Holdings is a leading global insurance broker, developing and delivering professional insurance, reinsurance, risk management, financial and human resource consulting and actuarial services to corporations, public entities and institutions around the world. Willis has more than 400 offices in nearly 120 countries, with a global team of approximately 17,000 Associates serving clients in virtually every part of the world.

This update is published for the benefit of clients and prospective clients of Willis. It is intended to highlight general issues relating to the subject matter which may be of interest and does not necessarily deal with every important subject nor cover every aspect of the subjects contained herein. If you intend to take any action or make any decision on the basis of the content of this update, you should first seek specific professional advice and verify its content. Copyright Willis 2011. All rights reserved.

Willis Limited, Registered number: 181116 England and Wales.  
Registered address: 51 Lime Street, London, EC3M 7DQ.  
A Lloyd's Broker. Authorised and regulated by the Financial Services Authority.