

Distinctive. Choice.



## Structured Credit & Political Risks

Value to Banks

# Structured Credit and Political Risks

## Overview

**The global financial crisis has highlighted to banks the advantages of utilising structured credit and political risks insurance. Banks that strategically utilise the structured credit and political risk insurance market as a risk distribution and/or risk enhancement tool have a distinct edge over the competition.**

For many years now, a considerable number of major international and regional banks have used the Structured Credit and Political Risks insurance market as valuable risk distribution and risk enhancement tool. This has become even more prevalent since the implementation of Basel II and the onset of the financial crisis.

Despite the financial turmoil, the insurance market has remained open to transactions during the financial crisis, paying significant levels of claims, and this has provided invaluable support to certain banks. Banks that use the insurance market have an edge over their competitors, in addition to mitigating some of the losses incurred during the financial crisis.

Banks that are utilising credit and political risks insurance as part of their overall risk distribution strategy are benefitting in the following ways:

- When banks' internal limits are constrained, insurance has offered the option of sharing the exposure to a transaction with a non-competitive partner, providing an alternative to the syndications market.
- In the current risk environment, banks are using credit insurance to further strengthen the structure of certain transactions.
- Banks are obtaining capital relief through the purchase of insurance that meets the test of a guarantee under Basel II.
- Increase in potential revenue due to greater participations and higher levels of financing.
- A strengthening in relationships with key customers through larger lines of financing.
- Banks are meeting internal credit requirements through the application of credit and political risks insurance.

## Validity

The current financial crisis has resulted in an explosion in claims. Underwriters have been and are currently paying claims in Bahrain, Kazakhstan, Russia, Ukraine and many other locations. An estimated US\$3 billion to US\$4 billion of structured credit and political risk potential losses have been reported to the insurance market.

To the best of our knowledge, all Basel II-compliant policies are responding as banks anticipated and claims are being handled in a satisfactory manner by underwriters, proving the value of this product.

This has given the banks that have utilised structured credit insurance or political risk insurance with a vital way of mitigating losses, following non-payment or non-performance by their borrowers and/or contracting counter parties.

Principal losses in the market: (estimated as of Jan 2010)
Alliance Bank - US\$250 million
Bahrain - US\$500 million
Brazil - US\$250 million (soft commodities)
BTA - US\$500 million
Ukraine - US\$600 million
Others - US\$1 billion (including several losses in Asia)

The losses arising in the Structured Credit and Political Risks insurance market in 2009 do need to be understood in context .

From a broader, insurance market perspective, even the headline 'worst case' number of US\$4 billion of losses in 2009 is the equivalent of the property and business interruption losses that may be caused by a small- to mid-size natural catastrophe in the USA. In other words, this is not a number that is life threatening for an insurance industry that has come into the credit crisis relatively well-capitalised, with the notable exception of AIG's special products team, which carried a relatively small exposure to the systemic credit losses that have impacted the banking sector. Therefore the market is continuing to operate without any significant impact upon available capacity or products.

## Lessons to be learned

International and regional banks have continued to utilise the insurance market as an important means of risk distribution and leverage especially in light of the issues faced over the last 18 months or so in the banking syndication market and in other risk distribution markets. Whilst insurers have become more selective in their risk criteria, all insurers have remained open for business throughout the financial crisis. Available capacity for 2010 is only slightly down from available capacity in 2009.

There are however some important lessons that can be learned from the financial crisis in relation to the utilisation of Structured Credit and Political Risks insurance:

- Structured Credit and Political Risks can be an invaluable tool for banks if correctly utilised.
- Banks that use the products in a more strategic risk sharing approach as opposed to "risk dumping" received far better results and responses from insurers.
- It is vital that your wording is precise and clear.
- Throughout the process including post-policy placement, management of the relationship is critical and this is where a broker should add true value.

## Structured Credit and Political Risks

- Communication is key to a successful policy and claims process.
- It is important to understand which underwriters have greater willingness to pay – an important component under Basel II.
- The Structured Credit and Political Risks insurance market is a trusted and valuable partner to banks, well demonstrated by the level of claims being paid.

### Coverage

Our Credit Insurance policies provide comprehensive non-payment insurance in relation to transactions where the beneficiary of the policy has agreed to provide financing. In the event that the obligor fails to make a payment under an insured transaction, the underwriter indemnifies the insured for an agreed percentage of any loss caused by an insured risk. The policy insures against the non-receipt of any amount due from an obligor (private or public entity) under an insured transaction, provided such non-receipt is not the result of one of the events specified as exclusions.

Our Political Risks insurance policies provide coverage for financing, investments and assets in overseas environments against a range of perils including Expropriation, Currency Inconvertibility and Transfer, War and Political Violence, Forced Abandonment, Forced Divestiture, Selective Discrimination, Breach of Contract, and Arbitration Award Default.



### Practical applications

Structured Credit and Political Risks Insurance can be used in a range of transactions including:

- Trade Finance
- Receivables Finance
- Commodity Finance
- Export Finance
- Structured Finance
- Project Finance
- Asset Financing

Tenors up to 10 years are available from the private insurance market for Structured Credit and up to 15 years for Political Risks coverage.

### JLT – a pioneer in insurance for the banking sector

- In 1989, JLT singlehandedly embarked on a market initiative that overturned the rules within Lloyd's and enabled underwriters to insure banks on a direct basis.
- In 1993, JLT successfully lobbied the insurance market to change the rules to allow Lloyd's to write credit risk on private entities.
- In 1996, JLT was the first broker to establish a specialist Credit and Political Risks team in Asia with a key focus on banks.
- In 2008, JLT once again took the initiative and led market evolution in writing Basel II-compliant policies

### About JLT

Within JLT, the Capital Risks unit is a global team of specialist consultants, political risks analysts and brokers who focus on advising, structuring and arranging political risks strategies and solutions for our clients. The team is one of the world's strongest and most successful insurance brokers for Credit and Political Risks. Our clients comprise, in equal measure, of multinational companies, banks and traders. On average, we handle more than US\$50 billion of insurance capacity for them at any one time. The Jardine Lloyd Thompson Group has Credit, Political Risk and Terrorism experts located in London, Singapore, Hong Kong, Tokyo, Sydney, Stockholm, Calgary, with affiliates in Paris and broker partners in the US.

Jardine Lloyd Thompson Group plc (JLT) is a market leader in insurance & reinsurance broking, risk management consultancy and employee benefits services. JLT employs 5,500 personnel and operates out of more than 100 offices in over 35 countries around the globe.

JLT only operates in specialist areas where it is or can become a market leader. Through the success of this business philosophy, it has grown to become one of the world's leading international insurance and reinsurance brokers. JLT also has a substantial employee benefits business which provides pension administration, outsourcing and employee reward and benefits consultancy.

Our operations in Asia date back to 1836. Today, JLT Asia is one of the most experienced brokers in this region, with over 700 staff in 12 locations across Asia – China, Hong Kong, Indonesia, Japan, Korea, Macau, Malaysia, Philippines, Singapore, Taiwan, Thailand and Vietnam.

We are an associate company of Jardine Matheson, an Asia-based conglomerate with a broad portfolio of market-leading businesses in engineering, construction, transport services, insurance, motor trading, property, retailing, restaurants and hotels. Through this relationship, JLT Asia has access to the skills and resources of one of Asia's most successful businesses.

You can obtain more information about JLT Asia at: [www.jltasia.com](http://www.jltasia.com)

**Matthew Strong**

Managing Director, Capital Risks Asia  
Tel: +65 6411 9343  
Mob: +65 9721 8456  
Email: Matthew\_Strong@jltasia.com

## REGIONAL OFFICES

**China**

Tessie Tang  
Tel: +86 10 6467 6199 ext. 198  
Email: Tessie\_Tang@jltasia.com

**Hong Kong and Macau**

Margaret Ho  
Tel: +852 2864 5397  
Email: Margaret\_Ho@jltasia.com

**Indonesia**

Armand Wibisono  
Tel: +62 21 2995 2584  
Email: Armand@jltasia.com

**Japan**

Takashi Okabe  
Tel: +81 3 3517 3030  
Email: Takashi\_Okabe@jltasia.com

**Korea**

Kim Jong In  
Tel: +82 2 397 8152  
Email: Kim\_J\_I@jltasia.com

**Malaysia**

Woon Wei Ming  
Tel: +60 3 2723 3372  
Email: Woon\_Weiming@jltasia.com

**Philippines**

Cecille Espiritu  
Tel: +63 2 706 8520  
Email: Cecille\_Espiritu@jltasia.com

Jonathan Neepomuceno

Tel: +63 2 706 8521  
Email: Jonathan\_Neepomuceno@jltasia.com

**Singapore**

Pei Ru Chiew  
Tel: +65 6411 9358  
Email: Chiew\_Pei\_Ru@jltasia.com

**Taiwan**

Margaret Ho  
Tel: +852 2864 5397  
Email: Margaret\_Ho@jltasia.com

**Thailand**

Jongjit Dejudomvittaya  
Tel: +66 2 626 2560  
Email: Jongjit\_D@jltasia.com

**Vietnam**

Doan Vinh Thang  
Tel: +84 8 3822 2340  
Email: Thang@jltasia.com

Website: [www.jltasia.com](http://www.jltasia.com)

