MARSH

RiskSpotlight

TAKING A MULTI-COUNTRY APPROACH TO POLITICAL RISK AND TRADE CREDIT INSURANCE

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Political risk and trade credit risks are high on the agenda for many organizations as political violence, terrorist threats, expropriation actions, and economic uncertainty are among the harsh realities of doing business globally. Nearly one-in-five countries experienced escalating political violence at the start of 2013, according to research from Marsh and Maplecroft. And beyond the violence and terrorism threats, global businesses face a diverse set of political and economic risks in the countries in which they operate.

FORECASTING POLITICAL AND TRADE CREDIT RISK

At first glance, some political and trade credit risks may seem easy to spot or to predict. A significant portion of political violence today, for example, is a result of violence in Libya and Syria "spilling over" into other countries in Western and North Africa and the Middle East, including Mali, Lebanon, and Algeria.

As evidenced by events in Egypt during and since the Arab Spring of 2011 and in Thailand and elsewhere, political instability can develop quickly. Much like the stock market, past performance is not necessarily an indication of future results. In other words: Political risk frequently emerges in countries that have historically been considered "stable" by risk managers, insurers, and other observers.

In the years since the peak of the financial crisis in 2008, global credit risk has persisted. The European sovereign debt crisis — and the growing willingness of companies to use bankruptcy as a strategic option — has added to multinationals' concerns about trade credit exposures, and made predicting the location of the next default difficult.

Further complicating matters are several broad macroeconomic and societal factors that have been at work for several years.

- **Geography:** Whereas in the past economic downturns and political turmoil would typically spread geographically, today's increasingly interconnected global economy means that "contagion risk" no longer knows borders.
- **Social media:** The broad availability and use of social media in countries at all levels of economic development has played an important role in fueling societal and political change. At times social media has even sparked unrest by spreading misinformation.
- **Emerging markets:** Global economic power continues to shift to emerging markets, which inherently carry more political risk than developed markets (see Figure 1).

A BROADER APPROACH

Given this new level of unpredictability, it might seem odd that businesses would try to anticipate specific countries in which they would face the greatest political and trade credit risks and the specific nature of those risks. But for much of the last decade, this is precisely what many multinationals did as they purchased separate political risk and trade credit insurance policies to cover particular risks in specific countries. For example, a company might buy a policy to cover war risks in Kuwait and a trade credit insurance policy on one customer in China, while leaving exposures in other countries uninsured.

Many multinationals have since discovered that this country-by-country approach may leave them vulnerable to unexpected events. In recent years, many businesses have recognized the unpredictability of global risk and have increasingly turned to a broader approach to political and trade credit risk management through the purchase of multi-country insurance policies.

A multi-country policy enables businesses to 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, but potentially more. These policies can be customized to cover a single region — for example, the Middle East and North Africa — or include countries worldwide.

Underwriters often prefer this multi-country approach as it allows them to spread their political and trade credit risks across several countries. Because of this, the terms available in such policies can often be more favorable than single-country policies. For example, policies may have higher limits available; provide coverage for countries that are typically difficult to insure, such as Egypt; and/or offer more attractive pricing.

Companies purchasing political risk insurance on foreign investments and assets are also seeking to insure a broader range of risks, rather than focusing on what they perceive to be the most likely events to occur. Some of these risks include expropriation, forced divestiture, political violence (including forced abandonment), business interruption and contingent business interruption, contract frustration, and trade disruption.

BEYOND POLITICAL RISK AND TRADE CREDIT INSURANCE

A strategic approach to managing political and trade credit risks, of course, extends well beyond assessing insurance needs. Organizations doing business in countries with high levels of political risk, for example, also should review their current business interruption and supply chain resiliency plans and procedures. These businesses should evaluate the immediate and long-term impact of potential political risk events on their own operations and on those of their customers and suppliers.

Among other things, businesses should ensure that they can give early warnings of any potential problems to employees, customers, and suppliers, and review crisis communication plans and procedures to ensure the safety of employees.

Business should also review their credit risks and credit control policies and procedures. Ongoing financial monitoring of customers and suppliers can identify strengths and weaknesses in their credit risk management processes, ultimately enabling businesses to avoid bad debts and improve cash flow.

Emerging markets play an increasingly important role in the global economy, making it clear that multinationals will require insurance and consulting services to help expand global sales and supply sources.

Figure 1: Political Risk (Dynamic Index): Top 20 Growth Markets

	COUNTRY	RATING*
1	China	High
2	India	High
3	Indonesia	High
4	Vietnam	Medium
5	Bangladesh	High
6	Brazil	Medium
7	Philippines	High
8	Nigeria	High
9	South Korea	Low
10	Malaysia	Medium
11	Russia	High
12	Tanzania	Medium
13	Singapore	Low
14	Hong Kong	Low
15	Peru	Medium
16	Thailand	High
17	Egypt	High
18	Colombia	High
19	Turkey	Medium
20	Uzbekistan	High

Source: Maplecroft

** Countries are classified as extreme, high, medium, or low risk based on governance frameworks, political violence, busiwness and macroeconomic risk, and societal forced regime change risk.*