GLOBAL REINSURANCE

Political risk: Bermuda's role

Three years ago Bermuda had virtually no involvement in the political risk (re)insurance. Today, two Bermuda companies are together by far the world's largest providers of underwriting capacity to the private market. Price Lowenstein explains how it happened.

Perhaps no sector of the (re)insurance market has undergone more change in the past few years than the private sector political risk investment insurance (PRI) market. Three years ago there were only two major players in the private PRI market, AIG and Lloyd's. The maximum policy term or tenor achievable on investment insurance covers was five years and per-project capacity was in the $50 to $75 million range.

By the end of 1998, three new players had entered the political risk investment insurance market: Sovereign Risk Insurance Ltd, a joint venture between ACE Bermuda and XL Capital; Zurich US Political Risk, a new subsidiary of the Zurich Group, and Chubb, which re-entered the PRI business in 1998 after withdrawing from the market in the late 1980s. All the new players (as well as AIG) offer 10 year terms and dramatically increased per-project capacity: AIG can now write $125 million per project, Sovereign $100 million per-project, Zurich $50 million and Chubb $50 million.

Driving some of these extraordinary changes in the PRI market has been the emergence of Bermuda as a new centre of political risk insurance and reinsurance underwriting. Consider that three years ago the Bermuda insurance market had virtually no involvement in the political risk insurance or reinsurance business. Today, two Bermuda companies, ACE Bermuda and XL Capital, are together by far the world's largest providers of underwriting capacity to the private market.

How, and more importantly, why did this happen?

When Bermuda became an important insurance and reinsurance centre during the 1980s, a number of Bermuda companies were formed as catastrophe or cat companies, capitalised and structured specifically to respond to low frequency, high severity events, such as large liability losses and natural disasters. Among those companies, ACE and XL were particularly successful and by the mid-1990s, both had become heavily diversified, well capitalised and highly rated international insurers.

By the middle of 1996, both had begun to look seriously at political risk insurance as an attractive new product to add to their portfolios. As a class of business which is "catastrophic" (that is, low frequency/high severity), political risk was a natural product for them as they expanded and became more global.

The first step in this initiative was taken in April, 1997 when ACE concluded a reinsurance treaty with the Multilateral Investment Guarantee Agency (MIGA), the political risk insurance underwriting arm of the World Bank. This treaty was an effective answer to MIGA's need for increased underwriting capacity.

The ACE-MIGA reinsurance treaty also marked the first time that a private reinsurer had offered a public investment/export credit insurer (ECA) matching tenors, in this case out to 15 years. Also during the spring of 1997, XL entered into a treaty reinsurance arrangement with Exporters Insurance Company, a specialty export credit underwriter based in New York.

The next step occurred in April 1997 when ACE and XL formed Sovereign Risk Insurance Ltd as a joint venture to enter the primary PRI underwriting market. Sovereign was formed to provide the private market with a new source of stable, highly rated, long-term investment insurance capacity to diversify ACE and XL's portfolios further and to provide "on-island" expertise to their multinational clients.

With per-project limits of $100 million and non-cancellable terms (including war/political violence) out to 10 years, Sovereign became a major player in the PRI market in less than two years. Its structure is also unique. Unlike other PRI underwriters, Sovereign is essentially a net writer to the two companies, who only reinsure a 10% share of their portfolio (with Risk Capital Reinsurance). ACE and XL each accept 45% of Sovereign's liabilities on a net basis.

Commenting on the formation of Sovereign in 1997, Brian Duperreault, ACE's chairman, president and ceo noted, "Our vision in forming Sovereign in 1997 was to create an underwriting agency which could offer banks, ECAs and multinationals meaningful per-project limits as well as the ability to write non-cancellable terms out to 10 years. We were also determined to give this new entity maximum flexibility and as much protection as possible from the sometimes erratic cycles of the commercial reinsurance market."

Brian O'Hara, XL Capital's president and ceo, stated: "The concept behind Sovereign was pretty clear. With the huge increase in emerging market investment and project finance activity, we felt the timing was right to enter the private political risk market. Its very gratifying to see this original vision become a success. Sovereign has exceeded our expectations, and we look forward to its continued growth and expansion."

Consolidation in the PRI market continued when in 1998, XL acquired Mid-Ocean Reinsurance, owners of the Brockbank underwriting agency (one of the three largest political risk underwriters in Lloyd's) and ACE purchased Tarquin Ltd, managers of the Charman syndicate (another of the large Lloyd's political risk underwriters).

More recently, the two Bermuda companies' involvement with MIGA was further extended in February 1999 through a new and expanded reinsurance treaty arrangement. ACE and XL will now each reinsure MIGA for $50 million per project and $150 million per country. This new treaty allows MIGA to increase its per-project limits to $200 million, matching those of the US government's political risk insurance agency, Overseas Private Investment Corp (OPIC), and it enables MIGA to increase its per country limits to $620 million. As with the original treaty, ACE and XL's reinsurance coverage will match MIGA's policy tenors which go out to 15 years.

MIGA's executive vice president, Motomichi Ikawa, noted: "The agreements with ACE and XL extend MIGA's close ties with the private insurance marketplace. The treaty testifies to the benefits of close and continued co-operation between insurers in extending coverage to client investors."

Today in Bermuda

Bermuda did not have a single, full time political risk underwriter 36 months ago, but today features ACE and XL with direct ownership of the two largest Lloyd's PRI underwriters, Charman and Brockbank; a 50-50 ownership interest in Sovereign Risk; a reinsurance treaty with Exporters Insurance Company and a major reinsurance relationship with MIGA. This is an impressive spread of business within the political risk market as it encompasses a multilateral ECA, a private export credit insurer, two Lloyd's syndicates and Sovereign Risk.

Bermuda's role in the public and private political risk markets is obviously a very positive development for these markets. The increased capacity provided to MIGA by ACE and XL make it possible for this agency of the World Bank to guarantee a greater number of developmental projects in emerging markets. ACE and XL's creation of Sovereign has added an important source of stable, long-term capacity to the private market, which is making it easier for banks to cover long-term project finance transactions and investors to cover long-term direct equity investments. Bermuda's role in Lloyd's is also seen as an important step in assuring the long-term viability of the Lloyd's PRI market.

As the public and private PRI markets continue to expand, so will Bermuda's importance. If the past is any prologue, this trend will continue and the PRI markets and Bermuda will develop at a pace and in ways that will surprise us all.

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