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UNIQUE PERSPECTIVES



**Liberty**  
Specialty Markets

FINANCIAL RISK SOLUTIONS

HOW INSURERS CAN  
DISPEL THE POLITICAL  
SHADOW OF COVID-19

With developing economies seeking investment to transition away from fossil fuels and to improve access to energy, the pandemic has highlighted the progressive role that Political Risk insurance can play, says Matthew Coomer.

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As news of COVID-19 began to spread through the world's media, many investors in emerging economies were already feeling anxious. A wave of social unrest throughout developing economies in 2019 had triggered a sharp market reaction and a growing sense that traditional risk measures like political stability, needed to be viewed alongside measures of inequality such as the Gini coefficient to fully understand country risk profiles. The tide of investment turned; money began to flow out of some of these countries.

Fast-forward two years. As vaccination programmes around the world take effect and the prospect of a new normality beckons, for developing countries, the need for foreign investment remains paramount. Concerns about climate change and the need for cleaner, sustainable energy sources are behind a significant number of solar, hydroelectric and wind projects. The capital investment required for such projects can range from \$10m to \$2bn. The hesitance of investors to deploy their capital in emerging markets due to the political risk environment has led to a financing gap and a reluctance among financial institutions to support energy and infrastructure projects. Forecasts of increasing political unrest as the economic effects of the pandemic unwind

exacerbate the problem. We are seeing this play out in Colombia and South Africa.

#### The race for cleaner energy

Low interest rates, and the associated yield depression on developed market assets, can make infrastructure and energy projects in emerging markets more attractive to investors, if they can mitigate the political risk. Emerging economies are well suited to solar energy projects, as many experience high levels of sunshine. These projects will bring affordable energy to some of the most underserved populations. Additionally, developed countries are pressing emerging economies to meet sustainability goals. A report by the World Resources Institute in 2017 noted that six of the top ten greenhouse gas producing nations were emerging economies.

The challenge is to make infrastructure and renewable energy projects in the developing world more attractive to potential investors on a risk-adjusted basis. Reducing the political risk of investment is part of the solution and that is where insurers like Liberty Specialty Markets' Financial Risk Solutions team has a vital role to play. Political Risk insurance – which provides protection against a loss in investment value because of government action – is key to increasing investor confidence. According to a 2018 report by the LSE-Oxford Commission on State Fragility, Growth and Development, 'investors cite political risk as the single most important constraint for investing in developing countries over the medium-term'.



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## Political risks

Currently, we provide Political Risk cover for around 35 live single project infrastructure or energy assets projects around the world. Of these, 11 are partnerships with Development Finance Institutions or multilaterals in which one party reinsures the other. Without insurance, these types of major infrastructure projects might struggle to attract the investment they need.

Typical political risks affecting investor confidence include:

- The government seizing control of assets. History is full of examples of newly-elected regimes forcibly taking ownership of privately-controlled assets. In these circumstances, investors may lose their entire investment without any compensation.
- Forced abandonment: the potential for politically-motivated violence to escalate to the point that a business has to abandon its assets and repatriate its people.
- The inability to convert or transfer earnings in a local currency: an investment made in US dollars, with cash flow generated by the overseas investment in local currency. Government-introduced currency controls or exchange controls, could restrict an investor's ability to repatriate currency into US dollars. It's a common problem in emerging economies that are struggling with their US dollar reserves.

- The inability of the off-takers to honour their contractual obligations under the Power Purchase Agreement. Often, these off-takers are state-owned enterprises and as a result of COVID-19, the creditworthiness of many emerging market countries is becoming more questionable, heightening such off-take non-payment risk in certain jurisdictions.

As an insurer, it is key to choose power project assets that are strategically important and likely to receive government support. Political Risk insurance protects investors, reducing uncertainty and allowing them to focus on raising capital and executing the project successfully.

## Underwriting process

So how does Liberty assess which projects to support? Unlike Property or Motor insurance, the infrastructure or energy project under consideration may not exist physically when a quotation is requested. The cost of Political Risk protection is often part of a preliminary pricing exercise by the client. Post-quotation, the project may never start, or it may take 6–12 months to secure the necessary approvals to proceed.

Assessing the political risks of a construction project can be challenging. We need to understand the investor's level of technical expertise and their track record in emerging markets. This is followed by a deep dive into the economics of the project and a review of the insured's

due diligence, for which a non-disclosure agreement is usually required. It is helpful when the investor is willing to explain their investment strategy. Do they have the ability to work out project issues and negotiate with the local authorities? What benefits will the project provide for the country? Is there government involvement and is the project likely to receive government support?

We conduct a country risk analysis to determine the political and economic risks and develop our own assumptions of its outlook. As we may be committing to provide cover for a 15–20 year investment horizon, our review will be extremely granular and discussed with our underwriting team.

## Post-pandemic jitters

Marsh's 2021 Political Risk Map shows larger increases than ever before in country economic risk across all regions globally. According to the broker, strains on public financing in emerging markets will result from increases in sovereign indebtedness and may create unfavourable conditions for domestic and foreign-owned businesses. The inability of governments to invest in much needed social reform programs is likely to result in an escalation in social unrest and political violence.

Our opportunity is to harness our combined 200 years of political risk underwriting experience and our data-driven approach to help mitigate the long-term effects of the pandemic on the global economy. ■

## Clean electricity in Africa

Landlocked Burundi is one of the world's poorest countries. Its growing population and limited infrastructure has seen this African nation struggle to meet demand for electricity. In recent years, blackouts have become common. 92% of Burundi's population has no access to electricity.

In January 2020, a public-private partnership reached financial close for Gigawatt Global Burundi: a solar photovoltaic plant capable of generating 7.5 megawatts, increasing Burundi's power generation capacity by 15%. This is the first power plant to be built in Burundi for more than 30 years.

Liberty's Financial Risk Solutions team provided Political Risk insurance to an investor for the development, construction, operation, and maintenance of the plant. Liberty Specialty Markets acted as the insurer with the U.S. International Development Finance Corporation (DFC), the US government's development finance institution providing reinsurance.

This project has won a number of awards for its developmental benefits. Including, in 2020, an international panel of judges named Gigawatt Global as Project of the Year for EEP Africa, a major clean energy funding body.