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PERSPECTIVES

Political Risk: Definition, Current Trends, Insurance & Claims

Our perspectives feature the viewpoints of our subject matter experts on current topics and emerging trends.

INTRODUCTION

Imagine this—the President of a country in which you do substantial business decides you are a threat to national security. He signs an executive order to shut down your business in 40 days. Now what?

Political risk is commonly considered a risk of doing business in developing countries or emerging markets, but it can happen anywhere—even in the United States, as the popular social media app TikTok recently discovered.

WHAT IS POLITICAL RISK?

Political risk is a company's exposure to the risk of a political event that would diminish the value of the company's investment or loan. Major insurable political risks include:

- Currency Inconvertibility (CI) and Exchange Transfer (FX)
- Confiscation, Expropriation, and Nationalization (CEN)
- Political Violence (PV) or War (including revolution, insurrection, politically motivated civil strife, or terrorism)
- Breach of Contract, Contract Frustration (CF), and Contract Repudiation (CR)
- Wrongful Calling of Guarantee (WCG)

Political risk can sometimes be conflated with economic risk. Economic risk, however, is the chance that macroeconomic conditions such as exchange rates or inflation—not political events—will affect a foreign investment.

CURRENT POLITICAL RISKS (AS OF AUGUST 2020)

According to experts, current potential political risks are varied and include:

- A US-China trade war (affecting foreign exchange volatility and the general health of the global economy)
- International cyber conflict (possibly involving Russia)
- War in the Middle East (possibly involving Iran, Saudi Arabia, or Israel)
- A rise in European populism and protest movements (such as Brexit)
- Mass civil unrest in Chile, France, and Hong Kong
- The COVID-19 pandemic

POLITICAL RISK CLAIMS – CURRENT STATISTICS & TRENDS

A 2019 study—performed by Willis Towers Watson (WTW)—of 41 large major corporations with extensive international operations found that political risk losses were reported from 37 countries. 68% of survey respondents had experienced a political risk loss. 61% believed that political risk had increased since 2018. And 75% had experienced expropriation losses in excess of $250 million.

Expropriation losses were the most catastrophic. Other political risks were more frequent, but smaller, such as sanctions against countries such as Venezuela, Russia, and Iran.

Political Risk Insurance

While 71% of respondents believed political risk was on the increase, fewer than half relied on political risk insurance. Political risk insurance is sometimes perceived as being insufficiently broad, although new and broader types of coverage are evolving rapidly in response to demand.

The WTW study also found that companies that have actually experienced a political risk loss are more likely to have coverage and are more likely to reduce their international presence. Buyers of political risk insurance (PRI) are typically multinational corporations, importers and exporters, project enders, financial institutions, capital markets (the highest users of PRI), foreign investors, and construction and engineering contractors. The countries that are currently most commonly avoided due to perceived political risk include Iran, Venezuela, Libya, Argentina, Russia, and Egypt.

WHO PROVIDES POLITICAL RISK INSURANCE & HOW IS POLITICAL RISK MEASURED?

Political risk insurers can be private (e.g., Lloyds of London) or public. Public insurers are state-backed investment guarantee firms that support government foreign policy and international development goal. They can offer longer, larger, and riskier policies than private insurers.

Companies frequently assess political risk by using a risk premium—that is, they increase the required rate of return for a project by adding a "risk premium" or quantification of the extra return required on the project to mitigate the perceived risk of operating in the country. Some companies, however, consider this approach as too financial and narrow and attempt to assess risk by using a more holistic, qualitative approach.

WHAT TO CONSIDER BEFORE MAKING A POLITICAL RISK CLAIM

Before making a political risk claim, insureds should consider the following:

- Know your policy before you have to use it. Ensure you have appropriate coverage.
- Carefully consider the language of your policy and take an active role in drafting it. There is no standard policy form for political risk policies. U.S. jurisprudence in interpreting policies is extremely limited. The scope of the policy may be dictated exclusively by its language.
- Ensure your policy addresses subtle or incremental forms of government expropriation, such as tax discrimination, denials of permits or licenses, actions by agents other than sovereign governments, or "creeping" expropriation that occurs gradually over a long period of time.
- Contact your insurance company as soon as you note any issues which may warrant filing a claim.
- Anticipate a lengthy review and approval process.

CONCLUSION

While global stability is always desirable, it is increasingly elusive, warranting that prudent U.S. companies seek additional security for their foreign investments. Political risk insurance can add stability to a company's international portfolio.

ACKNOWLEDGMENTS

We would like to thank Nora Ostrofe for providing insight and expertise that greatly assisted this research.

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