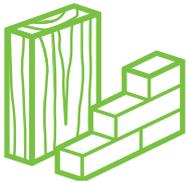
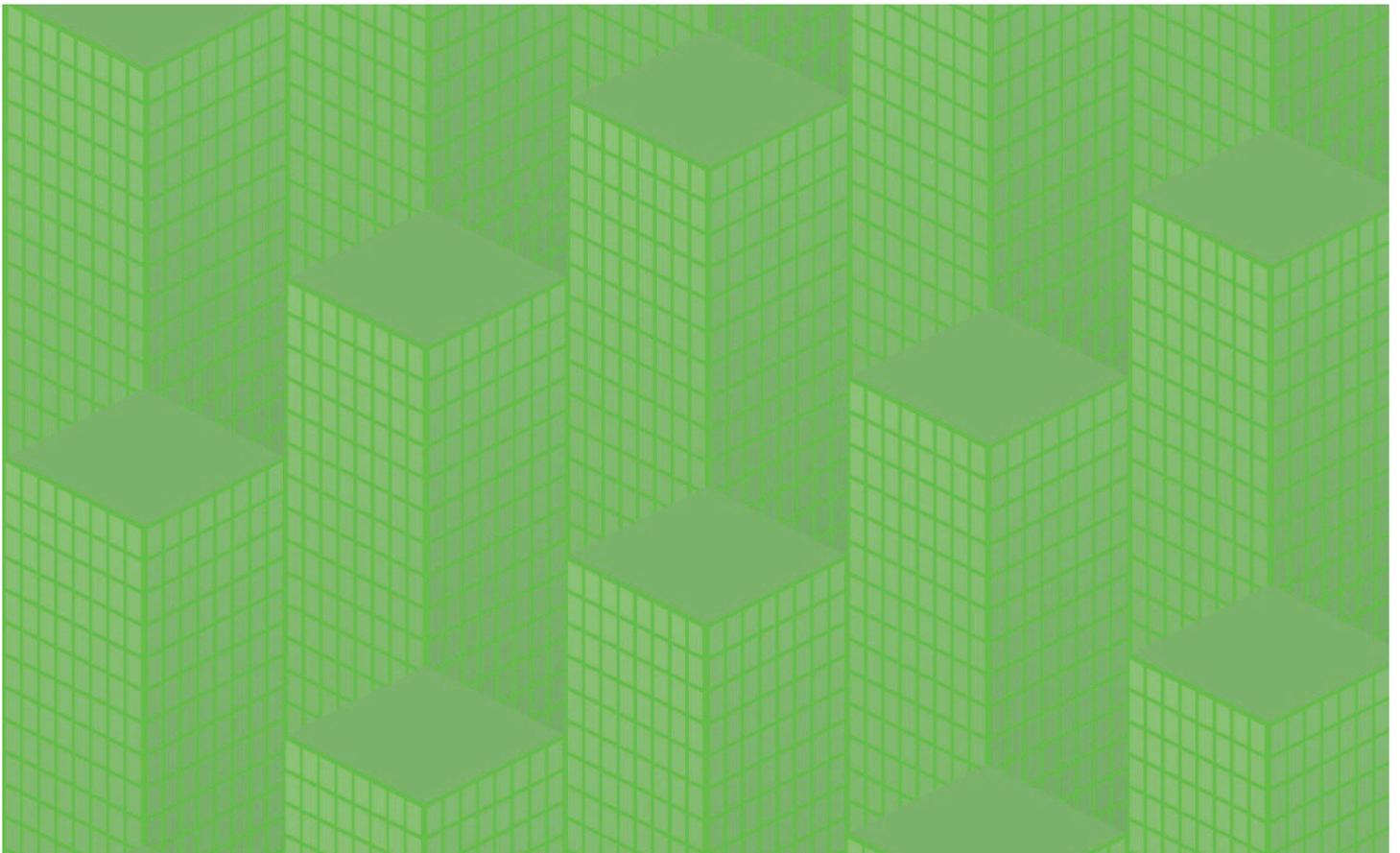


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# Construction insight



**Thrive in growth economies:**  
Part 1: Effective Political Risk Management for  
Construction Projects



## Introduction

This three part *Construction insight* series has been produced to guide and advise international construction firms and financiers, particularly those considering new territories or who are looking to keep pace with trends and opportunities to improve their insurance and risk management programmes:

**Part one:** Effective Political Risk Management

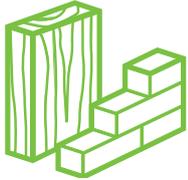
**Part two:** Professional indemnity

**Part three:** Infrastructure and tunnelling in an urban environment

The topics we have chosen created much interest with large Spanish contractors at a seminar organised by March JLT and the JLT Global Construction Practice that was held in Madrid on 29th November 2012, *Successfully Managing International Construction Project Risks*. Delegates at this event were able to meet construction sector and country risk experts and they all agreed that whilst there was growth opportunity in some parts of the world, it was vital to understand the risk environments and the business practices and laws in these different countries so that you can properly control risk and cost.

This is particularly true of some of the emerging or higher growth economies, which present distinct and complex political and environmental risks and where a thorough understanding of the insurance practices, laws and claims trends are vital in achieving a competitive insurance and risk management programme.

We hope that the series of papers helps your understanding in these key areas and that you find the *Construction insight* series useful in your planning. If you have any specific questions about these or other construction insurance and risk issues then please do get in touch.



# Effective Political Risk Management for Construction Projects

The constant demand to find new projects has taken European contractors into some of the world's most politically volatile territories, where they confront the challenges of unpredictable government behaviour, changing fiscal regimes, forcible renegotiation of contracts and political violence. Success in these projects is dependent upon an effective risk management strategy and a granular approach to assessing the risk landscape.

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### Political Violence – Strikes, Riots & Civil Commotion, Terrorism, War & Civil War

Infrastructure assets have not been a major terrorism target to date in light of a preference to undertake more newsworthy attacks on public places that may result in mass casualties. However, there is thought to be an increasing terrorism focus on economic targets and in this respect utilities and transport facilities may present a significant target given the interruption to international trade and the associated economic consequences a focussed terrorist attack could produce.

While terrorism insurance is often a requirement of financing banks, political violence in Thailand in May 2010 and more recently in the Middle East & North Africa, highlights the range of political violence events that can impact a project. A comprehensive approach to mitigating these risks that includes broad political violence perils avoids potential claim issues where there is a lack of clarity over what constitutes war, terrorism and other violence events, such as riots.

#### Case study

*We work with a major power company with billions of dollars' worth of assets around the world. Through a carefully structured global program it was possible for us to secure capacity for several territories unlikely to gain underwriter support on a standalone basis (including assets that have suffered previous attacks). The global programme also provided more comprehensive coverage and achieved significant savings (in the region of 60-90%) versus individual asset specific placements. One notable point is that this was achieved this despite stringent project lender requirements.*

*In our experience global programs deliver consistent coverage across all assets/ territories, leverage buying power, provide greater control of premium expenditure and create informed decision making. Furthermore centralised administration saves time and resource for the insurance department thereby minimising impact on other areas of the operation. It is also important, however, that it addresses local nuance including any government scheme participation.*

### Trading Environment – Country Economic Risk, Currency Inconvertibility & Transfer Risk, Sovereign Credit Risk

The financial crisis has undermined the notion that there are economically 'safe' countries in which to do business. Previously respected sovereigns have seen their credit ratings slashed, while the world's largest banks have been forced to accept government bailouts to survive. From this perspective, the risk profile of some developing markets is perhaps lower than that of their 'developed' counterparts.

When operating in overseas territories contractors face the risk of sovereign and sub-sovereign default and financial non-performance by private counterparties, leaving the contractor at risk of losing further work and amounts owed. When placing non-performance coverage, underwriters will always seek recourse to the end buyer to secure the greatest prospects of recovery, with a sovereign entity generally viewed more favourably than a private counterparty.

As contractors are usually paid in hard currency outside the project country, they are unlikely to be impacted by the imposition of exchange controls restricting transfer of funds outside of the host country or availability of foreign exchange.

## Investment Environment – Expropriation, Contract Agreement Repudiation, Legal & Regulatory Risk

Ensuring equitable reward sharing between project sponsors, the host government and other participants is crucial. A major driver for expropriation and contract agreement repudiation has been perceived inequality in returns when commodity prices rise or tariffs and tolls are increased. One way to address this is to link government royalties to project profitability. Direct government equity participation in projects can also be a risk management tool and may be an alternative to the royalty structure.

Engagement with non-governmental stakeholders can enhance the stability of a project. Many operational non-governmental organisations (NGOs) are more appreciative of the developmental benefits of investing in infrastructure projects and are willing to work with foreign investors. Their local expertise may prevent the project company from inadvertently creating new risks and, for example, in developing local infrastructure can advise on balancing the interests of competing tribes, employing from across ethnic groups and sensitivities to such things as religious and historical sites.

The benefits of working with multilaterals should also be considered. As a preferred sovereign creditor, the World Bank wields considerable influence in the event of contractual disputes and defaults with emerging governments. This influence is reinforced by the World Bank's role as a key source of liquidity when a country is in turmoil.

Dispute resolution mechanisms should also be in place at the time of contract signing. Clarity on law and jurisdiction, dispute resolution and arbitration provisions if dispute resolution fails are important considerations. Recourse under bilateral investment treaties (BITs) may provide a further source of redress if the treaties have been signed and ratified by the respective governments.

In the event of a dispute with a host government or local investment partner, a foreign investor is more likely to receive a favourable hearing outside the project's host state. The most favoured jurisdictions for legal contracts are England & Wales, France and New York. These territories are considered to have robust and impartial legal systems, staffed by highly competent legal practitioners that will consider a dispute without favour.

## Political Risk Insurance

Irrespective of how well structured a project is, there will always be political risks that cannot be managed. Governments change, contracts are renegotiated and acts of political violence can damage assets. These risks can be insured.

Political Risk Insurance (PRI) can insure against loss to foreign lenders, investors and suppliers to construction projects. The private PRI market, comprising of over 40 syndicates and companies and has theoretical capacity for a single project in excess of USD 1 billion. Securing this capacity and agreeing conditions and a competitive price is most successfully achieved by demonstrating clear identification of the underlying perils and appropriate risk management. Political risk underwriters of construction projects pay careful attention to due diligence and do distinguish between the qualities of similar projects in the same territories.

When a project is well structured and the correct PRI coverage purchased, it does act as an effective safety net for your business.

### World Risk Review

The World Risk Review is a strategic decision making tool designed to help corporations, banks and other organisations involved with international trade and investments. It provides a short to medium term assessment of the level of risk associated with a range of political and economic perils that could cause financial loss and is the most comprehensive risk assessment tool of its type. To access the ratings, country reports and insights go to [www.worldriskreview.com](http://www.worldriskreview.com)

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### About the author

Dr. Elizabeth Stephens is Head of Credit & Political Risk Analysis within the Political, Credit & Security team at JLT Specialty Limited. She has played a leading role in the development of JLT's *World Risk Review* - a country ratings tool that provides short to medium-term risk assessments across 197 countries and territories.

Elizabeth received a Ph.D. and MSc. in International relations from the London School of Economics & Political Science and Sussex Academic Press published her book on US policy towards Israel in 2006. She has contributed to numerous articles on political risk and international relations and is a guest Lecturer at the University of Birmingham.

### Resources

For more information on country ratings:  
[www.jltgroup.com/worldriskreview](http://www.jltgroup.com/worldriskreview)

Understanding Credit & Political Risk:  
[http://www.jltgroup.com/content/UK/risk\\_and\\_insurance/brochures/Understanding\\_Credit\\_\\_Political\\_Risk\\_052008.pdf](http://www.jltgroup.com/content/UK/risk_and_insurance/brochures/Understanding_Credit__Political_Risk_052008.pdf)

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## About JLT Specialty

JLT Specialty (JLT) annually place more than £400m of construction insurance premium in the market, which makes us London's leading construction broker and gives us the leverage to negotiate the most competitive rates on our clients' behalf.

Our personnel are responsible for arranging and managing insurance and risk management services for both project-specific and annual construction insurance programmes globally. Of particular benefit to our clients, we have:

- A dedicated Construction Claims Team co-located with the servicing teams
- The lowest staff turnover rate of our peer group, engendering close working relationships throughout the construction phase and into operations
- The only construction team with an integrated specialist Design & Construct Professional Indemnity capability
- A flat senior management structure, ensuring that Board-level contacts are accessible to our clients.

We have extensive experience of designing, placing and managing insurance programmes for some of the worlds' largest and most complex construction projects in the energy, power and utilities, civil engineering, real estate and heavy industry sectors. In recent years these have included more than 350 PPP projects as well as:

- New Doha Port Project, Qatar (USD 6bn contract value)
- Shatin to Central Link, Hong Kong (USD 7bn)
- Ras Laffan C 2730MW Combined Cycle and Desalination Project, Qatar (USD 3.1bn)
- Fehmarnbelt Fixed Link, Denmark/Germany (EUR 7bn)
- Singapore LTA Mass Rapid Transit (USD 10bn+)

Jardine Lloyd Thompson Group plc is listed on the FTSE250 index of the London Stock Exchange and is one of the world's largest risk specialists and employee benefits consultants. Through JLT International Network we are able to provide our clients with services in more than 135 countries.

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