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‘Political risk insurance in Africa – The Sasria Solution’

1. POLITICAL RISKS INSURANCE – BACKGROUND

1.1. Elements of Political and Credit Risk Insurance

Political risk insurance is a type of insurance that can be taken out by businesses, of any size, against political risk—the risk that revolution or other political conditions will result in a loss. In some insurance circles political risk is defined as coverage against financial losses in connection with cross-border trade and investment transactions due to governmental interference. This may include risk that a sovereign host government will unexpectedly change the rules under which businesses operate.

The insurance payout is usually aimed at covering damage to property or other assets (e.g. due to fire), business interruption (standing charges or full loss of profit), and sometimes legal liability. Limits (on cover and territorial scope) and excesses are commonly built into contracts.

Other losses which may be covered include:

- governmental expropriation or confiscation of assets
- governmental frustration or repudiation of contracts
- inconvertibility of foreign currency or the inability to repatriate funds

Losses related to the following are often excluded:

- Ransom
- Nuclear/Biological/Chemical
- Pollution
- Fines and penalties
- Threat or hoax not resulting from the political risk

- Discrimination
- Political threat outside a given radius.
- War

For the purposes of the discussion in this paper, the definition of political risks will include terrorism riots, strikes, and other forms of civil commotion within the country borders that may not necessarily have been caused by the government. As most global economies are maturing into democracies, the risks associated with freedom of expression (i.e. strikes, public disorder, election violence, food riots, government policy protests) become imminent. Therefore providing insurance and reinsurance for individuals and corporates against such perils becomes imperative. This paper will discuss political risks in that context.

Foreign creditors to any country face various credit risks which are directly or indirectly related to political risks. Sudden changes in legislation, outbreaks of war, unexpected political violence, and such events may render debtors (individuals or corporate) incapable of servicing their debts. As a result of these risks, credit risks insurance was designed specifically to cover losses resulting from political events.

Many international companies see this type of credit risk as a must when doing business with emerging market countries. For example, if an international company or institution invests money in a project in Africa, they may need assurance that they will receive their money back if political events cause project failure. Credit risk insurance may be used to protect the company. Protection against default for non-political reasons may or may not be covered under such policies. Appendix country risk rating (business climate and country rating):

1.2. Characteristics of Political Risks

Events of a political nature are generally infrequent and often unpredictable. However a single event may result in particularly large insurance losses. As a result, many political perils (e.g. terrorism) are classified as catastrophic risks and underwriting these risks usually requires large amounts of capital.

A common feature of political risks is clustering, where similar (and often coordinated) events may occur in different locations in the same time period. An example is the simultaneous food riots in Africa, Asia and Americas in the 2008 recession period.

Geographical accumulations are usually of key importance when analyzing political risks (as is the case with other catastrophic risks). As a result, major commercial centres (major shopping and entertainment centres, mines, oil refineries, etc.) are usually areas of greatest interest when analyzing risk exposure.

1.3. Political Risks – World Events and Impact

The most notable event of recent times is the 9/11 attacks on the World Trade Centre and the Pentagon. Insurance losses related to these attacks amounted to US\$32.5bn. The main sources of loss were in the Business Interruption, Property Damage, and Liability.

Other recent events of note include:

- 2004 Madrid train bombings
- 2006 Mumbai train bombings
- 2008 Taj Mahal bombings
- 2005 civil unrest in France (damage estimated at over US\$200m)
- The 2008 food protests in Haiti
- 2007 Mexico's Tortilla crisis

1.4. Political Risks – Africa

Africa has not been immune to acts of terrorism and riots. In South Africa we have had numerous cases where angry commuters have set fire on trains and even train stations, leading to huge insurance losses.

African events of note include:

- 2007 election riots in Kenya
- 2007 Algeria bombings
- 2008 US Embassy bombings in Kenya
- 2009 seizure of Meikles Africa by the Zimbabwean government
- November 2007 poverty related riots in Senegal

1.5. Impact on Economies

Political risks have far reaching economic and social impact worldwide. Political risk can impact on number of key economic activities with a country including:

- Stock market
- Economic growth
- Consumer confidence
- Foreign direct investment

The destruction of the physical assets was estimated in the US national accounts to amount US\$14 billion for private businesses and 1.5 billion for State and local government.

Political risk may alter operating cash flows via discriminatory regulations as well as the investment via expropriation.

2. GLOBAL PERSPECTIVE ON POLITICAL RISK (RE) INSURANCE

2.1. The World's Response To Political Risk

Due to various political (and sometimes non-political) events, various countries decided to set up risk pools to insure political risks for local companies and individuals. The figure below shows a number of insurance pools that have been set up over the years.

Following the 9/11 bombings most governments in developed markets took over the covering of political and terrorism risk. Australia's terrorism insurance scheme commenced on 1 July 2003. It applies to insurance for commercial property in Australia and associated business interruption losses and public liability claims. The scheme provides cover for terrorism risks through a number of layers. The first main layer of cover is provided by a monetary pool (which was initially planned to accumulate to \$300 million), funded by reinsurance premiums. The pool is supplemented by a line of credit of \$1 billion, which is underwritten by the Government, after which the Government has provided a \$9 billion indemnity.

Government terrorism programs exist in 8 of the Organisation for Economic Co-operation and Development OECD countries – Australia, Austria, France (GAREAT), Germany (Extremus), Netherlands, Spain, UK and the US (TRIA). All have mandatory deductible limit at the lowest risk level, coinsurance at middle risk level, and full coverage at highest tier. All these pools were established post-9/11 except:

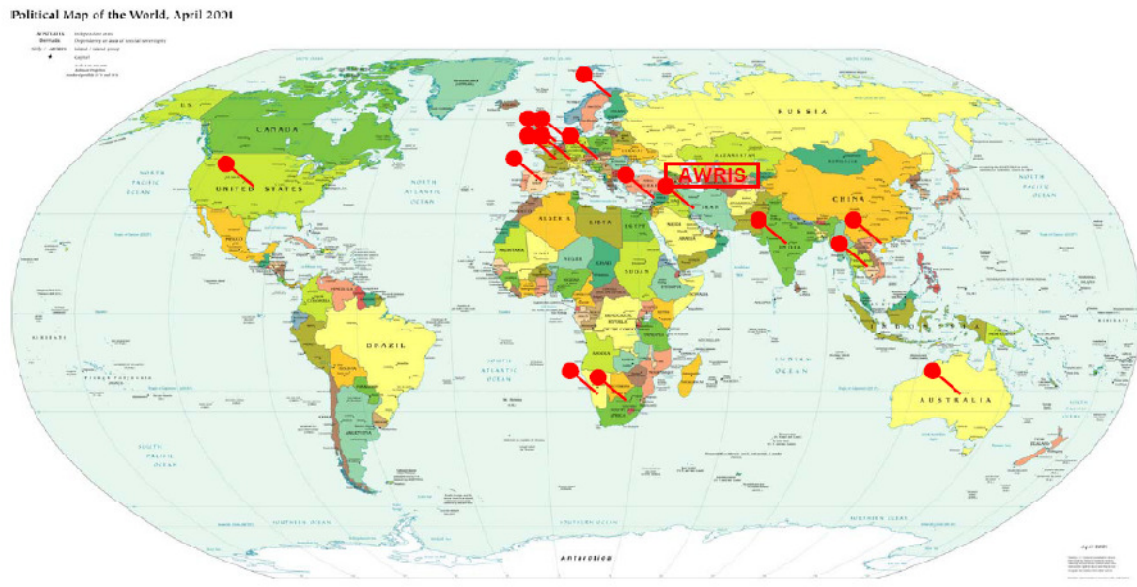
- Spain where terrorism is covered by Consorcio de Compensacion' de Seguros (CCS)
- In UK where Pool Re was created in 1993 in response to IRA terrorism.

The table below summarises some of the pre-2002 pools:

1941	Consorcio (Spain)
1961	PTCF (Israel)
1979	SASRIA (South Africa)
1981	AWRIS
1993	Pool Re (UK)
2002	FTIP (US – set up under TRIA)

Source: Hannover Re

The figure below shows the various pools that are now in operation across the world:



Source: Hannover Re

The purpose of these pools is to provide the respective insurance markets with capacity to carry political risks (especially terrorism risks). These pools are generally funded by governments with the insurance industry playing underwriting roles. In some cases, these pools have government guarantees.

In addition to risk pools, there are insurance and reinsurance companies around the world which now underwrite political risks. According to a Marsh Report (January 2009), the current worldwide terrorism risk is just under US\$3.1bn. Even more capacity exists in the international markets for other subsets of political risk.

It therefore seems that the world has sufficient capacity to carry political risk. However, as we shall see below, this capacity is not easily accessible to some markets.

2.2. The African Market

As many economies in Africa have continued to develop at a high pace, insurance and reinsurance markets have become well established. There are also a number of insurance companies who underwrite political risks.

Companies on the African continent are aware of the need for political risks insurance and reinsurance. There is vast demand for this type of product but to date supply has been limited.

Those companies which have the necessary international affiliations typically place political risks on the London market through brokers. Capacity among African insurers and reinsurers is still very limited.

For those who manage to obtain cover from the London and other markets, it is provided at very high rates. Research has shown that insurance rates for political risks in the developing world are on average three times higher than in the developed economies. This is partly due to the lack of supply and the often incorrect perception that all African countries have a high risk profile.

Many companies and private individuals have no access to political risk insurance. Even for those companies who manage to place their risks on foreign market, difficulties in communication make business difficult. Slow responses to queries, late renewals, and slow claim settlements are not unheard of.

3. AFRICA'S INSURANCE AND REINSURANCE NEEDS IN THE CONTEXT OF POLITICAL RISKS

Increased availability of political risks insurance in a territory will allow businesses to be more confident about doing business in that territory. This will result in improved economic activity in that territory. This principle applies especially to Africa, which is generally perceived to be a poor political risk.

I believe that there is a need for capacity to be created in Africa to carry political risks. This will result in better access to insurance, particularly for those clients who do not have international affiliations.

In addition to the need to build capacity, there is also a need to build expertise in political risks insurance. This may be achieved through investment in the development of local talent and in action aimed at sharing knowledge and experience between different countries.

Locally based insurers and reinsurers will have a clearer view on the risks faced by local companies. This will lead to improved underwriting and better rates for clients in low risk territories. There will also be greater scope to tailor products to the needs of unique clients.

Carrying some of the risk locally will probably result in lower administration costs and this may translate into better rates.

There will always be a need to place some of Africa's political risks in international markets. Where this is done, there is a need for increased negotiating power in order to secure better rates for our clients.

Political risks will remain a common feature in emerging democracies especially in the face of economic recession where there is huge disparity between the rich and poor nations. If Africa pools its political risks it will be able to create internal diversification within the continent.

4. THE SASRIA SOLUTION

4.1. Background

Sasria is political risk insurer within South Africa. Sasria Limited was established in 1979 in terms of Section 21 of the Companies Act, necessitated by the political unrest of 1976 and subsequent years, at which point there existed no insurance protection for the perils of riots from political activity.

It was a product of a series of meetings between the Government of the Republic of South Africa at the time and the short-term insurance industry (under the auspices of the South African Insurance Association), which culminated in agreement that Government would henceforth act as the reinsurer of last resort for special risks as defined in the Material Damages and Losses Act. Sasria was then consequently incorporated to provide such cover on a non-refusal and non-cancellable basis to all sections of the community.

Over the years, this mandate has been extended to cover damage caused by non-political riot, public disorder (including labour disturbances, civil unrest, strikes and lockouts) and loss in respect of mortgage loans as well as terrorism. Sasria Limited derives its premiums in the form of tariffs which represent a small percentage of

premiums paid to conventional insurers. Sasria does not underwrite any of its cover but relies on a network of insurers who act as agents to it.

Indeed, much has transpired since Sasria Limited was incorporated. The single most significant change in this regard relates to the democratisation of South Africa following the 1994 dispensation, with its numerous spinoffs – South Africa is now a major role player on the African continent and internationally, exposing the country to both negative and positive aspects of globalisation.

Sasria vision, mission and values are as follows:

Vision:

“To be the leading African insurer for extraordinary risks”

Sasria believes that symbiotic relationship with the following stakeholders will be key to attaining its strategic objectives:

- South African government
- South African Insurance industry
- Relationship with insurers and reinsurers both on the regionally and internationally

4.2. What We Do – Product Offering

Perils Insured by Sasria in Terms of the Reinsurance of Material Damages and Losses Act No.56 of 1989 are:

- I. any act (whether on behalf of any organisation, body or person, or group of persons) calculated or directed to overthrow or influence any State or government, or any provincial, local or tribal authority with force, or by means of fear, terrorism or violence;
- II. any act which is calculated or directed to bring about loss or damage in order to further any political aim, objective or cause, or to bring about any social or economic change, or in protest against any State or government, or any provincial, local or tribal authority, or for the purpose of inspiring fear in the public, or any section thereof;

- III. any riot, strike or public disorder; or any act or activity which is calculated or directed to bring about a riot, strike or public disorder;
- IV. any attempt to perform any act referred to in clause (i), (ii) or (iii) above;
- V. the act of any lawfully established authority in controlling, preventing, suppressing or in any other way dealing with any occurrence referred to in clause (i), (ii), (iii) or (iv) above.
- VI. Sasria operates through a network of short-term insurers (agent companies and brokers)

4.3. Credentials

4.3.1. Africa's First Political Risk Insurer

Sasria is the pioneer of political risk insurance in Africa and has been in existence for 30 years. Due to the growing scourge of terrorism, most political risk pools around the world are modelled on Sasria.

4.3.2. Proven Business Model

Sasria's monopoly is legislated in the following Acts:

- The Reinsurance of Damages and Losses Act, No. 56 of 1989, as amended by
- the Reinsurance of Material Damage and Losses amendment Act, No 65 of 1990, and
- Conversion of Sasria Act No.134 of 1998

The Reinsurance of Damages and Losses Act No. 56 of 1989 defines the perils that Sasria may underwrite and further restricts other insurers from providing the cover for those perils.

Sasria was converted into a public company in 1998 through the Conversion of Sasria Act. The purpose Conversion of Sasria Act No. 134 of 1998 is amongst others to ensure the orderly restructuring of the State's role in the short-term insurance industry as

regards to special risks and to reduce the State's risk exposure. This Act further confirms that the Government conferred monopoly status on Sasria by allowing it to be the sole supplier of insurance cover for special risks in the Republic.

Sasria works through a network of agent companies (short-term insurers) who distribute the Sasria coupon on Sasria's behalf. Brokers work on behalf of agent companies. Policy holder (business and personal lines) can get cover via a broker or directly through an agent company. Currently Sasria business model does not allow it to deal directly with policy holders. The agent is the most significant part of the Sasria business equation.

In the event of a claim, a policy holder can lodge a claim via either a broker or an agent company. The agent companies assess and submit the claim to Sasria on behalf of the client. Sasria assesses and makes the decision either to pay or decline a claim. Sasria strives to avoid litigations of claims and therefore adopt a transparent and fair settlement of claims.

4.3.3. Self Sufficient

Since its formation in 1979, Sasria has been self sustainable, with neither the government or insurance industry being called in to inject additional capital. By 1998, at the implementation of Sasria Conversation Act, Sasria had accumulated over R12 billion (US\$1.6bn) in reserves which have since been declared to the South African government (the shareholder). The company is one of the few most profitable public entities. As a result the South African government views Sasria as a strategic asset.

4.3.4. Affordable Premiums

Sasria Limited rating has followed the initial intentions of being affordable to the citizens of South Africa. Sasria Limited premium rates are significantly low as compared to other insurance industry companies covering the same perils. In India, for industrial and non-industrial establishments a rate of 0.13% and 0.22% of sum insured is applied respectively. On the contrary Sasria fire rate is 0.0144% (Refer to Sasria Rate Schedule below in Figure 1). The Lloyd's are under the impression that the Underwriters will be selective in covering properties and might definitely increase their rates they are

charging at the moment, due to the perceived risk. The treasury government of Australia use's the Tier rates which range from 2% to a maximum of 36%.

Sasria does not cancel or refuse to cover to a person or company who wants to insure their property with Sasria for the perils covered by Sasria on the basis of risk profile. Most insurance companies tend to give notice of policy cancellation if political risks recur. Sasria does not cancel client policy regardless of the eminent unfavourable political environment or a prevailing periods of unrest.. Figure 1 shows Sasria Rates Schedule:

Sasria Rate Schedule as September 2009

<i>Product/ Class</i>	<i>Annual Rate on sum insured</i>	<i>Annual premium</i>
Motor: Cars (domestic/ private)		R20 (US\$2.50)
Goods vehicles		R45 (US\$5.63)
Large taxis		R45 (US\$5.63)
Motor ferries & traders	0.0086%	
Buses	0.50%	
Contract works/ Plant	0.0072%	
Standing charges	0.0007% - 0.0036%	
Material damage: Fire Commercial	0.044%	
Domestic Fire	0.0038%	
Goods in Transit and Marine	0.0012% - 0.0144%	

Figure 1 NB: The exchange rate of US\$1 = R8. This table is for illustrative purpose.

4.4. Case Study – South Africa

4.4.1. Pre 1994 Claims

Prior to 1994, the bulk of the claims that were handled by Sasria agent companies on behalf of Sasria were mostly politically motivated. The South African political climate during 1976 and 1994 is summarized below:

June 1976	The township of Soweto riots; mass opposition to apartheid begins.
August 20, 1983	The United Democratic Front – a coalition of trade unions, women's groups, and youth organizations – is established.
September 1984	Riots in Vaal Triangle; beginning of township rebellion.
July 21, 1985	The first state of emergency is imposed.
June 12, 1986	The second state of emergency is imposed; thousands are arrested.
October 1989	The government begins releasing imprisoned leaders of the African National Congress (ANC).
February 11, 1990	After 27 years in prison, black leader Nelson Mandela is released.
August 26-29, 1994	South Africans vote in fair and free elections; the ANC government is voted into power.

Figure 2: Source <http://www.aforcemorepowerful.org/films/afmp/stories/southAfrica.php#timeline>

The losses that occurred in the 1980's and the 1990's started to decrease prior to the CODESA negotiations in number and severity due to the engagements that were taking place between the government and all the political parties that took part. During the era

prior to the elections in 1994, the claims department was immersed with claims where people saw any government and white owned property being targeted as items of showing defiance and frustration.

4.4.2 Post 1994 Risks

Following the 1994 democratic elections, the air of change in the country was that of hope, freedom and a sense of belonging to a country where one knows that they are acknowledged, and they have rights recognized by the state and entrenched in the Bill of Rights and the Constitution of the country.

Although the change brought some relief on politically motivated claims, Sasria Limited has seen a change in perils where the claims occur. With people feeling empowered claims as a result of strikes, labour unrest and public unrest are growing and this is less of the claims that we are yet to see which relate to terrorism. So far we have only settled one claim that may be linked to a terrorist attack which took place in Cape Town at the Planet Hollywood restaurant in August 1998. The under-mentioned table is the breakdown of where current Sasria claims emanate from:

Claims classification as at October 2008

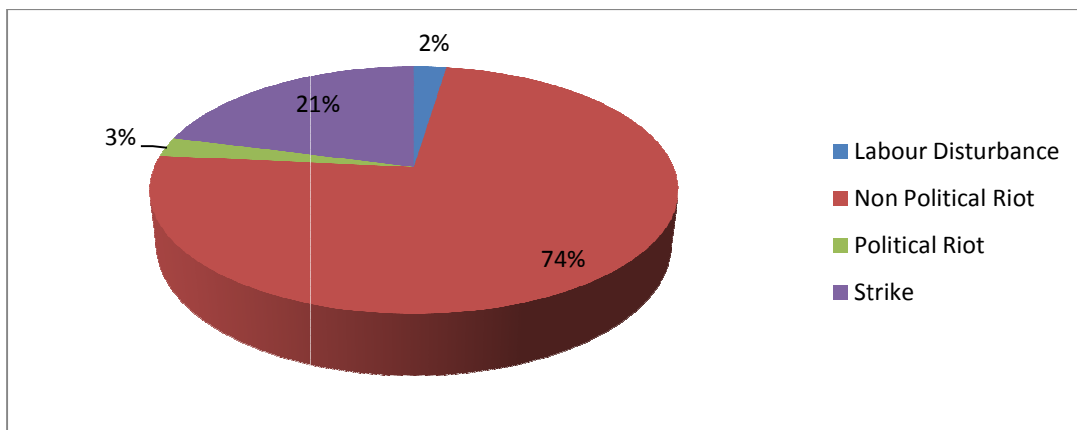


Figure 3: Sasria 2009

Figure 2 identifies non-political riot as the greatest source of Sasria claims in the new South Africa. Most of the prominent non-political riots claims over R10 million came from property damages, xenophobia, public disorder (train set alight) and bus driver's strikes:

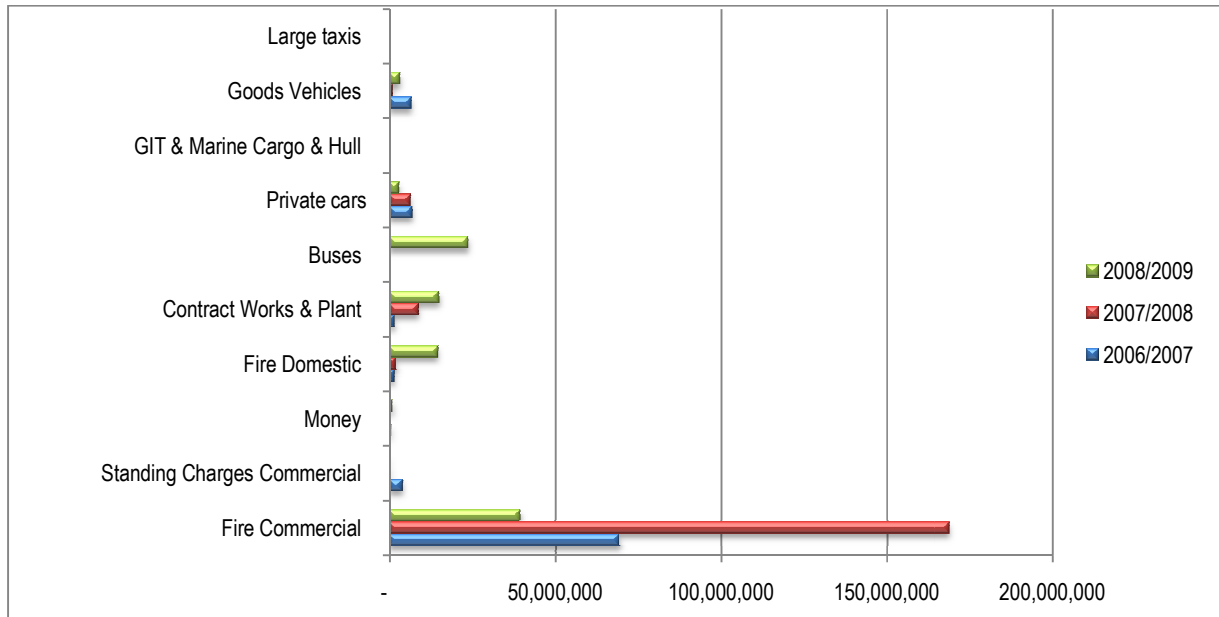


Figure 4: Claims per Class of business

From Figure 4, Sasria claims in recent years are mainly related to fire commercial. Buses and contract works related claims also were higher in 2008 in comparison to other previous years.

4.4.2. Events Specific Covers

South Africa has successfully hosted many international events such as Elections, Rugby world Cup 95', Africa Cup of Nations 96', IPL and the upcoming 2010 world Cup. On all these events Sasria ensured that all political risk needs for both corporate and individuals were covered at the time of each event.

5. SASRIA'S AFRICAN POLITICAL RISKS SOLUTION

5.1. Overview

Our strong solvency levels have allowed us to increase capacity offered to the South African market through enhancement of products, including introduction of higher limits. I believe that this capital strength enables us to extend our cover beyond the borders of South Africa. This will assist in meeting the need for capacity to be created in Africa.

As it shall be seen below, the solution that we are proposing will also involve local reinsurers. Our vision is that in the long term expertise and capacity be built within each market to cover political risks, but the work has to start now.

5.2. Our proposal – Option 1

Our first recommendation is that of Sasria working with governments, the insurance and reinsurance industries to create political risks pools modelled after SASRIA in individual countries.

The business model recommended under this option is given in Appendix 1. The model may be summarised as follows:

- The government should set up a Risk Pool which will be a registered company covering political risks.
- Insurance companies may then underwrite political risks and cede them to the risk pool. The risk pool may then cede some of the risks with local reinsurers up to the level that they are willing to accept given their capital levels and risk appetite
- Risks not carried locally may then be reinsured by Sasria
- As local capacity increases, the need to reinsure some of the risks with Sasria may decrease
- Because of its expertise and experience, Sasria will provide advice and other necessary assistance to the appointed Administrator of the Risk Pool. Advice may be provided on (among others):
 - Underwriting and rating
 - IT systems requirements
 - Staff requirements

- Financial modelling and other actuarial services

The following are the main requirements for such an arrangement to be successful:

- Buy-in from government and the insurance and reinsurance industries
- Government may need to pass an Act outlining the powers and obligations of the Risk Pool

5.3. Our proposal – Option 2

As it can be seen, Option 1 has the potential to be administratively onerous. Option 2 may apply where for certain reasons Option 1 is not possible.

In such a case, we suggest that individual reinsurance companies set up a Risk Pool on their own. The Risk Pool together with Sasria which will then operate as an ordinary insurance company specialising in political risks. The reinsurer (holding company) may then reinsure some of the risks carried by the Risk Pool and cede the rest to Sasria. Again Sasria will provide advice on setting up the Risk Pool.

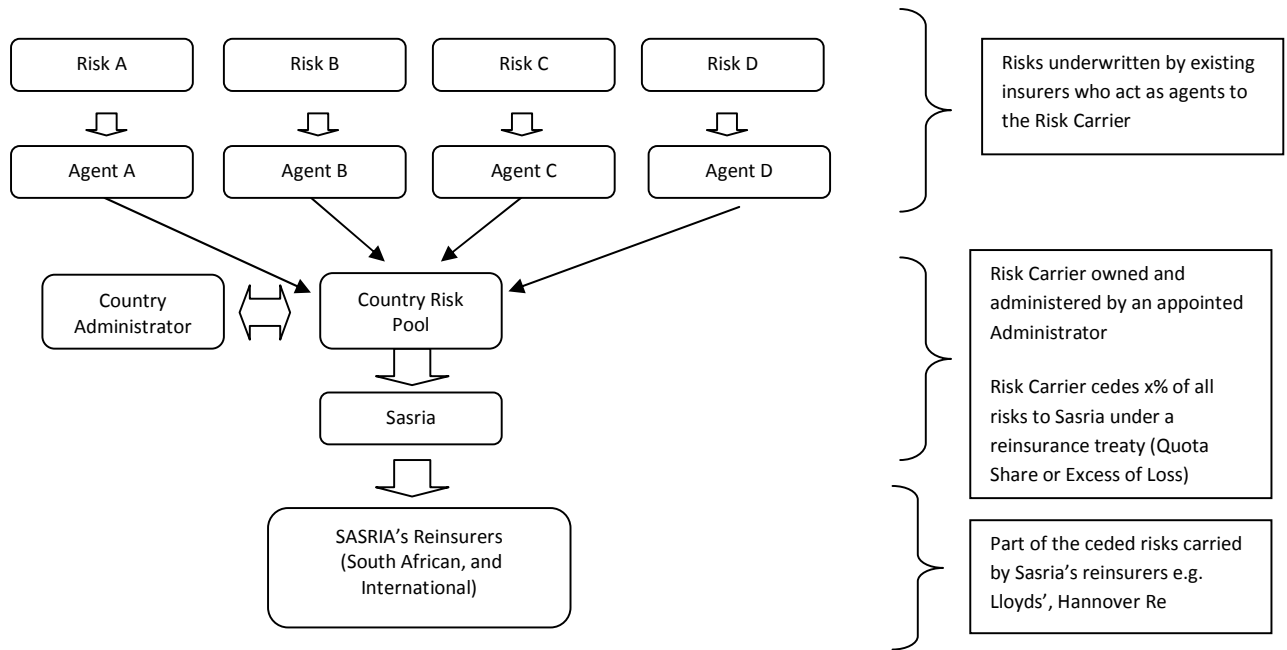
Outside such pools Sasria can provide reinsurance capacity to individual companies who wish to provide such cover to all their clients and incorporate it in their wording. This would ensure that there will be no selection. This option of course will also be dependent on the extent at which the market within a specific country is willing to participate which will guarantee volumes and thus lower premiums in the long run.

Sasria is open to talk to any country or organisation that would like to have this cover in place. Our team will be on standby for any discussions.

Thanks You

Appendix1

Sasria Political Risk proposed Reinsurance Pool Model



Appendix 2

Political Risk Rating for African Countries

According to Coface Rating Agency (2009), the following scale was used to rate African countries political risks:

A1	The political and economic situation is very good. A quality business environment has a positive influence on corporate payment behavior. Corporate default probability is very low on average.
A2	The political and economic situation is good. A basically stable and efficient business environment nonetheless leaves room for improvement. Corporate default probability is low on average.
A3	Changes in generally good but somewhat volatile political and economic environment can affect corporate payment behavior. A basically secure business environment can nonetheless give rise to occasional difficulties for companies. Corporate default probability is quite acceptable on average.
A4	A somewhat shaky political and economic outlook and a relatively volatile business environment can affect corporate payment behavior. Corporate default probability is still acceptable on average.
B	Political and economic uncertainties and an occasionally difficult business environment can affect corporate payment behavior. Corporate default probability is appreciable.
C	A very uncertain political and economic outlook and a business environment with many troublesome weaknesses can have a significant impact on corporate payment behavior. Corporate default probability is high.
D	A high-risk political and economic situation and an often very difficult business environment can have a very significant impact on corporate payment behavior. Corporate default probability is very high.

Table 4: Political Risk Rating for African Countries

12.3 African countries rating

The following table shows all African countries from scale of A1 – D

AFRICA	Business Climate Rating	Country @Rating
Botswana	A3	A2
Mauritius	A3	A3
Namibia	A4	A3
South Africa	A3	A3
Morocco	A4	A4
Benin	C	B
Cape Verde	B	B
Gabon	C	B
Lesotho	C	B
Mali	C	B
Mozambique	D	B
Senegal	B	B
Tanzania	D	B
Angola	D	C
Burkina Faso	C	C
Cameroon	C	C
Congo	D	C
Djibouti	D	C
Ethiopia	D	C
Ghana	C	C
Kenya	C	C
Mali	C	C
Mauritania	C	C
Niger	D	C
Sao Tome	D	C
Togo	D	C
Uganda	C	C
Zambia	C	C
Burundi	D	D
Central African Rep.	D	D
Chad	D	D
DRC Dem. Rep. of the Congo	D	D
Equatorial Guinea	D	D
Guinea	D	D
Guinea Bissau	D	D
Ivory Coast	C	D
Liberia	D	D

Malawi	D	D
Nigeria	D	D
Rwanda	D	D
Sierra Leone	D	D
Sudan	D	D
Zimbabwe	D	D

Table 5: Political Risk Rating for African Countries