INPUT PAPER
NO. 2

STOCKHOLM INSTITUTE OF TRANSITION ECONOMICS

SCEEUS STOCKHOLM CENTRE FOR EASTERN EUROPEAN STUDIES

Stockholm Conference on Private Sector Engagement in Ukraine's Recovery and Reconstruction

Ukraine War Facility Update

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The Phases of Disasters

In reflecting on Russia's war on Ukraine, special attention should be given to the risk, along with the possible and available risk transfer mechanisms concerning warfare. Much like other catastrophes, the risk of war follows similar phases of rehabilitation and recovery. However, unlike natural catastrophes, which typically occur within a short timeframe and are immediately followed by an emergency relief process, the risk of war involves an ongoing event where relief efforts are conducted even as the conflict persists.

Given the lengthy and constantly changing dynamics of war, only a specialized niche market is capable of providing various lines of insurance business, conditioned by the degree of tension between the conflicting parties. As the risk appetite corresponds with the actual war situation and the losses incurred, the result can be high volatility up to a total withdrawal of capacity.

Due to a gap in reinsurance capacity, the insurance market provides war insurance on a more opportunistic and selective basis, essentially on a net basis. However, with a ceasefire and the termination of war, the commercial specialty market for political risk will be the first to resume its capacity. As soon as the market stabilizes, leading composite reinsurers will follow suit and equip the market with full capacity.

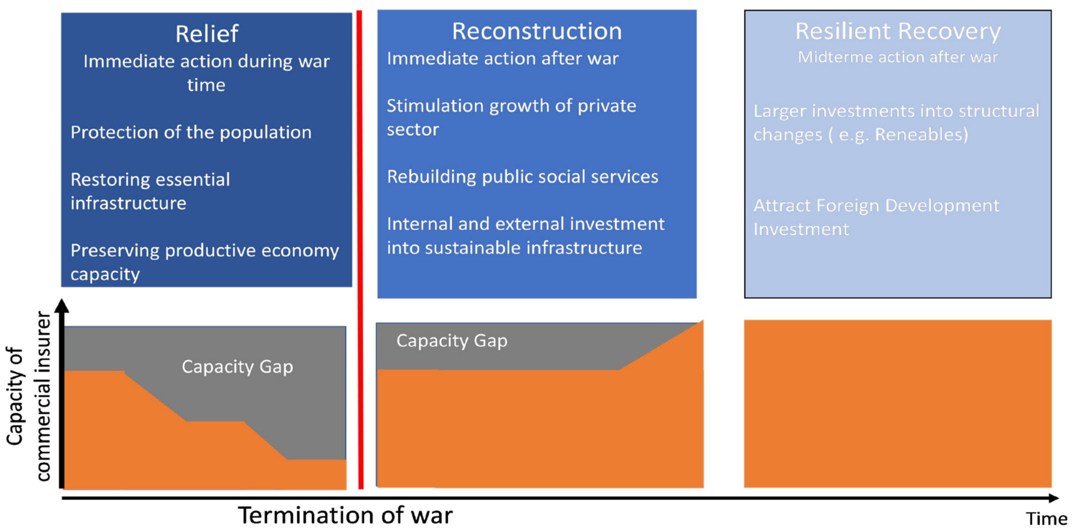

Figure 1. *Phases of war rehabilitation and commercial insurance capacity provision.*

Political Violence Insurance

When examining the political risk and war insurance market, it's important to note that the landscape underwent a significant transformation following the 9/11 terrorism act. In response to the massive losses and the ever-present threat of terrorist attacks, many countries established national terrorism pools, backed by governmental guarantees, to provide insurance against losses and damages due to the following risks:

- Terrorism;
- Sabotage;
- Riots and/or Strikes and/or civil Commotions;
- Malicious Damage;
- Insurrection, Revolution and Rebellion;
- Mutiny and/or Coup d'Etat;

Generally, the risk of war was excluded from the available political violence insurance, except in the case of the Spanish and Israeli pools. Concurrently with the development of governmental insurance pools, a private market focused on terrorism risk (Specialty market) also emerged.

Israel (established 1941)	Spain (established 1941- Recovery after Spanish civil war)
Objective	**Objective**
Compensation for losses caused by war and terrorism act	Compensation for losses caused by extraordinary risks: Nat-Cat events, armed forces, Terror acts, strikes
Key coverages:	**Key coverages:**
✓ Property damage	✓ Property damage
✓ Business interruption	✓ Business interruption
Territory	**Territory**
✓ Domestic	✓ Domestic
✓ International is offered by certain properties	✓ international is offered by certain properties
Capacity	**Capacity**
Pure public paid out of the national compensation fund	Unlimited state guarantee- no reinsurance in place so far
Network infrastructure	**Network infrastructure**
✓ Mainly insurance market	✓ Insurance market

Figure 2. *Profile of existing war pools.*

The coverage of these pools is primarily domestic, although certain properties can be insured internationally against damages due to acts of war and terrorism. Special attention is here given to the Israeli War Pool, which was tested during the Second Lebanon War in 2006. According to available statistics, a large portion of claims were related to indirect losses, including business interruption for small and medium-sized enterprises (SMEs), as well as losses in agriculture and tourism sectors.

Applying the experience of the Israeli War Pool to the Ukrainian economy, we anticipate that the demand for protection against war-related agricultural losses could be substantial. Both the Israeli and Ukrainian war pools utilize the commercial insurance market infrastructure to disseminate and administer their war insurance policies.

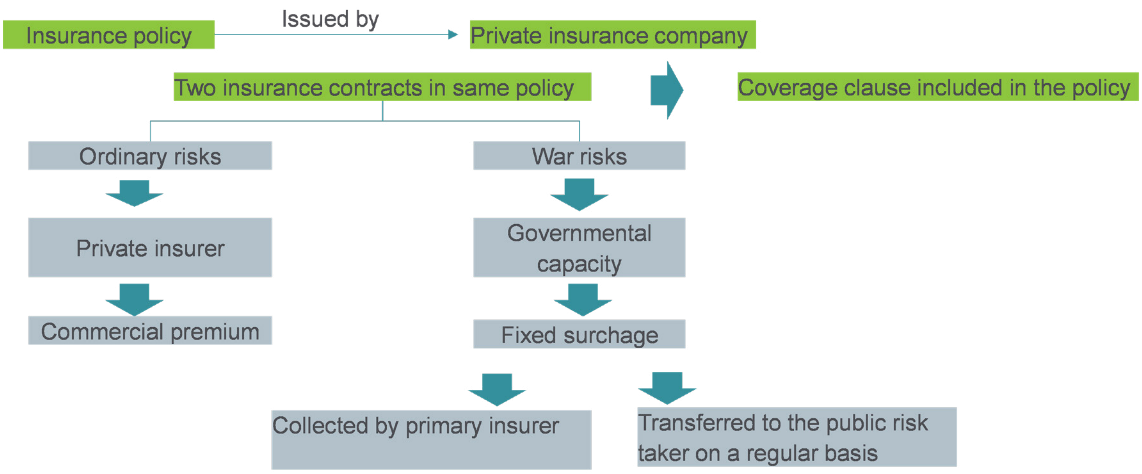

Figure 3. *War insurance as complementary cover.*

While the commercial market offers standard coverage under a single policy, war insurance is provided through a separate policy. On behalf of the public capacity provider, the insurer collects premiums and manages claims. For these services, the insurer is compensated by the government through a service fee.

Political Risk insurance

This type of insurance is designed to protect equity investors against the risks of Expropriation, Currency Inconvertibility, War and Civil Disturbance, and Breach of Contract. In addition, lenders can protect against the risk of non-honoring of sovereign obligations. The insurance is mainly offered by companies that, by mandate, have indirect or direct political influence on governmental representatives of the host country (Multilateral, ECA).

The insurers' potential for diplomatic and political intervention is considered a risk-mitigating component with respect to potential losses. For instance, as a member of the World Bank Group, the Multilateral Investment Guarantee Agency (MIGA) utilizes its relationship with shareholder governments to provide political risk insurance in developing and emerging markets. MIGA's capacity is additionally supported by the reinsurance market.

Marine War and Strike

For sea and airborne transport (cargo) as well as hull insurance, the marine market offers dedicated coverage against the risks of war and strike. Coverage and pricing are provided separately for each route. It's worth noting that these types of coverage include a 7-day cancellation clause, giving the insurer the right to cancel the coverage within 7 days if the war situation deteriorates.

Overview of the Speciality Insurance Market and the Impact of the Ukraine War

The specialty insurance market, especially in areas of aviation war, marine war, and political violence (PV), is expected to face more challenging renewal conditions as reinsurers and consequently insurers adjust their portfolios in response to substantial losses from the Ukraine war. Global businesses face a significant increase in the cost of insurance for political violence and war risks (PV), following a gamble by some insurers that the war on Ukraine would end by the close of 2022.

So far, the market anticipates PV losses of up to USD 1-2 billion. These expected losses have placed additional strain on the niche reinsurance market for PV capacity. Given that Lloyd's is the primary capacity provider for this market, losses are predominantly concentrated on the London market.

For the January 1st renewal period, it has been reported that reinsurers began withdrawing their capacity, which had a significant impact on the PV market.

The Marine Market

The London Market has emerged as the primary capacity provider for sea and airborne shipments concerning war risks. Apart from a few opportunistic insurers providing 'innocent' capacity, the market seems to be extremely cautious, supporting these high-risk categories by only insuring small risk cessions. In addition, under the management of Marsh and led by Ascot, a pool of twenty London insurers began to provide capacity exclusively for grain shipments. However, past experiences have shown that these facilities' capacities cannot be regarded as a reliable standby since they have been withdrawn several times due to escalating political tensions between conflicted parties.

The dynamic nature of war leaves the market riddled with extreme uncertainties. The withdrawal of stable commercial (re)insurance capacity has created a capacity gap and opened doors for opportunistic actors.

"To restore a resilient market and close this capacity gap, a dedicated and robust provision of war cover for the Black and Azov Sea is needed," as quoted by the London Market.

We can rely on prudent underwriting, as insurers are still willing to support this market with small shares on a net basis.

Political Violence Protection

When considering insurance for local assets against war damage, the reinsurance market withdrew its capacity with the January 1st renewal. The existing facilities, led by the major brokers who underwrite 50%-60% of the market, faced close scrutiny following low single-digit billion losses in Ukraine, with some expecting them to unravel entirely by January 1st. According to recent news, the majority of reinsurers have withdrawn their capacity—at least for conflict-prone areas like Ukraine. Given the limited available capacity of primary insurers providing on a net basis, it is expected that the market may not be functional from January 1st onwards.

As per general market practice, the insurance of political risk for inland transit and movable goods falls under Political Violence (PV). So far, inland transit insurance is only available on a named perils basis, excluding both indirect and direct losses due to acts of war and strike. However, with the Ukraine war, new issues have emerged, as it has become increasingly challenging to differentiate between "indirect war losses" and "non-war losses" (for example, overturning of a vehicle due to a road destroyed by war bombs). This ambiguity leaves considerable room for interpretation and the withdrawal of standard inland transit capacity.

To address this issue and the existing coverage gap, a complementary war insurance for movable and stored goods (which is commercially unavailable) is being requested. A dedicated capacity provision should be considered for insuring essential infrastructure, up until final arrival at the consignee in Ukraine. In doing so, we should equip the local insurance market with a suitable reinsurance capacity candidate to ensure proper provision of inland transit and storage insurance, in alignment with national insurance regulations.

Credit/Political Risk/Investment Insurance

While there hasn't been a formal withdrawal of public insurers (such as ECAs) from covering risks associated with Ukraine, informal sources suggest their current activity is very limited.

MIGA recently provided cover for the Austrian Raiffeisen Bank and has established a 30 million USD fund, though it's unclear whether this fund is currently in use. The German investment insurance scheme has also recently announced successful coverage of a German investment in Ukraine, which included war cover.

In terms of public credit insurance, we currently don't see coverage for imports to Ukraine. Emergency goods, like power generators, might be sold under EU or US programs where credit risk is not a major concern.

Furthermore, we lack information on whether private insurers are still actively covering Ukrainian risks. It is highly likely that private reinsurers have withdrawn their capacity, which typically leads to the withdrawal of capacity by primary insurers as well.

Summary of the Addressed Demand Regarding Ukraine War Insurance

Reflecting the feedback from market representatives and the experience of the Israeli war pool, the protection of the following risks has been identified as the highest priority:

Indirect Agriculture

The protection against potential losses and income disruptions due to war or war-related activities seems to be one of the prevailing concerns. This is particularly true for the farming sector, where banks have issued dedicated loans that take a portion of the farmers' harvest as collateral. Consequently, any external shocks that reduce or destroy the harvest not only threaten the farmers' ability to repay but also diminish the value of the collateral. To address this issue, farmers have insured their harvest yield against all kinds of risks, with the exception of war. Since this type of coverage isn't available in the market, a dedicated agricultural war policy needs to be developed, supported by a 100% government guarantee.

Property Damage

We anticipate that the demand for insurance against war damages to movable goods (inland transit/storage) as well as immovable property will substantially increase, particularly in the conflict zones of Ukraine. Good monitoring and assessment of the conflict area is essential in determining the area of insurability. Based on the experience of the specialty market, we expect that the primary insurers in these markets will be prepared to retain a portion of the risks. This capacity might increase substantially once the war ends. In line with agricultural insurance, we expect that banks, which often take property as collateral for a loan, will be highly interested in reducing their war risk exposure in their loan portfolios through insurance.

Indirect Property Damage

When considering indirect property war damage, we understand this to mean loss of income due to business interruption related to war damage. Typically, these types of covers have a dedicated waiting period (up to 60 days) and the coverage is limited to a predetermined period (180 days). The intention is to compensate for income losses incurred as a consequence of property damage due to war. It's important to emphasize that business interruption insurance typically requires an insured property damage event (war) as a prerequisite for insurance payout. Consequently, the commercial market's risk appetite aligns with standalone war property damage as the market usually offers property damage coverage either standalone or in combination with business interruption.

Political Risk Insurance

As outlined earlier, general political risk insurance secures a sort of preferred creditor status for the purpose of recourse in case of a loss. This risk-mitigating factor doesn't exist in case of war, as legal or contractual action would need to be taken against the offending government. Particularly during war and for a specific period after war termination, we expect that commercial capacity will be scarce. In terms of insurance demand, we anticipate that the demand for war insurance protecting local investments will be significantly higher than the demand for protection of foreign investments.

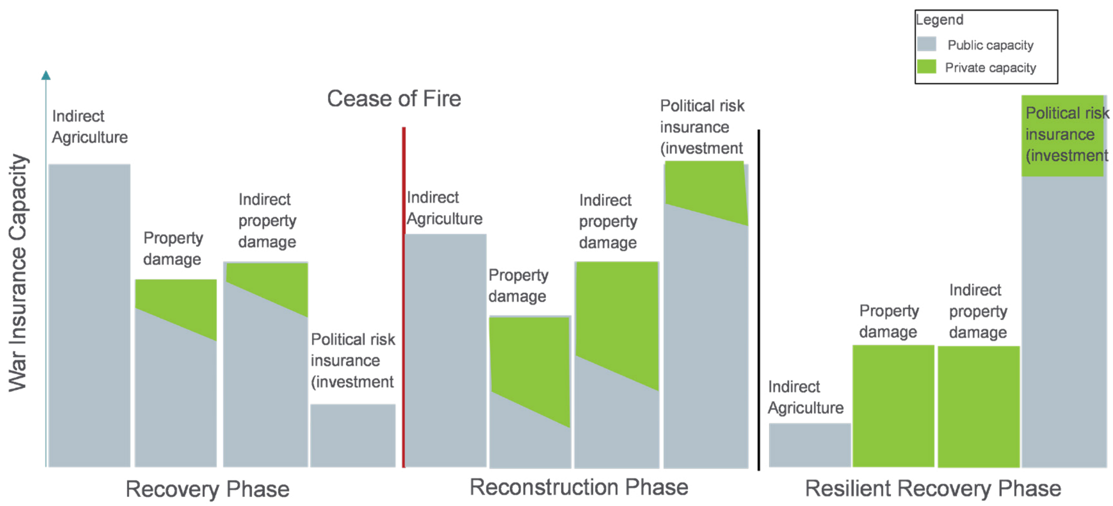

Figure 4. *Overview of available war insurance products.*