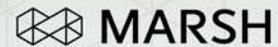




REIMAGINING RISK



THE UNWINDING OF GLOBALIZATION ?

WEDNESDAY MAY 17, HARTFORD, CT

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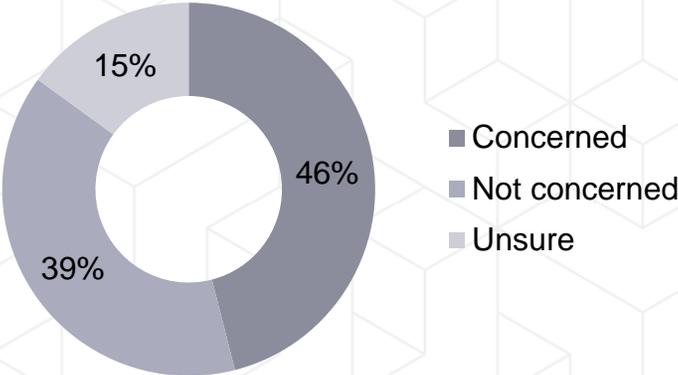
Marsh USA Political Risk and Structured Credit

New York, NY

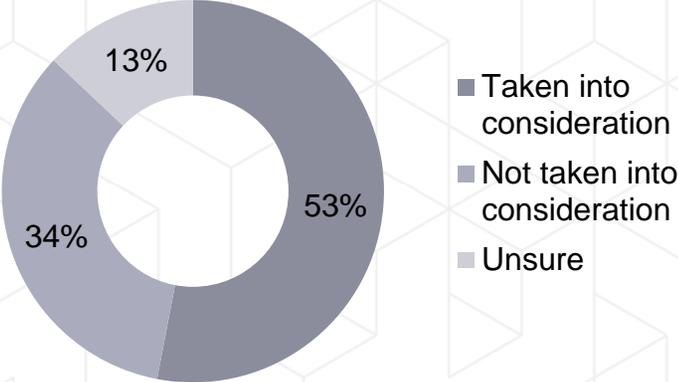
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Businesses are Thinking about Political Risk

C-Suite and Board Concern Regarding Geopolitical Risk



Treasury and Finance Function's Consideration of Change in Expectations of Risk to Growth Due to Geopolitical Event

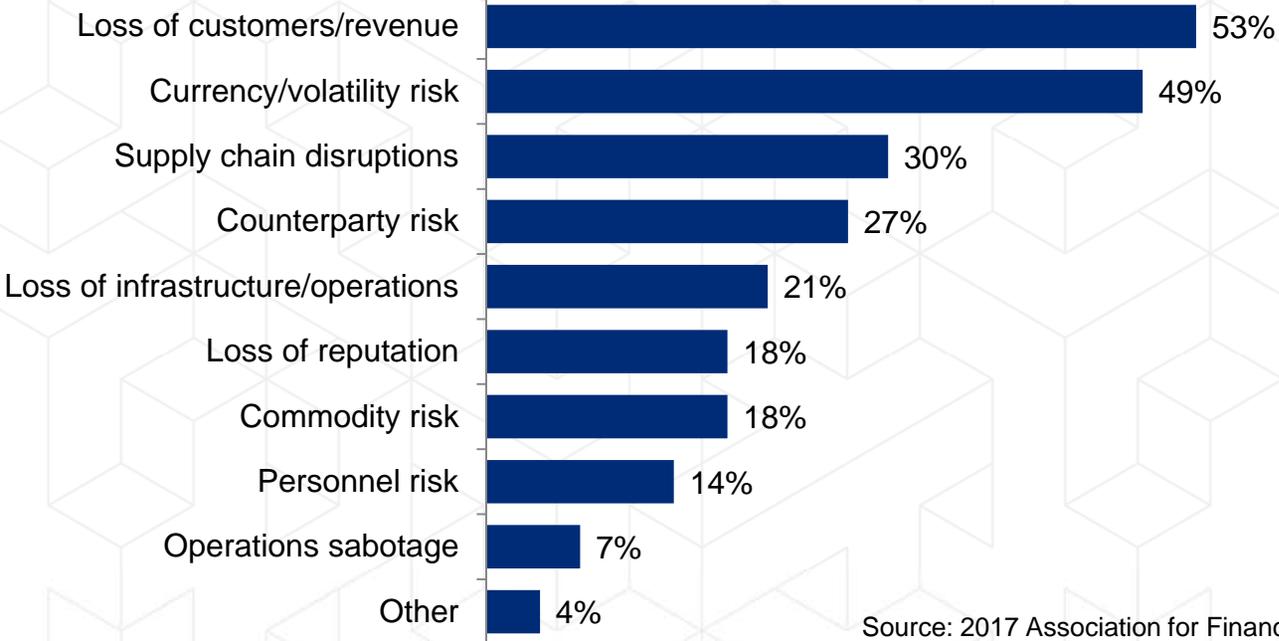


Source: 2017 Association for Financial Professionals Risk Survey



Businesses are Thinking about Political Risk

Organizations' Key Areas of Concern or Opportunity with Regard to Geopolitical Risk



Source: 2017 Association for Financial Professionals Risk Survey



GLOBALIZATION THEN AND NOW



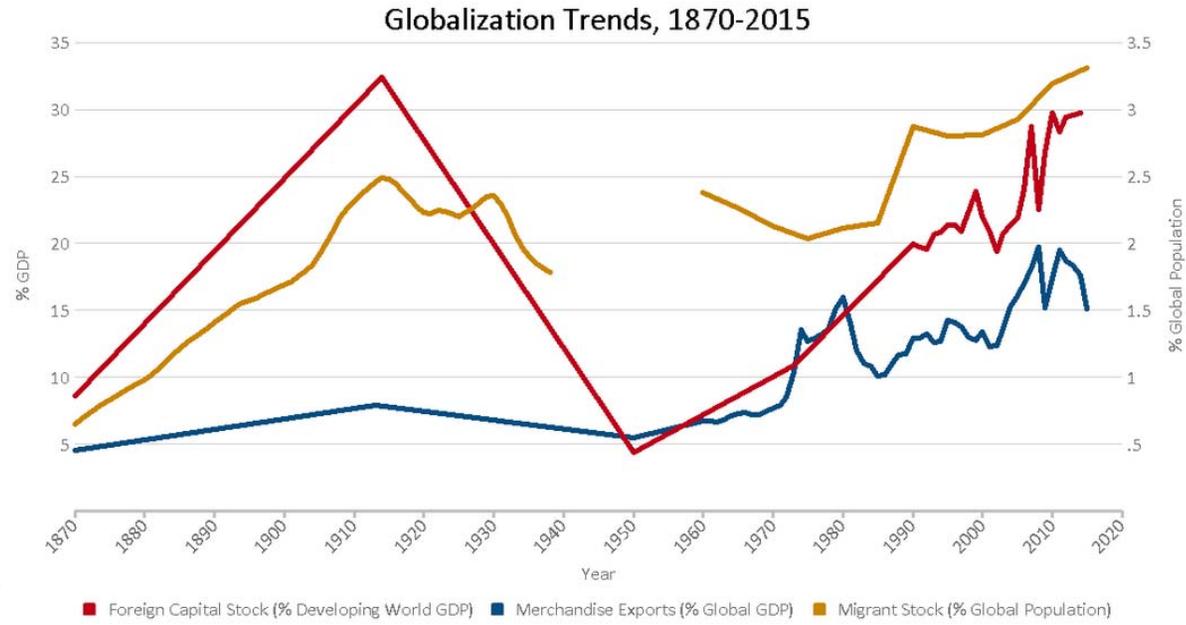
What is Globalization?

“That loose combination of free trade agreements, the internet, and the integration of financial markets that is erasing borders and uniting the world into a single, lucrative, but brutally competitive marketplace.”

Thomas Friedman



History of Globalization



Source: Brookings Institution

The breaking of globalization's first wave a century ago is proof that the forces of globalization and integration are neither irresistible nor irreversible.



More History !

- **1815:** The defeat of Napoleon and the Congress of Vienna, setting the stage for the peaceful international order of the next 100 years.
- **1815:** Britain started building its far-flung global colonial empire, propelling the first wave of global immigration, commerce and investment.
- **1815-1914:** Pax Brittanica, during which the British Empire became the unmatched superpower and adopted the role of a global policeman, supported by the Royal Navy (the world's most powerful military force), until surpassed by the USA during WW2.
- **Late 19th to early 20th century:** emergence of the US as a powerful industrial country and potential rival to Britain on the world stage.
- **1914 – 1945:** 2 world wars in succession left Europe and Britain devastated and militarily and financially weakened.
- **1945 – Present Day:** Pax Americana: emergence of “the West” and the Washington Consensus led by the US.



The Washington Consensus:

- A very popular and often pilloried term in debates about trade and development. Seen as synonymous with “Globalization.”
- A set of policies imposed on foreign countries by the Washington-sponsored international financial institutions: IMF, World Bank, WTO, UN, etc., including:
 - *Fiscal discipline*
 - *Tax reform (to lower marginal rates and broaden the tax base)*
 - *Interest rate liberalization*
 - *A competitive exchange rate*
 - *Trade liberalization*
 - *Liberalization of inflows of foreign direct investment*
 - *Privatization*
 - *Deregulation (to abolish barriers to entry and exit)*
 - *Secure property rights*
 - *Corporate governance*
 - *Anti-corruption*
 - *Flexible labor markets*
 - *WTO agreements*
 - *Financial codes and standards*
 - *“Prudent” capital-account opening*
 - *Independent central banks/inflation targeting*



The Unwinding of Globalization?

- **Are we on the cusp of another long-cycle “reversion to the mean” (and overshoot on the other extreme) ? Or just a pause in a continuous uptrend?**
- Declining confidence in western financial institutions.
- The US has pulled out of the 12 nation Asia-Pacific trade accord.
- In the US, President Trump is:
 - Considering dumping NAFTA.
 - Questioning NATO’s usefulness.
 - Considering slashing the US financial contribution to the UN and other international organizations.
- Opposition to Globalization has been most evident in the West, but some EM countries are also getting on the bandwagon (Philippines, Malaysia...). Is this anti-Globalization or a symptom of global superpower rivalries?



The Case Against Globalization

- Increased inequalities in wealth: “The 8 richest billionaires have the same wealth as the lowest half of the world’s population of 3.66 billion people.”¹
 - Eroded job security for middle and lower income families in developed countries; wages depressed as businesses seek low cost workers in poorer countries.
 - Belief that international trade agreements and global financial institutions (e.g. IMF and WTO) undermine local decision making principles, the integrity of national legislative authority, independence, and sovereignty.
 - Multi-polarism: China and others driving their own version of global cooperation.
 - Improving communications and transportation technologies are not causes of, but only enablers of, Globalization - and don’t guarantee its advancement. Localization trend.
- **Rise of populist political movements: USA, United Kingdom, France, Netherlands, Italy, and the Philippines.**

¹ Oxfam. “An Economy for the 99%”, available at <https://www.oxfam.org/en/research/economy-99>, accessed April 11, 2017.



The Case For Globalization

- Lifted hundreds of millions out of poverty (e.g. in India and China).
- Increased the standard of living, life expectancy, literacy, and employment rates in many countries.
- Reduced conflict and threat of war through political globalization.
- Encouraged cultural diversity.

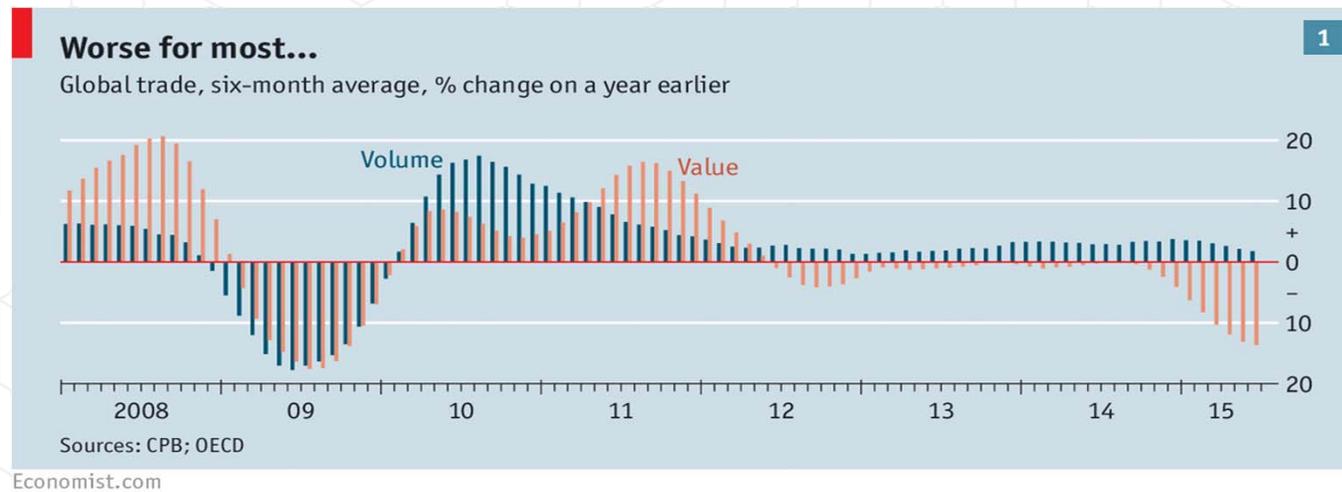


Implications of Unwinding Trade

- US accounts for 11% of global trade volumes, much less than its 24% share of global GDP.
- Is the US role in global supply chains understated?
- Potential retaliation – e.g. China threats.
- Slower growth due to higher trade barriers and lower trade.
- Shrinking middle class.
- Abandonment of the Washington Consensus:
 - reverting from multilateral trade agreements to bilateral deals: balkanization of trade and investment
 - what happens when the influential cheerleader of a global movement (the US) stops cheering?



Global Trade Conditions: 2016 another challenging year for trade



- Weaker than expected growth in the **US**: growth strong relative to other developed markets, but weaker than expected. **Eurozone** growth slowed, but higher consumer spending. EM growth limited: slowdown in China. Recessions in Brazil and Russia.
- A tepid recovery in commodity prices is projected to drive growth in emerging markets, but long-term trend has been slow growth. Uncertainty is mainly driven by the expected renegotiation of trade agreements, including for the US.



Implications of Unwinding Financial System

- Cross border capital flows affected.
- **US accounts for 18% of global foreign direct investment assets.**
- Repudiation of global norms and institutions that underpin the global economy.



Implications of Unwinding Security

- US stepping back from mechanisms that underpin international security and mutual accountability.
- Weak NATO and other security arrangements.
- Higher likelihood of instability as less inter-dependence translates into more willingness to engage militarily.

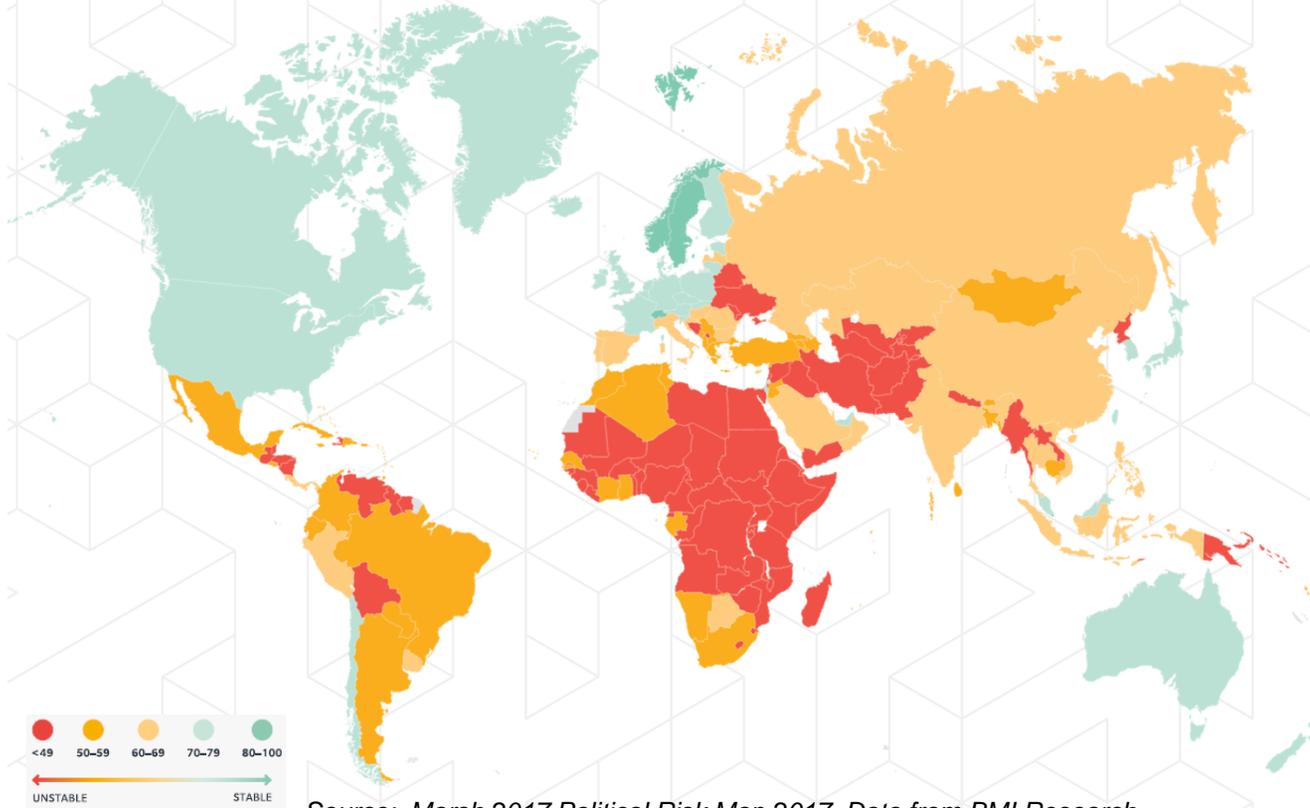


Implications of Unwinding Migration

- US is most globalized relative to other economies in terms of its openness toward migrants.
- US home to 19% of the world's migrant stock while accounting for only 4% of the world's population.
- US is top destination for migrants from 60 countries.
- Expulsion of migrants and increased restrictions would alter the global economy



Is Pragmatism Required?



Political risks in developed markets are gaining headlines.

- Overall risk in developed markets — including the US and Western Europe — remains low.

Developed market risk will magnify developing markets:

- Major economies pulling away from multilateral trade agreements.
- Cross-border cooperation muted.
- Greater unpredictability.



What Can Businesses Do?

- Prepare for uncertainty.
- Review supply chains.
- Consider a bipolar or tripolar world and the medium term / long term decline of US dominance.
- Consider credit and political risk insurance mitigants against :
 - Protection against embargoes, license cancellation, and contract repudiation.
 - Political violence, business income loss, and forced abandonment.
 - Adverse catastrophic government actions.
 - Supply chain financing disruptions.



Political Risk Insurance: 2 main types

Contract Coverage

Allows for coverage of a single, large contract.

Covers failure to pay by the Buyer (credit risk) and includes coverage for political risk events, such as:

- War, civil war, etc.
- Cancellation of contract by government.
- Cancellation of import and export licenses.
- Embargo, sanction.

Investment and Asset Coverage

Covers physical assets and equity ownership of overseas operations.

Can include coverage for:

- Expropriation/confiscation.
- Currency inconvertibility & transfer risk.
- Political violence physical damage (from War, Civil War, Terrorism, etc.) and business interruption.
- Cancellation of operating licenses or concessions.



THE GLOBAL POLITICAL RISK INSURANCE MARKET



TOKIOMARINE



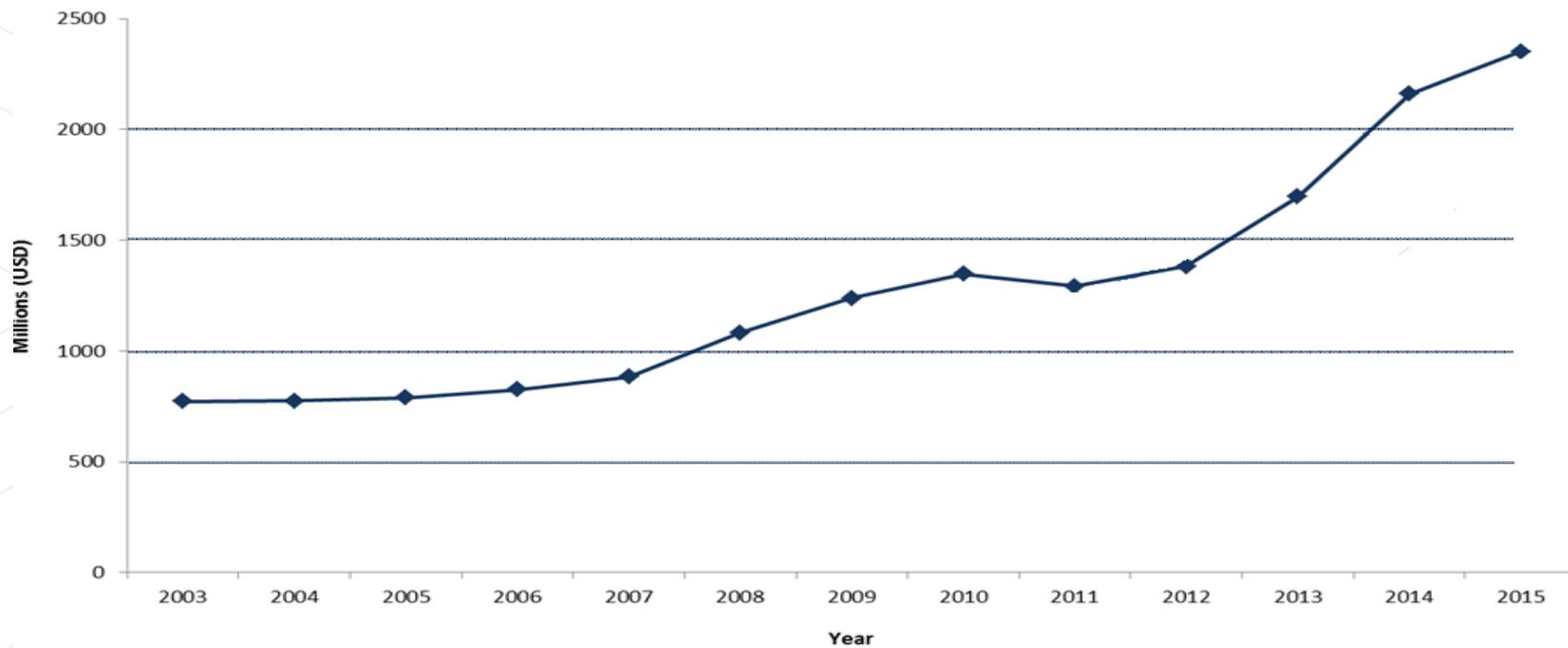
(AMONG OTHERS ...)



REIMAGINING RISK

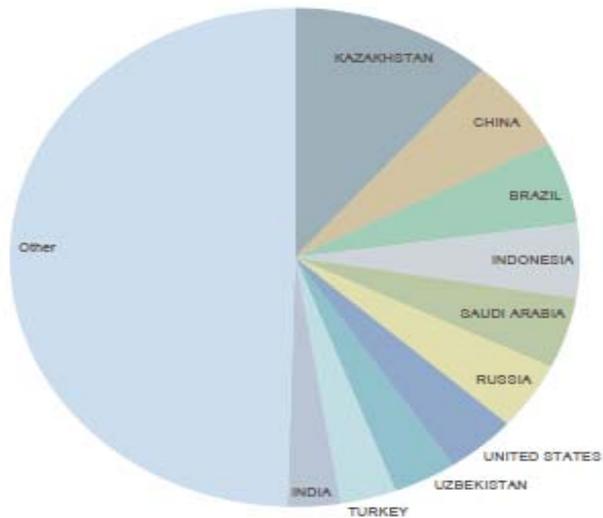
THE PRIVATE POLITICAL RISK INSURANCE MARKET

Record insurance capacity for any single policy



Where coverage is purchased

INV New Business 2015
Top 10 Countries



all figures given in USD Million	2014	2015	
KAZAKHSTAN	10,386	11,095	→
CHINA	6,740	5,875	↘
BRAZIL	5,840	5,183	↘
SAUDI ARABIA	1,155	4,698	↗↗
INDONESIA	4,820	4,477	→
UZBEKISTAN	4,245	4,268	→
UNITED STATES	5,288	3,897	↘
RUSSIA	4,100	3,516	↘
INDIA	2,486	3,107	↗
TURKEY	2,308	2,869	↗
OTHERS	51,766	48,181	→



REIMAGINING RISK

Political Risk Insurance

- **Despite difficulty in some countries, the overall political risk insurance market remains favorable to buyers.**
 - Approximately 60 insurers offer coverage.
 - Strong competition and choice for buyers.
- **Loss notifications have increased this year.**
 - If claims develop, the insurance market could begin to harden.

Coverage is difficult to obtain in:

- Afghanistan.
- Libya.
- Syria.
- Somalia.
- Ukraine.
- Venezuela.

- Brazil.
- Russia.
- Turkey.



Certain Do's and Don'ts of Political Risk

- **Don't rely on Rear View Mirror forecasting.** Just because the country has been stable, doesn't mean it will be in the future.
- **Consider but don't rely on political risk forecasts.** Information is helpful but especially over the long-term, many forecasters get it wrong. In era of Globalization, many reverberations are difficult to assess. Understand that government and opposition policies are often not rational.
- Undertake scenario planning, dynamic analysis and contingency plans.
- Companies' appetite for risk plays a key role in planning decisions. **Make an informed decision** rather than ignoring the potential for loss.
- **Expect the unexpected** (Arab Spring, Rise of ISIS, Russian invasion of Ukraine) and **give serious consideration to outlier, non-consensus scenarios.**



Do's and Don'ts of Political Risk Insurance

- **Just in time PRI placement doesn't work** so plan ahead – buy when the market is soft.
- **Buy broadly** – you never know where or how the next event will flare up.
- Ensure that the **policy wording is tailored** to your risks and structure.



What Political Risk Coverage Can't Do

- Make a bad deal better; Coverage wraps the deal as structured.
- Cover risks when the “house is on fire”.
- Make an uncreditworthy entity creditworthy.
- Provide blanket cover.
- Cover commercial risks.
- Protect against Insured's failure to perform.
- Protect a country's nationals against the legitimate authority and laws of their own country.



Political Risk Map



REIMAGINING RISK



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