保險業監管局
Insurance Authority

IFFO 金管局基建融資促進辦公室
HKMA Infrastructure Financing Facilitation Office

STRATEGIC ROLES OF INSURANCE AND GUARANTEE IN PROJECT RISK MANAGEMENT

Managing risks properly does not only help improve project bankability, but also increases balance sheet resilience to withstand shocks if risk events occur.

While risk management sounds like a cliché, the importance of using insurance and guarantee as risk management tools often lacks the necessary attention. In extreme cases, insufficient coverage may lead to significant economic loss or even project failure if unexpected risks events occur. On 26 March 2019, the Insurance Authority (IA) and the HKMA Infrastructure Financing Facilitation Office (IFFO) co-organised a seminar to showcase the strategic roles of insurance and guarantee on project risk management. This article aims to summarise key messages taken from the seminar, which may be useful in facilitating stakeholders' development of risk management strategy.

Political and Credit Risk Insurance - MFAs vs ECAs vs Commercial Market

As investors and financiers are the two major participants in infrastructure projects in emerging economies and Belt and Road region, political and credit risk is often one of the top issues that needed to be tackled with. While there is no universal definition on what constitutes political risk, the usual coverage available in the market would include the following action or inaction by a government authority:

- Confiscation, Expropriation, Nationalisation and Deprivation (CEND)
- Currency Inconvertibility / Non-Transfer
- Political Violence, War and Civil Disturbance
- Non-honouring of an arbitration award by a government entity / breach of contract

Broadly speaking, there are three major types of political and credit risk insurance providers offering various products covering debt and equity interests with various tenors. They are multilateral financial agencies (MFAs) such as Multilateral Investment Guarantee Agency (MIGA) under the World Bank Group, export credit agencies (ECAs) such as China Export & Credit Insurance Corporation (SINOSURE) and commercial insurance providers.

Traditionally, MFAs and ECAs have been and are used to be playing a major role in the political and credit risk insurance market. In recent years, the commercial insurance market is emerging with increasing capacity for structured political and credit risk products. Each of them has different niches and appetites. Banks, investors and project owners should obtain professional advice when looking for the appropriate solution based on individual circumstances.

Political and Credit Risk Insurance		Niches & Appetites
	MFAs	carry multilateral status with stronger negotiation power with member countries
	ECAs	usually government-backed to promote national export and investment abroad
	Commercial Market	provide flexible and bespoke solutions

> "Large and complex power and utility infrastructure projects on average run 35% over budget and behind schedule by 2 years."
> *EY Report 2016*[1]

Plan for Success Starts with Risk Due Diligence

Without going through adequate due diligence at the early project planning stage, project investors would be exposed to a high possibility of making substantial investment loss or even giving rise to project failure. Risk analytics could help identify various risks that a project would face and assess the optimal way in addressing them.

There are certain risks that can be mitigated through proper planning from project management and engineering perspectives. For example, if a project location is vulnerable to floods, buildings and infrastructure facilities should be built with flood-resistant design, critical and valuable equipment should be placed on higher floors, and contingency and recovery plans should be in place to minimize the time of business interruption when flooding occurs.

For the identified residual risks, if insurable, early professional advice should be sought on the availability, coverage and pricing of the relevant insurance products.

It is important for project owners and relevant stakeholders to take a holistic view on the risk landscape they are facing, embracing risk prevention, risk mitigation, risk management and risk transfer options as appropriate.

Quantifying Risks Tolerance Level and Protection Needed

A common question faced by project owners is how to justify the cost of buying insurance and determine how much they should buy. To answer this question, they should first assess and evaluate how much risks they are prepared to tolerate by assessing the likelihood and quantifying the potential impact of the concerned risk events should they occur. Scenario and sensitivity analysis should be conducted to estimate how key financial performance indicators would change negatively should a risk event occur and in what circumstances such impact would exceed the tolerance level set.

Through qualitative and/or quantitative risk analysis, project owners would have a clearer idea on the risks they are facing and the level of protection they need. This facilitates their decision making in adopting the appropriate risk management measures including risk engineering as well as transferring insurable risks to the insurance market.

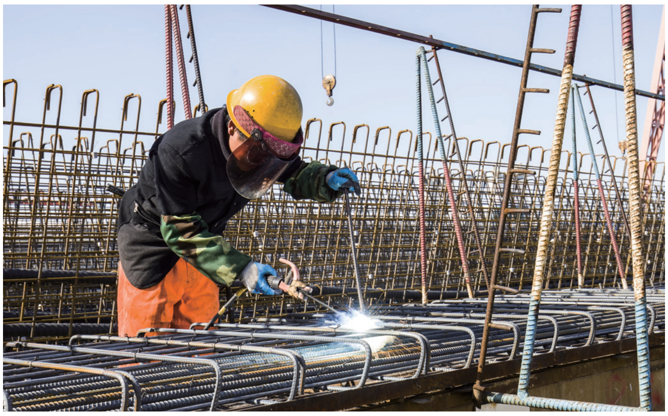
Wide Spectrum of Risk Management and Insurance Solution

Project risk landscape evolves as it enters into different phases of project life cycle. It requires a wide spectrum of insurance solution to address a multitude of specialty risks. Some of these risks, for example, include:

- ⚠ damages to property, plant and equipment;
- ⚠ business interruption;
- ⚠ unplanned delay in start-up;
- ⚠ construction and engineering risks;
- ⚠ inherent defects;
- ⚠ losses on or damages to goods and equipment in transit;
- ⚠ employees safety;
- ⚠ professional liability;
- ⚠ default of contractors and operators;
- ⚠ terrorism;
- ⚠ cyber risk; and more.

There is also an increasing concern on the environmental, social and governance (ESG) risks for infrastructure projects, which may create reputational risks if not managed properly.

Risk management is crucial to the sustainability of infrastructure projects. Relevant stakeholders should seek professional advice as early as possible. Where risk transfer option is viable, obtaining professional advice from insurers, reinsurers and insurance brokers with knowledge, capacity and global network is paramount.



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- Willis Hong Kong Limited

About IFFO

As part of the Hong Kong Monetary Authority (HKMA), IFFO's mission is to facilitate investments and financing of sustainable infrastructure and green development by working with a cluster of key stakeholders. The functions of IFFO are:

- providing a platform for information exchange and experience sharing;
- building capacity and knowledge;
- promoting market and product development; and
- facilitating investment and financing flows.

In May 2019, the HKMA announced the setup of the Centre for Green Finance (CGF) under IFFO. The objectives are to promote both Hong Kong as the hub for green finance in Asia and the importance of sustainability within infrastructure investment and financing.

For more information, please visit http://www.iffo.org.hk.

About IA

The IA is the independent insurance regulator in Hong Kong responsible for regulating and supervising the insurance industry, for the promotion of the general stability and sustainable development of the industry, and for the protection of existing and potential policy holders.

To help enterprises from the Mainland, Hong Kong and overseas that participate in projects and other commercial activities related to the Belt and Road Initiative identify and create feasible risk management solutions, the IA announced in December 2018 the launch of the Belt and Road Insurance Exchange Facilitation (BRIEF) platform. BRIEF aims to bring together a cluster of key stakeholders and provide a platform for exchanging intelligence on risk management and insurance, forging alliances and facilitating networking.

For details please visit www.ia.org.hk/brief.

[1] *EY. (2016). Spotlight on power and utility megaprojects – formulas for success*