SPECIAL REPORT
BELT & ROAD INITIATIVE

Risks and opportunities

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Belt and Road Initiative

Risks and opportunities

China's BRI has captured imaginations around the world since it was announced in 2013 and sparked plenty of debate. But what are the true risks at the heart of the $1 trillion investment project that hopes to create new economic corridors and facilitate global trade, and what are the insurance and reinsurance opportunities?

The construction of a $7bn high-speed railway across one of the poorest and least developed countries in South East Asia is fast becoming a symbol for China's Belt and Road Initiative (BRI). Around a quarter of the Laos-China high-speed rail project has been constructed and it is on schedule for completion by 2021. When active it will link into the Thai and Malaysian rail networks, and eventually Singapore.

Such initiatives are desperately needed, according to Asia Development Bank, which has estimated that 45 Asian countries need to invest $26 trillion between 2016 and 2030 to fix their infrastructure shortfall. It is hoped BRI will kick-start the new cycle of infrastructure spending in Asia and beyond.

BRI is arguably the most significant macro-economic scheme ever embarked upon. Also known as the "one belt, one road", the project aims to link China to other countries around the globe using a "belt" of overland corridors – a modern day Silk Road – in addition to a maritime "road" of shipping lanes. Projects are earmarked or underway in over 60 countries and over $1 trillion (between $4 trillion and $8 trillion according to some estimates) is set to be invested in infrastructure, energy and mining projects.

Five years on

It has been over five years since President Xi Jinping announced his ambitious plan to connect Asia, Africa and Europe and to date, over 1,700 BRI projects have been completed or are near completion. It is estimated that $210 billion has been spent so far, the majority within Asia. Some of the more notable and complex projects include the Indonesian Jakarta-Bandung high-speed railway, the Pakistan Kohala Hydropower Station and, in the pipeline, Nigeria's Ibadan-Kano rail line project.

There are undoubtedly significant economic advantages to be gained from the tremendous size and scope of the BRI, with the economies involved accounting for one-third of global GDP and trade. BRI should further enable these countries – including developing nations such as Afghanistan, Nepal, Tajikistan and Laos – to improve trade and contribute more to international commerce, by strengthening local and cross-border infrastructure and plugging "connectivity gaps" in transport, communications, trade and investment.

"The BRI focuses on the long-term development and prosperity of developing economies while uniting developed economies around the world into this mega plan," says Jacky Xingchen, regional manager, Greater China, Trust Re.

> *"One top risk that will affect all projects is legal and sovereign risks in various regions along the BRI"*

"The recent breakthrough between China and Japan, where both countries have established a committee to promote the development of Japan-China private business activities to a third of countries, is particularly noteworthy."

According to the World Bank, which has ongoing commitments of $86.8bn in a number of BRI projects, this is a "large unexploited potential". "The Belt and Road Initiative can be a catalyst for a new approach to development, where we crowd in private capital to meet people's rising aspirations," said World Bank Group president Jim Yong Kim, speaking at the Belt and Road Forum for International Co-operation. "But realising the promise of this initiative will require appropriate policies, institutions, and services."

BRI introduces a series of complex exposures which need to be managed and mitigated. The IMF has raised concerns, for instance, that financing of the project could increase the public debt in some countries to unsustainable levels. To date, around 10% of BRI projects outside of China have secured funding.

Political instability is another concern. Instability in some BRI countries could make it difficult to get projects moving or realise investments in full, according to the Economist Intelligence Unit.

"As much as BRI is perceived to be one of the largest projects around the world in history, it has its inherent risks embedded throughout the cycle of a project," says Xingchen. "Amongst the top risks that will affect all lines of business and the projects themselves are legal and sovereign risks in various regions along the BRI routes."

"These risks are inevitable in that the legal, political, economic, cultural and religious systems are varied from one region to another. Thus, companies that are involved should analyse and prepare themselves against these risks from the very beginning."

Among the complexities to be overcome, are the risks associated with major infrastructure projects, which fall under the broad headings of environmental, economic and geopolitical.

In its Global Risk Report 2018, the World Economic Forum (WEF) notes that the hope is for BRI and other infrastructure plans to "foster peaceful relations by creating new links and patterns of co-operation".

However, it warns the ambitious nature of the plans and approach to financing could exacerbate rather than prevent tension between economic corridor partners. WEF notes that potential triggers for unrest could result from corridors crossing contested territory or pushback from a country that feels its sovereignty is being undermined, referring to protests at Hambantota Port in Sri Lanka as an example of what can go wrong.

Then there are the more traditional risk concerns. Much of the regions at the heart of BRI are also exposed to natural catastrophe perils, including earthquake, windstorm (typhoon) and flood. Several disaster risk reduction initiatives and agreements have been set up, including the International Programme for Disaster Risk and Comprehensive Mitigation under the B&R Initiative (2016-2021).

Risk transfer opportunities

Insurance and reinsurance will play an important role in facilitating BRI projects from design through to completion and from there into the operational running of the various schemes.

BRI: THE CHIEF RISK CONCERNS

Geopolitical

Political risks are one of the biggest threats concerning the BRI, according to JLT Specialty. In its *Risk outlook* report, it notes that projects will pass through countries as diverse as Poland and Iraq, "exposing companies to myriad political risks." It continues: "Companies moving into territories for the first time may be unfamiliar with these developments in the risk environment."

Specialist reinsurance products such as political violence, political risk and trade credit offer some protection against issues such as war, terrorism and contract frustration. While there have been initial gains in the region's smaller, less stable markets, political turbulence or armed conflict may stall projects in the future.

Economic/financial

Fitch Ratings has warned that infrastructure projects could create debt risk for the banks funding them and broader economies. Many of the BRI countries have a poor sovereign debt rating, or no rating at all. There is some concern that loans made by Beijing to CEE countries could lead to financial instability in smaller economies, which are vulnerable to unsustainable levels of debt.

Unlike the Marshall Plan (or European Recovery Programme), which BRI is often compared to, the financing of infrastructure projects is not based on aid or foreign direct investment, but on loan financing. "This underscores the importance, for creditors and debtors alike, to carefully factor in pertaining risks," says the Economist Intelligence Unit.

Environmental

Countries within the BRI ecosystem have diverse geographies and exposures to natural perils, among them, earthquake, windstorm and flood. The majority of BRI funding to date has been spent on projects in Asia, which is disproportionately affected by nat cats in comparison to the rest of the world.

The UN has warned that natural disasters could cost Asia-Pacific as much as $160bn per year by 2030, of which only 5% is insured. Clearly, BRI projects need to be built with disaster resilience in mind. Foreign governments are increasingly requiring environmental and social impact assessments and compliance with environmental and workplace laws.

"Realising the promise of this initiative will require appropriate policies, institutions and services"

It is anticipated that demand for cover could generate as much as $10.6bn in commercial insurance premium in Southeast Asia alone through to 2030, half of it for property-all-risk covers.

Purchase of construction and engineering products (construction-all-risks, erection-all-risks, delay in start-up and third-party liability) will account for a further $3.9bn in premium. There will be a strong demand for trade credit and political risk, marine project cargo, workers' compensation, professional indemnity and surety bonds among other risk transfer products. The need for political violence and terrorism cover will vary depending on the stability of the regions under the BRI.

The larger and more complex the project, the more likely it is there will be delays and demands for compensation, warns the World Bank, noting that the average time for resolving a commercial dispute is 621 days across BRI countries. In anticipation of this, China has established two international courts to handle disagreements that arise during the course of BRI construction, based in Shenzhen and central Xian respectively.

Xingchen expects that insurance and reinsurance needs will increase as more and more construction and infrastructure projects come on line.

"While it is set to benefit the global reinsurance industry as most reinsurance carriers are multinational, if we have to divide based on a geographical basis, those who have presence and are active in hubs like London, Dubai, Singapore and Hong Kong are set to benefit most from BRI."

BRI: Mapping the risk

More than 60 BRI countries in Asia, the Middle East, East Africa and Eastern Europe contain

69%

of the world's total population and account for **51%** of global GDP

The Belt
A land corridor which passes through Central Asia before reaching Europe

The maritime Road
A maritime route passing through Southeast Asia, South Asia, the Middle East and East Africa

BRI TRACKER

The **MERICS Belt and Road Tracker** draws upon a large database of projects within the framework of China's BRI. The database contains more than 1,000 entries and is continuously updated.

It contains projects within the scope of two Chinese policy documents that outline the BRI: the "Vision and Actions on Jointly Building the Silk Road Economic Belt and 21st-Century Maritime Silk Road" and the "Vision for Maritime Cooperation under the Belt and Road Initiative."

The database shows that $715m of infrastructure projects have been completed over the past five years since BRI was officially launched. More than $3bn of Chinese financing is connected to projects currently under construction. For planned projects, the figure is below $7bn.

The BRI's six trade corridors

1. China-Indochina
ASEAN already has plans to invest in the region's railway and highway network. BRI adds capital

2. China-Myanmar-Bangladesh-India
China-Myanmar oil and gas lines are active. Extension to India is a challenging and long-term ambition

3.China-Pakistan
Significant infrastructure investment has been made. Corridor is strategically important

4. China-Central Asia Asia-Western Asia
Huge infrastructure investment is needed. Has commercial scale, but long-term ambition

5. New Eurasian Land Bridge
Infrastructure already in place pre-BRI and being used by logistics companies

6. China-Mongolia-Russia
Primarily a commodities route. Infrastructure investment has been increased recently

SOURCE: SILK ROAD ASSOCIATES

How reinsurance facilitates complex construction and engineering projects

Major infrastructure projects of the BRI would be impossible without the specialist support of insurance and reinsurance carriers, explains Arthur Underwood, CPCU, ARe, operations projects manager with Trust Re

Technology has enabled some of the most ambitious infrastructure projects the world has ever seen, as part of the BRI ecosystem. However, with complexity comes a changing risk landscape and increases in risk severity. As BRI gathers pace, these risks need to be carefully managed and mitigated through a close tripartite relationship between contractors, re/insurers and brokers. Scenario planning and stress testing is also important in ensuring no gaps in cover.

From high-speed railways to new economic corridors, there are thousands of projects in the pipeline, with hopes to finish by 2049, the scale of BRI cannot be underestimated.

Take the China-Pakistan Economic Corridor (CPEC), the beneficiary of up to $55bn in investment, which was launched in 2015. CPEC involves expanding the Gwadar port, constructing energy pipelines and building power plants, new highways over the tallest mountain range in the world (with passes of over 5,000 metres), high-speed railways, fibre-optic cables and special economic zones. The aim is to link Pakistan to the rest of Asia and offer China new trading routes. China describes the CPEC as the "fastest and most effective" of its BRI projects to date. However, with complexity comes increased risks – from physical risks (such as nat cats) to intangible and financial risks (such as project delay costs) and geopolitical considerations (CPEC runs through Gilgit-Baltistan, a contested region of Kashmir).

This is when reinsurance comes into its own. Reinsurers are the ultimate capacity provider and a crucial technical adviser. Many of the BRI projects are in developing markets, where the local insurance companies lack the technical expertise to underwrite and even serve as advisors on such ambitious projects. Reinsurance companies can therefore assist in providing much of the capacity that is needed to cover the huge assets at risk, while also providing specialist knowledge on risk management and claims mitigation.

A close relationship between all parties (contractors, insurers, reinsurers, brokers and loss adjusters) will help with information sharing and ensuring there is a common awareness and approach to all the risks involved. An atmosphere of trust and co-operation is helpful for all stakeholders, and ideally should be established at the design stage before construction work has even begun.

Scenario planning is an important tool. Reinsurers are able to offer frequency and severity judgement of the risks we are underwriting. We are able, for instance, to share the likely return period for a tropical cyclone in Oman or Vietnam, which is useful information when constructing a road or railway – whether near to the coast or not. Scenario planning and stress testing can also help identify potential gaps in cover. As these infrastructure projects become more complex, the likelihood of consequential financial loss grows. Alongside significant demand for traditional property and construction-all-risks covers, BRI projects will also require specialist covers, such as delay-in-start-up, trade credit, political risk and surety bonds.