



CONSTRUCTION IN EMERGING MARKETS: PERFORMANCE AT RISK

Introduction

Topics for Discussion

- What are the seismic trends facing the construction industry in emerging markets?
- How do these factors impact contractors and what must they do to remain competitive?
- How can surety, political risk, and parametric tools help navigate these risks?

Introduction

Speakers

- **Martin Bennett**, Managing Director, Infrastructure Practice, Marsh.
- **Richard Marshall**, Head of Infrastructure Research, BMI Research.
- **Adrian Pellen**, Senior Vice President, Infrastructure Practice, Marsh.
- **Robert Deeley**, Senior Vice President, Credit Specialties, Marsh.
- **Vincent Moy**, Managing Director, International Surety, Marsh.
- **Tom Markovic**, Senior Vice President, Weather & Energy Specialty Products, Marsh.

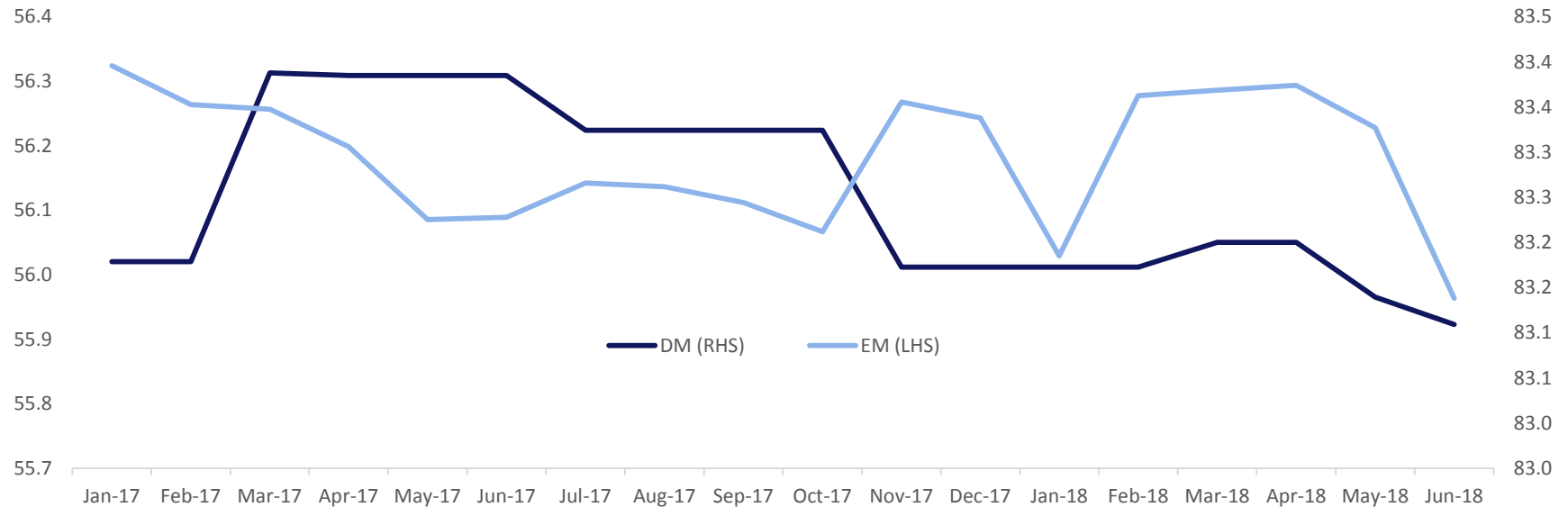
Trends In Infrastructure



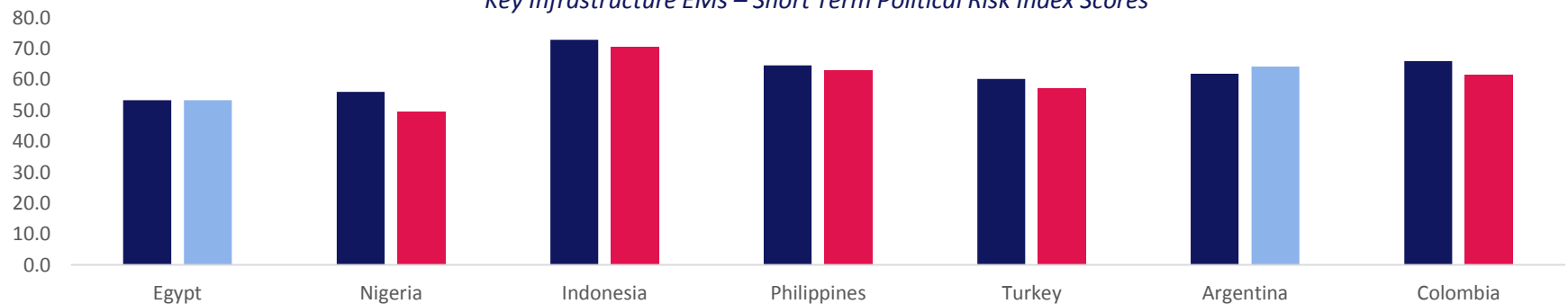
Political Risk

Ever Present, But Growing

Developed & Emerging Markets – Long Term Political Risk Index Scores



Key Infrastructure EMs – Short Term Political Risk Index Scores



Event Calendar 2019



Feb | Nigeria

General Election

Pres. Buhari faces defeat, yet opposition win would not bolster reforms; risk of violence.

STPRI Score: **48.5/100**
Global STPRI Ave: **63.4/100**



29 Mar | EU-UK

Brexit

Transition deal likely, but still risk of 'cliff-edge' Brexit if UK and EU fail to agree on deal.

STPRI Score: **74.4**



April-May | India

General Election

PM Modi set for re-election, boosting reform and macroeconomic prospects.

STPRI Score: **75.0**



May | EU

EU Parliament Election

Key test for anti-EU populist parties, post-Brexit.

STPRI Score: **N/A**



by Oct | Greece

General Election

Overall economic outlook improving, but socioeconomic hardships persist.

STPRI Score: **59.6**

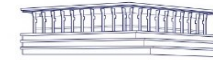


by Oct | Canada

General Election

PM Trudeau's popularity waning; NAFTA negotiations pose risks.

STPRI Score: **92.7**



by Nov | Israel

General Election

Possible hung parliament; strong performance of far-right parties could harden stance towards Palestinians and Iran.

STPRI Score: **67.5**



by Nov | Poland

General Election

Relations with EU in focus ahead of elections.

STPRI Score: **69.6**

January

February

March

April

May

June

July

August

September

October

November

December



Feb | Thailand

General Election

Military could delay election; concerns persist about freeness and fairness of vote.

STPRI Score: **70.2**

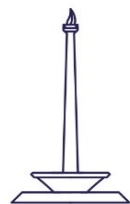


31 Mar | Ukraine

Presidential Election

Pres. Poroshenko likely to lose; reforms and relations with Russia at stake.

STPRI Score: **44.8**



April | Indonesia

General Election

Pres. Joko Widodo set for re-election, but extremist organisations pose security risks.

STPRI Score: **71.5**



May | South Africa

General Election

ANC to win, but structural obstacles will delay Pres. Ramaphosa's reforms.

STPRI Score: **65.4**



13 May | Philippines

Mid-Term Election

Pres. Duterte remains popular; Senate win would allow more aggressive implementation of agenda, but checks and balances at risk.

STPRI Score: **63.1**



July | Japan

Upper House Election

Ruling LDP could lose supermajority, delaying reform agenda.

STPRI Score: **83.1**

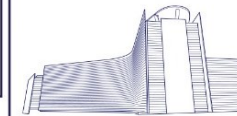


27 Oct | Argentina

General Election

Pres. Macri set for re-election; economic reforms to continue.

STPRI Score: **65.8**



31 Oct | EU

Mario Draghi's ECB term ends; Jean-Claude Juncker's EC terms ends

New ECB and European Commission presidents to take over at crucial time.

STPRI Score: **N/A**



by Nov | Australia

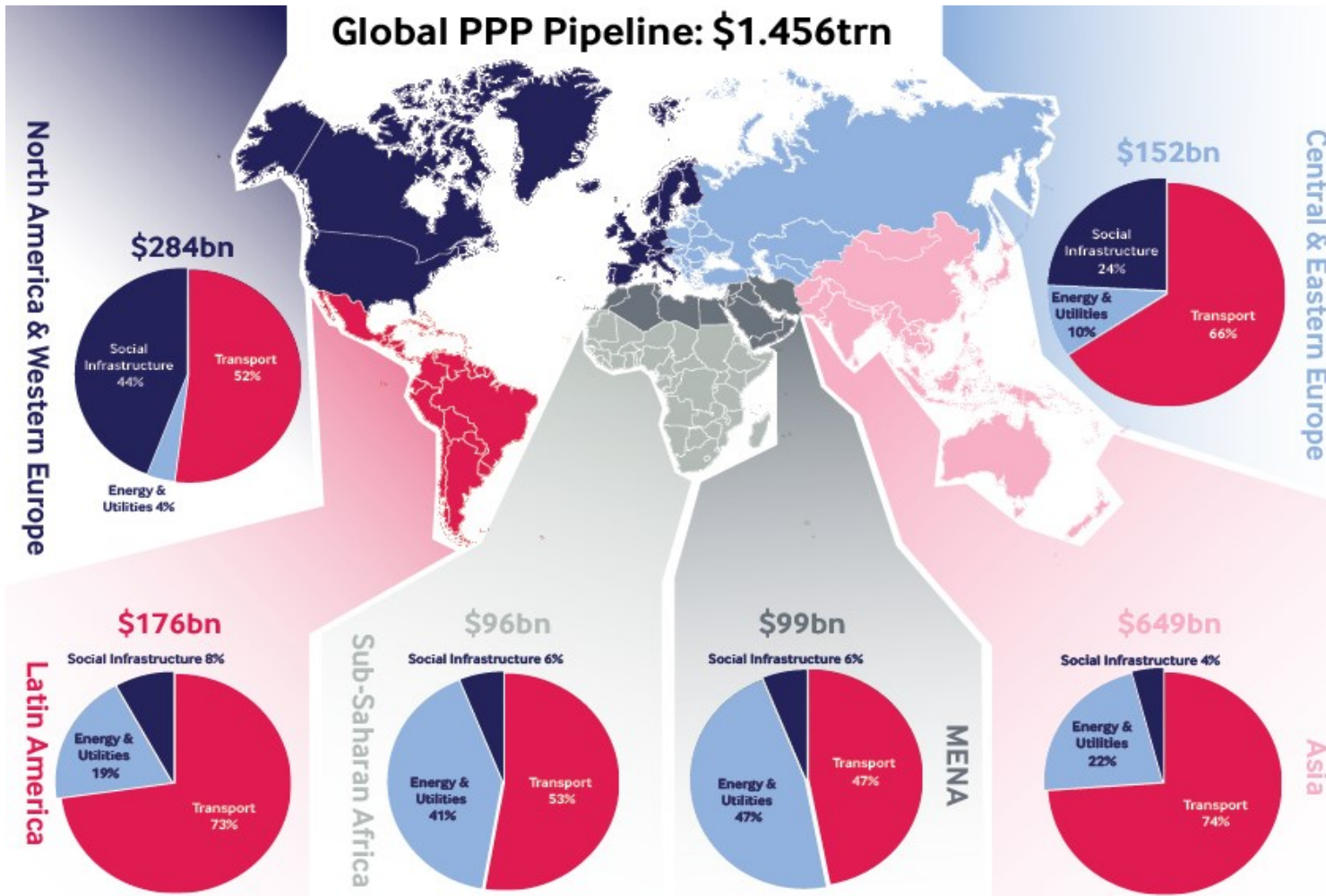
General Election

Liberal-National coalition at risk of defeat; fiscal consolidation at risk.

STPRI Score: **75.2**

Financing Landscape

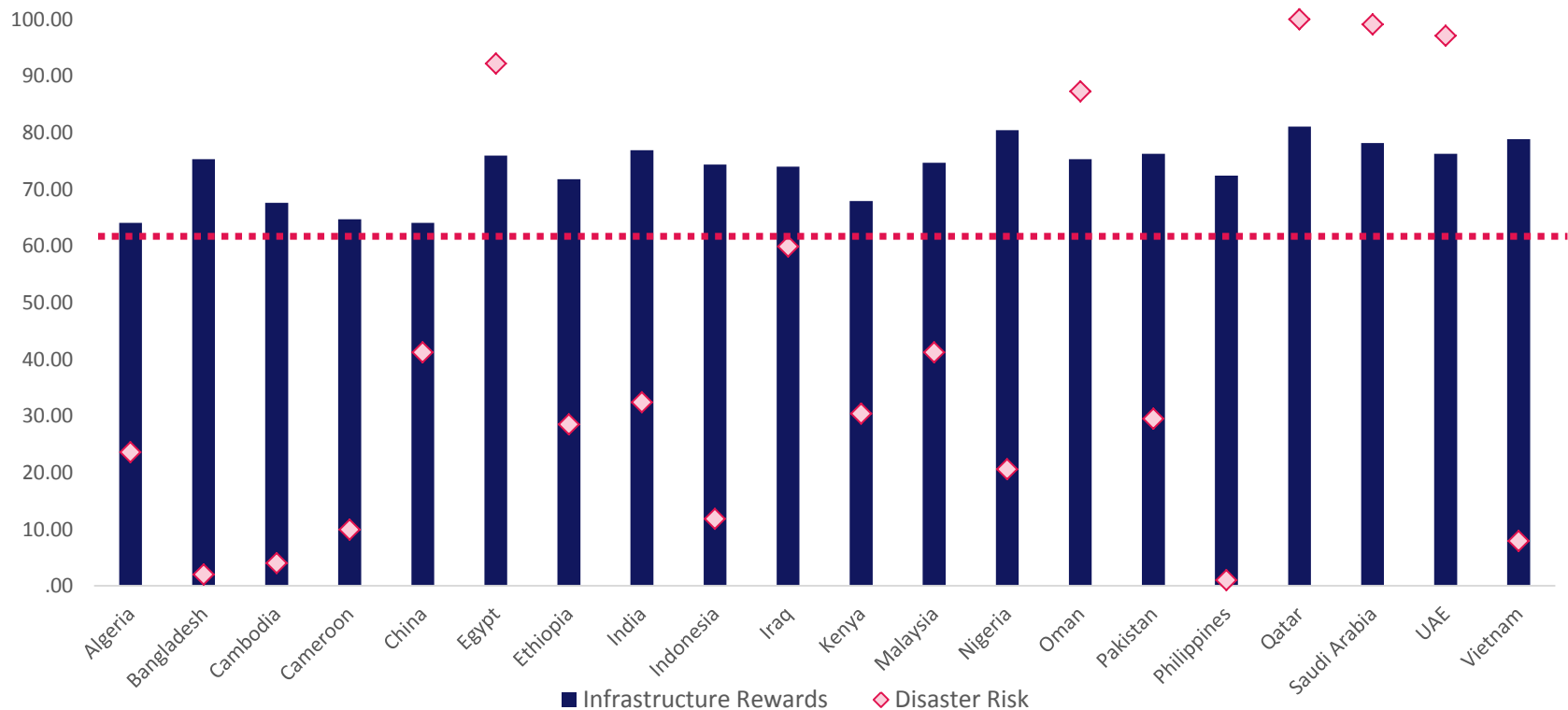
Rise Of The PPPs



Climate Exposure Growing

High Reward But High Risk Markets

- **EM construction markets attractive on a Rewards basis** - ahead of DM peers on growth, and adding significant scale over coming decade.
- Significant exposure to natural disasters – **major EM markets exposed** to rising sea levels, storms, drought, floods, wildfire and other extreme weather.
- Can be an opportunity – huge growth in climate efficient projects, flood defence, desalination, water treatment projects.
- Projects also **less likely to be resilient** – budgetary pressures, poor government capacity, nascent environmental standards, less developed construction standards.



Seismic Trends: Generating Uncertainty For Contractors

Adrian Pellen

Risk Factors



- **Sovereign risk.**
- **Cancellation.**
- **Contract frustration.**

- **PPP = more risk.**
- **Lender scrutiny.**
- **Role of rating agencies.**

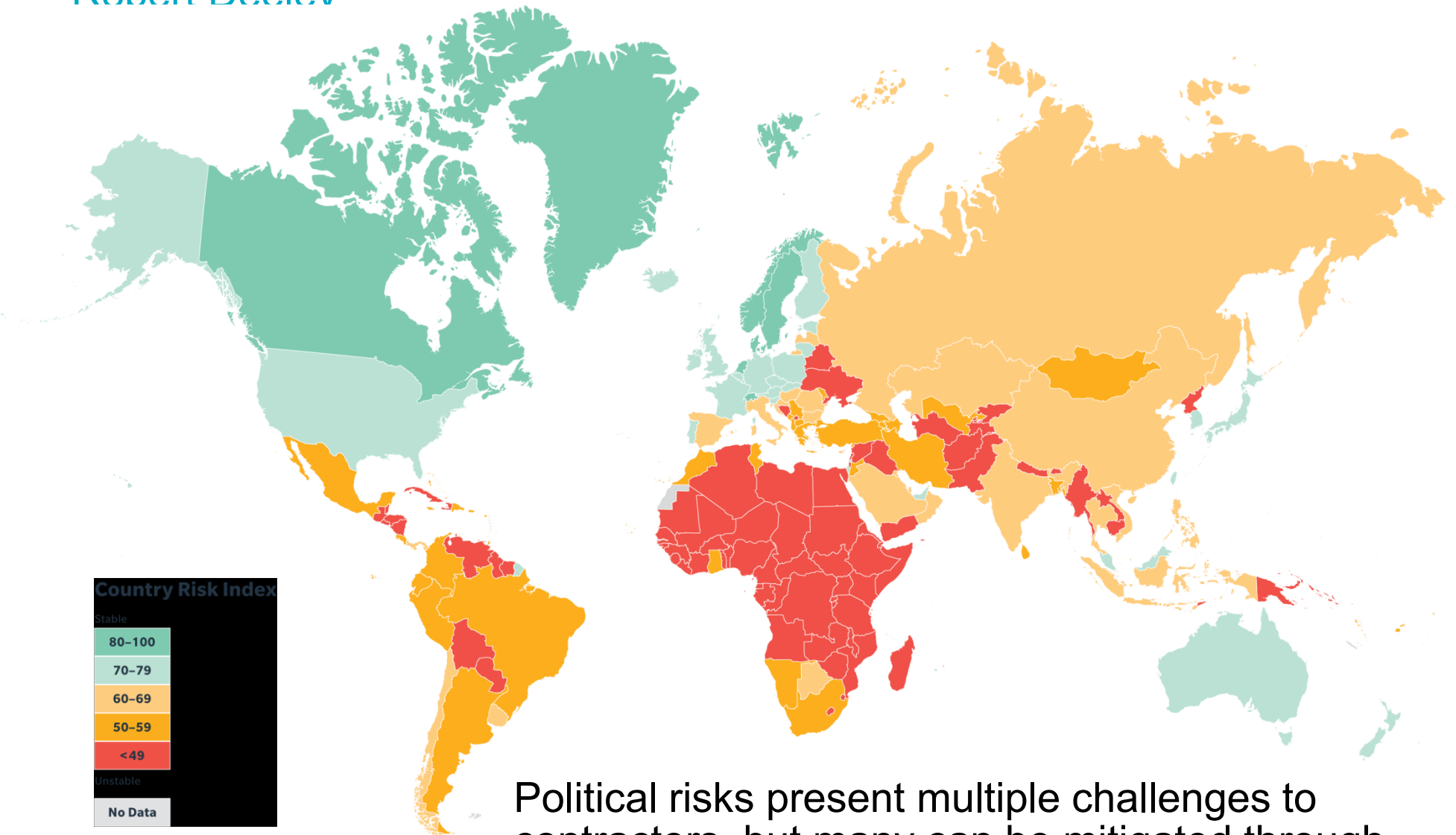
- **Direct damage.**
- **Loss of equipment.**
- **Delay and liquidated damages.**

Solutions



Political Risk Map 2018

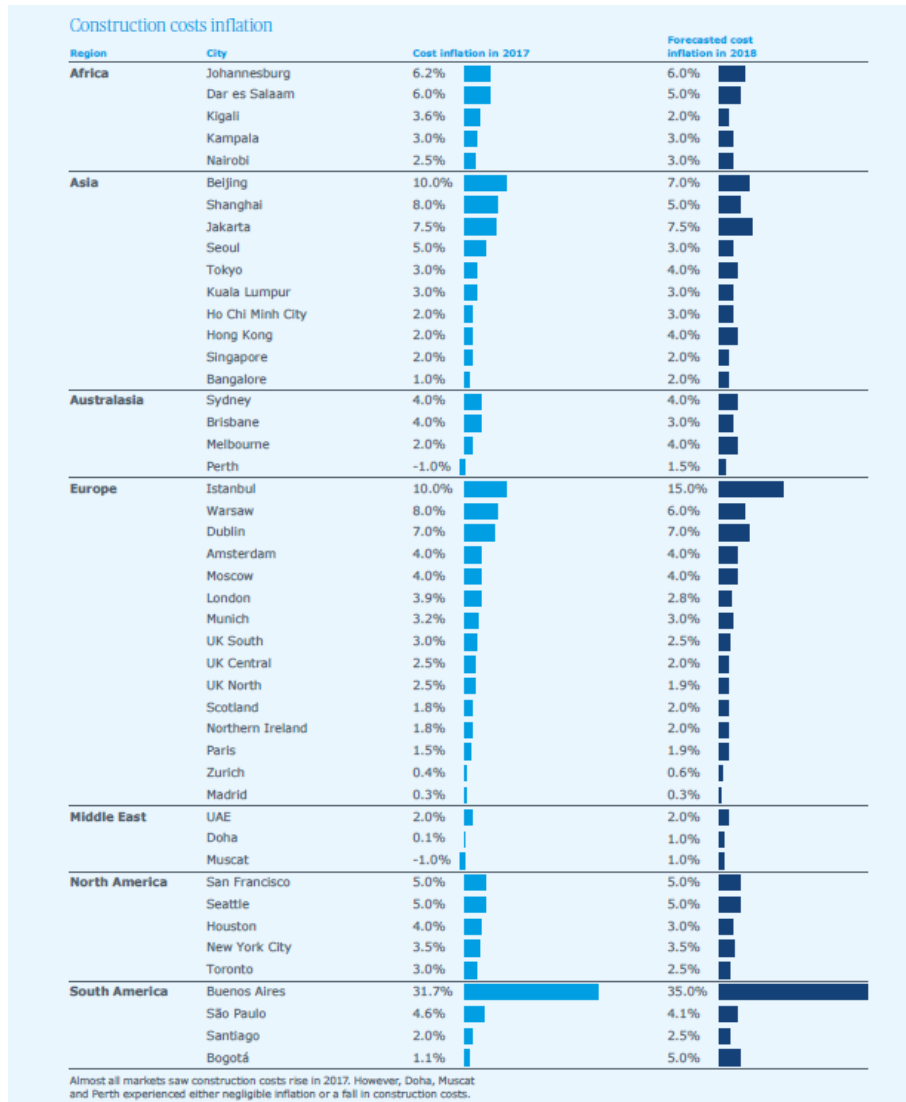
Robert Deelev



Political risks present multiple challenges to contractors, but many can be mitigated through insurance.

Surety Bonding

Vincent Moy

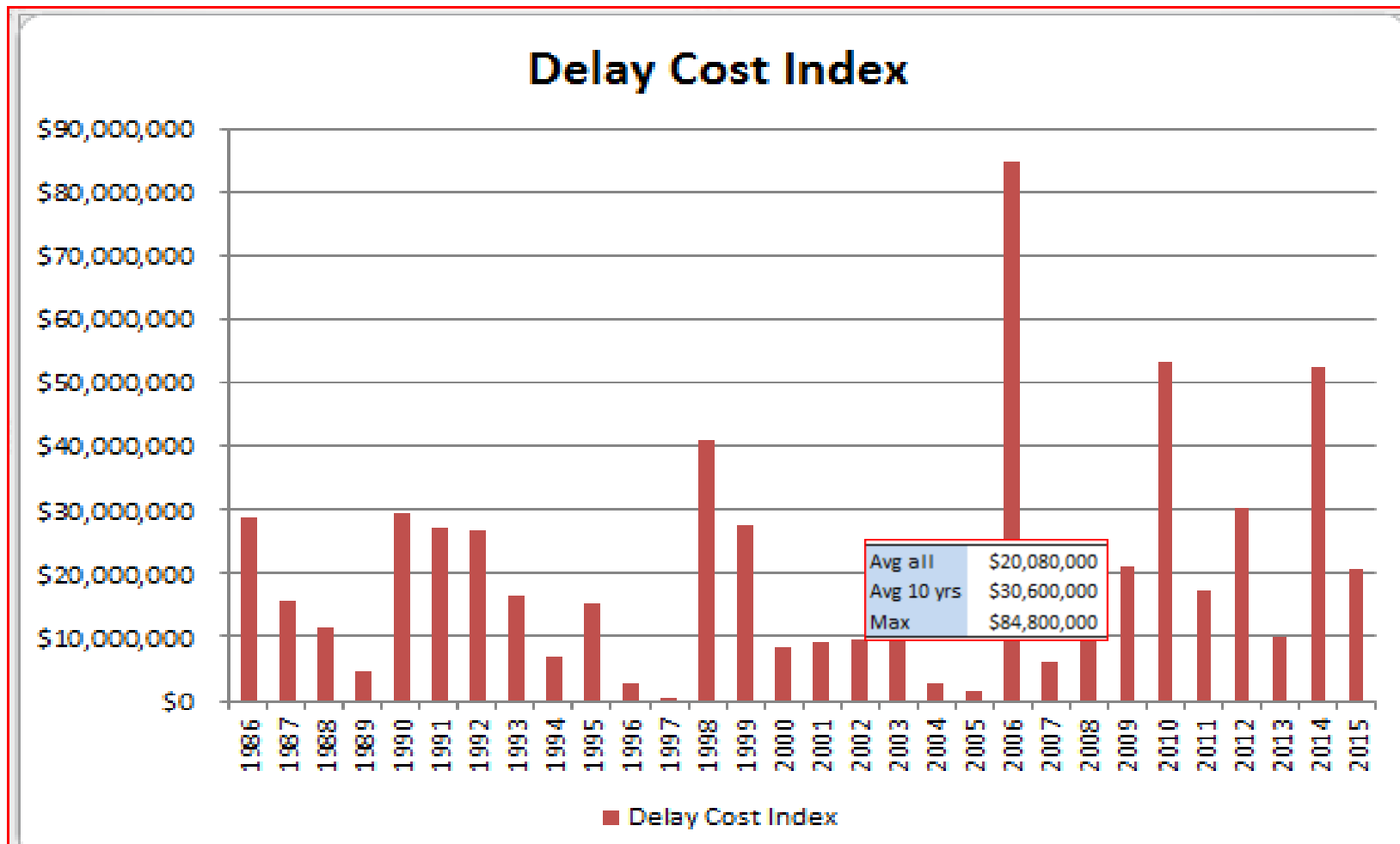


- Competition for work driving down profit margins while costs are rising - creating financial uncertainty for contractors.
- Projects more complex, larger, and take more time to complete.
- Bank and surety bonds protect investments and safeguard financial and completion risk.
- Contractors and banks facing headwinds to meet increasing demands for bonding capacity.
- Surety bond market offers alternative source of bonding lines of credit.

Source: Turner and Townsend International construction market survey 2018

Weather Protection

Tom Markovic



Increased weather volatility exposes contractors to significant and unpredictable adverse impact on delay-related project costs. Parametric solutions are designed to mitigate this exposure.

Q&A



Appendix



CONTRACTORS

PRODUCT	DESCRIPTION	FEATURES	BENEFITS
Surety Bonds	<p>Surety bonds are used to guarantee a variety of obligations where bank guarantees or cash escrow are currently utilized. Construction firms need a variety of surety bonds to satisfy contractual requirements and in some regions to comply with governmental regulations.</p> <p>PERFORMANCE A performance bond guarantees to an owner the contractor will complete an underlying contract according to its terms and conditions. A variety of service, installation, supply, or construction contracts can be guaranteed by a performance bond.</p> <p>BID SECURITY A bid bond guarantees that a contractor will honor its bid proposal and execute contract documents if awarded a contract.</p> <p>ADVANCE PAYMENT An advance payment bond protects against contractor default for the down payment received by the contractor.</p> <p>COMPLETION A completion bond protects the financing of a construction project against contractor default.</p> <p>WARRANTY A warranty bond guarantees defective work of a construction project be repaired during a warranty period.</p>	<p>Surety bonds is a form of credit rather than a pure insurance product as the insurer is taking an unsecured credit risk on the contractor.</p> <p>A surety bond protects the beneficiary, not the contractor.</p> <p>Surety product always issued on recourse terms by way of group indemnity taken from contracting group.</p> <p>Surety bonds tend to be conditional and require proof of default of the underlying obligation and loss suffered as a consequence.</p> <p>This compares with banks which provide on-demand primary obligation instruments and which require no proof of default or demonstration of loss.</p> <p>Surety bonds cannot be used to guarantee the repayment of principal and interest.</p> <p>While there is an upfront bond premium, there is no deductible or excess</p>	<p>There are several advantages of utilizing surety bonds over bank guarantees, including:</p> <p>Potential cost savings.</p> <p>Surety bonds are typically classified as “off balance sheet” or “contingent liabilities.”</p> <p>Surety bonds offer better protection for the Client and issuing Surety company</p> <p>Preservation of bank limits for other purposes such as working capital and hedging or to fund expansion plans, acquisitions and investments.</p>
Bank Surety Syndication	<p>The surety is provided via a bank fronted structure, where a bank issues a guarantee on behalf of the contractor but the bank’s recourse is to the surety.</p>	<p>Marsh delivers regulatory-compliant access for banks to the largest specialist insurance market with annual premiums of USD 14 bn facilitating hundreds of loan transactions for corporates worldwide.</p>	<p>Potential cost savings.</p>

Political Risk Insurance

Robert Deeley

PROJECT RISK			
PRODUCT	DESCRIPTION	FEATURES	BENEFITS
<p>Credit & Political Risk Insurance:</p> <p>Specific Contract Coverage</p>	<p>Bespoke credit & political risk insurance for EPC firms that wraps around a particular contract and its cash flows, protecting the firm from financial loss caused by:</p> <ul style="list-style-type: none"> • Full payment default of the sovereign (or sub-sovereign) owner; • Unilateral cancellation of a project by a sovereign (or sub-sovereign) owner – leaving the Contractor with unrecoverable costs; • Credit risk (including insolvency, bankruptcy or protracted payment default) of a private, commercial owner. • Circumstances that “frustrate” the Contactor’s performance of the contract, leaving it with unrecoverable costs and/or unpaid invoices following: <ol style="list-style-type: none"> 1. Actions of the Insured’s Country (such as sanction, embargo, or cancellation of export license); 2. Actions of the Owner’s Country (or a third party country) (such as a law, order, decree, regulation, including cancellation of import or other licenses or government performance critical to project completion); 3. “Force Majeure”-type political events occurring in the Owners’ Country that “frustrate” the Contactor’s performance, including war, civil war, terrorism, invasion, coup d’état, insurrection and other types of civil disturbance that 	<ul style="list-style-type: none"> • Typically, policy covers Loss up to a specified dollar limit with risk sharing by insurers of 90% of the Loss. Policy limits and market capacity are available for as little as USD \$20MM or up to USD \$1 Bn per contract. • Insurers (and Marsh) are accustomed to delivering indications to clients at pre-bid stages as to the availability and cost of coverage; • Offered by Insurer risk appetite for Owner and Country risk in the S&B B+ and better range; • Insurers’ ability to cover medium and long term EPC contracts as long as 3, 5 and even 7 years on a non-cancellable (by the Insurer) basis with committed, non-adjustable terms (incl. premium rate); • Can cover services as well as goods, and the local as well as imported components of a contract (denominated in local currency as well as hard currency) without regard to national content requirements; • In the case of loss by way of unrecoverable costs, Insurers also indemnify for loss of an imputed profit margin of up to 10%; 	<ul style="list-style-type: none"> • Enables EPC firms to enhance competitiveness via offering more flexible payment terms on new Contracts- knowing that they have a “silent partner” - an investment-grade, market specialist credit insurers, rated S&P A or AA sharing the bulk of the risk. • Contractors can know the cost of insurance in advance and build it into their bid. • Financially conservative Contractors can expand by taking more financial risk & pursuing high return/ higher risk opportunities. • Significant flexibility by insurers to cover high risk counterparties and the largest, longest contracts. • Ultimate flexibility to design the contract according to what makes most sense to minimize the bid and win the business. • Value-added enhancement to coverage indemnifies not only for direct loss but also lost profit.

Political Risk Insurance

		PROJECT RISK	
PRODUCT	DESCRIPTION	FEATURES	BENEFITS
Credit & Political Risk Insurance: Contractor's Plant & Equipment Coverage	<p>Protection for mobile assets used by the Contractor on the construction site in Emerging Markets against a host of political perils, including:</p> <ul style="list-style-type: none"> Physical damage loss to the Contractor's equipment due to "Political Violence" (PV): <ul style="list-style-type: none"> War, Civil War, Terrorism, Coup d'État, and other forms of Civil Disturbance; Willful destruction by the Government of the Owners' Country. Loss of business income & extra expense due to PV; Inability to repatriate Contractor's equipment due to the Government of the Owner's country either: <ul style="list-style-type: none"> Confiscating, Expropriating, Nationalizing the equipment; Canceling a re-export license for the equipment or otherwise blocking the re-export of the equipment ; For equipment lessors, inability to repossess and re-export equipment pursuant to lessee default or lease expiry, and government interference with owners' legal rights. 	<ul style="list-style-type: none"> Ability to insure one item or a portfolio or whole fleet of equipment items. Coverage customizable for one project or for a continuous stream of projects in scheduled countries. Allows the insurance proceeds to be directed to lenders. 	<ul style="list-style-type: none"> Provides security to the Contractor over valuable assets that are temporarily on-site in the Owners' Country, where potential security/political violence issues may exist and where foreign contractors' property rights may not be robust.
Credit & Political Risk Insurance: On-Demand Calling of Bonds Insurance <small>MARSH</small>	<ul style="list-style-type: none"> Where Contractor is required to use on-demand callable bank instruments (like bank guarantees or standby l/c's) as Advance Payment or Performance Guarantees delivered to the Owner, insurance covers <u>wrongful calling</u> by the Emerging Markets Owner of such bonds, or <u>fair calling</u> due to specified force majeure political risk events, being 1) embargo, sanction, cancellation of permits or import/ export licenses; 2) war, civil war, terrorism, civil disturbance, etc. (Political Violence) ; 3) any law, order, decree, regulation by the Owner's Country; in either case that frustrate the Contactor's performance. 	<ul style="list-style-type: none"> Can cover one or more bonds specific to a discrete project, or a portfolio of project bonds (either global, or geographic focus); Can be combined with Specific Contract Coverage; Allows the insurance proceeds to be directed to lenders. 	<ul style="list-style-type: none"> Such on-demand instruments provide financial protection against the possibility of an unscrupulous Owner <i>unfairly</i> drawing the bond, even if the Contractor has fulfilled its contractual duties. The bank is required to pay causing the Contractor a financial loss: "draw first, ask questions later". Contractor performance may be tripped up by the aforementioned force majeure political risk events beyond its control, triggering a "fair call" of the bond instrument

Weather Protection

Tom Markovic

CONTRACTORS

PRODUCT	DESCRIPTION	FEATURES	BENEFITS
Waiting-on-Weather (WoW) Protection	<p>Parametric solutions designed to protect clients against losses from unexpected weather delays.</p> <p>Climate patterns have been increasingly volatile, and World Economic Forum has identified weather risks as 3 out of 5 largest impact risks for 2018.</p> <p>Prolonged adverse weather conditions may cause delays in the completion of a construction project, leading to weather delay penalties / liquidated damages, additional equipment rental costs, increased labour costs and missed opportunity costs. The impact can be compounded as the project is delayed into a more adverse weather season.</p> <p>Projects impacted:</p> <ul style="list-style-type: none"> Off-shore – cable installation, wind farm construction, gas/oil asset construction or decommissioning, salvage & transport On-shore – road and pipeline construction, cement pouring, crane operation <p>Perils:</p> <ul style="list-style-type: none"> High wind speeds & wave heights, strong currents, freezing temperatures, excessive rainfall, wildfire risk <p>Each program is designed to maximize the client's expected return while minimizing weather and related risk.</p>	<p>Parametric, index-based coverage designed to cover the costs of construction delays caused by any measurable weather perils with reliable data history.</p> <p>Index-based solutions involve contracts where the payout is a function of a quantitative index designed to replicate actual losses. For example, payout for any day during construction period during which the average wave height is above 3 meters, subject to a pre-agreed deductible in terms of number of high wave height days.</p> <p>No claims adjuster is needed - quick settlement based on pre-determined weather index and payout formula. Settlement typically within few days from the end of construction period, as soon as weather data are available.</p> <p>Payout can be applied to any cost or revenue loss: liquidated damages, extra wages, additional equipment rentals, etc.</p> <p>The solution offers a flexible structure, customized to individual project exposures. Marsh can offer comprehensive analysis that incorporates a full range of program comparisons and utilizes state-of-the art quantification methodologies to facilitate the decision-making process.</p> <p>Clients gain access to both the insurance and capital markets through our specialized Weather and Energy Specialty Products analysts licensed through MMC Securities Corp.</p>	<p>We enable contractors and project owners to optimize bidding strategies, understand contractual ramifications / changes in risks for their projects, and receive quick settlement at time of need if adverse weather conditions arise.</p> <ul style="list-style-type: none"> Protects against uninsurable or under-insurable exposures No claims adjustment, no physical damage requirement Quick settlement improves liquidity Payout can be applied to any weather-related losses or costs Individual project or portfolio coverage; single or multi-trigger Transparent, flexible coverage Program designed to maximize the expected returns while minimizing weather risk Pre-construction project & contract optimization (e.g. season & equipment or vessel selection) Contract credit enhancement (A-rated paper or better) Insurance or financial format



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