

Mr. Richard Cross
Nelson Hurst Ltd



The role and the expertise of the International Insurance

and Reinsurance market in connection with B.O.T. and B.O.O. contracts.

I apologize for my lack of languages, but that is common in English people. We are not very good at learning foreign languages. Up till now the speeches have been very broad in addressing this problem. However, I'm an insurance broker. I've worked in London for 30 years, specializing in construction and engineering projects. 15 of those years I worked with Mr. Curioni here and we have enjoyed some durable success. I've already heard speakers considering the broad risks faced by financiers. They are endless and you need to be very much a lateral thinker to be able to control a B.O.T or a B.O.O. project. But it must be remembered that the insurance market is there to respond to the demand of the people buying insurance, so that, if bankers, financiers have a problem, which I think insurers can solve, and, in fact, the problem is quantifiable, the insurance market will develop a solution. I'm sure that I know some of the underwriters here in the Swiss, German and Italian market. They are as innovative as any in the world. So, although this concept is new to Italy, it is not new to them, because they have been considering projects in Asia and Latin America for many years now.

The insurance market is very specialized, it's compartmentalized in its approach to insurance and Franco Curioni and Paolo Calderone's brave idea to try and develop a blanket insurance proposal is very exciting and if it comes off, it will be a world-wide sale, but it will need immense amount of work. Unfortunately, as I said earlier, I'm a specialist in construction engineering, so I can only talk to you really knowledgeable of the insurance from that part of the risk. There is nothing strange in the physical risks for the B.O.T. contract, this is just the construction projects that we've looked at 100 times before. The necessity for insurance protection during construction is universally recognized and in its own it's a complex exposure. The modern C.A.R. policy, and it must be remembered that C.A.R.s only came in after the Second World War. I think the first policy was issued by Lloyd's of London in about 1948. It encompasses an immense range of exposures and perils. During the period of a C.A.R. policy, the exposures change

and the risk increases to the insurers, as the money spent on a project increases. You start from the green field site and you finish up doing a power station, a pulp mill, a chemical plant. The initial risks that you face are the storage, transportation, the ground works, the silver construction works, the machinery erection, the testing and the commissioning: these we are all familiar with. We also have the risks connected with the work itself. The method of construction employed - we've seen the new Austrian tunnelling method, which is no longer new, causing an immense flying in London with the Heathrow Tunnel collapse, that's looking like a 100 million pound loss. So you have the method of working, you have lifting operations, you have got the carelessness of workers, which is the human error factor, which can never be controlled. Everybody is you. You have the incurrent risks, the adequacy of the design, the quality of materials and the quality of the equipment, which means that you financiers must be certain that the contractor is absolutely top class.

These are the physical risks, they are quantifiable, they are known to us. We can look at those when we have the basic underwriting information, when we have description of the project, its location, the breakdown of the contract value, the works program and the risk inherent to the site. There is no problem with that: it's all experience. When we move into underwriting the delay in a project, then we move into a completely new scenario and it changes this completely. We have to get into this situation, we have to understand the information. The only people who have that information are the project developers and the financiers and it is their duty to disclose as much of that as possible to the insurance market and that's where the problem comes in. We must build in the costs at the very beginning of the insurance party's monitoring the progress of the project. They want to be able to control the risk themselves and they need to look at the overall picture, they need to look at what will happen if one part of the project is delayed, if one part of the project is damaged, if one item of the machinery is damaged. That becomes a much bigger problem for us to look at. The project can be delayed for many other reasons, not necessarily connected with the indemnifiable damage under the all-risks policy. These are late delivery, later disturbances, things of that nature and for that reason, the insurers will need to have somebody, if not themselves, to visit the site regularly throughout the life of the project. Initially they will concentrate on the physical layout, the storage, fire precautions, safe working methods. These are the type of things which can cause erosion of the premium base to such an extent that you can lose money, before there is a major loss. There is no major delay, but you insurers can lose money quickly. We need full cooperation from the site management for this. We can't stress too strongly that it is the site management who will control that this project goes ahead and it's successful or not.

The basis of the indemnity in the advent of a delay to a project caused by a physical damage event must be clarified by insurers of

the outset. This is to avoid any unpleasant surprises to the financiers, when they suddenly realise the risks that they thought were covered are not covered. We can also include in there the fixed additional cost, prearranged income flows, things which can be easily quantified. We can count those quite easily, but when we get into a project where we have projections of sales, projections of production, you cannot accurately assess a loss, until the project is brought to its final completion and until it has been operating for a period of time where you can establish what that loss would have been if the project had started, say, 12 months earlier.

This last can cause some problems with the bankers and the financiers.

The C.A.R. insurance market will respond to all your needs, if it so chooses, but it has to be remembered that there is a basic understanding for the C.A.R. material damage policy. If there is no damage, there is no claim. Likewise for the delayed start-up section of that policy: if there is no loss of income as a direct result of that delay, then there is no claim either. So I can deviate now from this little bit of writing I did earlier and explain that we have a particular situation in a project in the Far East, where the construction project went ahead and was completed perfectly. It was a fast-track construction policy and the project went ahead without any major damage or claim whatsoever. It was completed ahead of schedule, which insurers and financiers said it was marvellous.

The problem is this was a power station, the transmission line was not part of the contract, the transmission line was to be provided by the government. There is no transmission line. You cannot test the power station, you cannot operate the power station. It is going to take 6 to 9 months of hard work to put the transmission line in. And that's if you can get the government offer back size and get them doing it.

So we have to look at how we can address that problem. We know that the contractor has done his job, the financiers have done their job, the government haven't done their job. We thought we were safe, because there was an energy conversion agreement. We said that if the power station existed in a workable state, then the government would pay the fees to the owner of the power station, which would enable them to repay the loan interest. But without transmission line, you cannot test the power station. If you cannot test the power station, you cannot get a certificate which says that you have a power station. So we have an unsolvable problem.

In time this type problem will be addressed by insurers and they will solve this problem. I'm certain, but in what area we don't know, this covers another problem for Franco Curioni to include in his package policy. It's a type of political risk, but it isn't really a political risk. We must develop the market, that's our job. Our job is to develop the market and so really build owner operating transfers is a way of going forward, but every project

we do, that's in London, we find another problem raises its head and another consideration comes in, because this is new, not just to Italy, this is new to us. It's a question of 3 or 4 or 5 years out of a 30-year career. So to me it's still new and to people who have looked at this project before is even newer. But I'm sure that people around here will solve the problems. So I cut my speak short here and thank you very much for listening.