

RECENT TRENDS IN PUBLIC POLITICAL

The riskiest countries in the rankings remain the ones most affected by natural disasters or high levels of conflict.

RISK INSURANCE COVERAGE

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Over the past decade, political risk products available to investors have changed and grown. These changes can be attributed to current, worldwide events, which have resulted in the changing needs and demands of businesses and companies with regard to political risk insurance coverage.

In fact, according to the Insurance Journal, “the current events in the Middle East have brought political risk back to the fore of global investors and markets.”¹ Similarly, in Africa, “the demand for political risk insurance has also surged in light of increased debt protection costs and yields on government debt across the Gulf region,” and also in light of “political instability.”² Euromoney reports that “the riskiest countries in the rankings remain the ones most

affected by natural disasters or high levels of conflict, including the Central African Republic, Democratic Republic of Congo, North Korea and Haiti.”³ Thus, although there may be disagreement on where political risk is greatest, there can be no doubt that there is a growing need globally, for political risk insurance.

These events had a quantifiable and immediate impact. According to the Insurance Journal, “[e]merging markets, which experienced improvements across

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all major risk indices in 2009, suffered a reversal in 2010 with expropriation and creeping expropriation ('ECE') and legal, regulatory and licensing ('LRL') risks on the rise across all regions except Eastern Europe. Resource nationalism, especially in the energy sector, was a key driver behind this trend, pushing Alliant's ECE and LRL global indices down by 3.5 points in the last 12 months."⁴ These changes provide a benchmark for the increased demand for new products from political risk insurance carriers.

Current events also showcase one of the major advantages of political risk insurance compared to other risk mitigation tools: speed. Discussing ongoing events in Libya, one company noted that it had already received compensation for all of its political risk-related losses from its insurance provider. Even as events deteriorated, the same business expected that all future losses would be covered with the same speed.⁵

But a key concern has been whether the current political risk insurance offering in fact fits the need of companies investing in the contemporary political risk landscape. Many political risk insurance products were first drafted to deal with fundamentally different challenges in the 1950s and 1960s. Although some of the same themes remain—resource nationalism, political violence and potential foreign currency shortages to name a few—the manner in which they manifest today may in many instances have changed with the times.

The political risk insurance market has reacted to changing needs. Both major public sector insurers like the Overseas Private Investment Corporation ('OPIC') and the Multilateral Investment Guarantee Agency ('MIGA'), and private sector providers continue to offer new products.⁶ The private market in particular has been able to attract a growing number of clients with its current offerings.

Political risk insurance in the public market

OPIC and MIGA are fine tuning their respective portfolios to respond to mar-

ket demands. OPIC in 2003 expanded its tested staple of coverage of expropriation, political violence, and inconvertibility coverage with insurance offerings for terrorism related damage. However, OPIC's terrorism coverage seems to exclude weapons of mass destruction damage. This may lead to some uncertainty of how the coverage could be applied in practice if there is a major terrorist event.

OPIC's coverage currently also includes special coverage, such as institutional loans, capital markets, leasing, oil and gas, natural resources, and contractors and exporters. Most recently, OPIC expanded its coverage to facilitate and mitigate risks associated with renewable resource projects.⁷ Specifically, OPIC is providing insurance to reduce the risk from the host government "[b]reaching an agreement/concession/contract with the investor, unlawfully revoking or denying Letters of Approval issued by the DNA, imposing undue burdens on carbon credit projects such as a confiscatory tax on the sale or transfer of the environmental benefits or carbon credits derived from carbon credit projects, restricting or prohibiting the transfer of the Certified Emissions Reductions, denying the investor an adequate and effective forum to review the legality under applicable laws of a breach of an agreement with the host government, and failing to pay an arbitral award to the investor subsequent to a final, binding and non-appealable judicial determination that the host government is at fault for breaching the contract with the investor."⁸

MIGA similarly has updated its portfolio in light of recent demand. Similar to OPIC, MIGA also offers a broad range of political risk insurance coverage. MIGA's website advertises traditional coverage for currency inconvertibility and transfer restriction, expropriation, war, terrorism and civil disturbance, and breach of contract.⁹ On top of traditional guarantee products, MIGA now offers a guarantee for non-honoring of sovereign financial obligations. The non-honoring of sovereign financial obligations is applicable in situations where a sov-

ereign's financial payment obligation is unconditional and not subject to defenses. The trigger for coverage under this product is binary: it does not require the investor to obtain an arbitral award. Rather, a certificate that there was non-payment is enough to recover.¹⁰

Traditional OPIC coverage has a proven track record due to its significant claim determination history. From the 1960s onwards AID, and later OPIC, resolved claims through archived—and now published—claims determinations. These determinations, addressing issues from currency inconvertibility to expropriations to war, insurrection and civil war claims provide valuable insight into the claims and payment history of OPIC. But, as is to be expected, many of the new OPIC products have not yet been tested. Their true value, therefore, will become fully apparent only once the first claims are paid.

Unlike OPIC, MIGA does not have a longstanding claim history—owing largely to the fact that its coverage has not been called upon as frequently as OPIC's. In fact, MIGA has only had to

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pay three claims since 1988, including a claim in 2000 regarding an equity investment in P.T. East Java Power Corporation in Indonesia, a claim in 2002 regarding a

power project in Nepal, and a claim in 2005 regarding a Toll Road Project in Argentina. According to a World Bank Group Report on MIGA from March 31, 2009, "... from 580 projects that have received MIGA support, there have been more than 60 cases treated as possible claims, but in which no claim has been paid."¹¹ All other potential claims could be settled without need to engage the formal claims procedure.

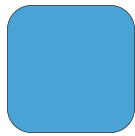
Political risk insurance in the private market

In addition to the public market for political risk insurance coverage, there is a measurable increase in demand for private

PRI coverage.¹² Many businesses are negotiating to expand the scope of their political risk insurance cover to include mobile equipment, rigs (gas and oil), and personal assets, such as fine art and property. The scope of new coverage differs on a case-by-case basis with many private insurance companies placing restrictions on riots and strikes coverage to balance their exposure.¹³

Like the public market, over the past decade, insurance companies in the private market have also been changing and expanding their political risk insurance coverage. AIG Global—a leading international insurance organization—is now also extending political risk insurance coverage in areas such as sovereign payment default, which includes failure of a sovereign entity to honor payment obligations under a promissory note, bond, sovereign loan or sovereign guarantee, and failure of a sovereign entity to honor payment obligations under a letter of credit. AIG Global also includes coverage for political violence to meet the demands of businesses. Political violence includes politically motivated acts of violence, including terrorism, war and civil war, which result in physical damage to property.¹⁴ In addition, AIG Global has successfully offered traditional coverage in areas of confiscation, expropriation and nationalization, currency inconvertibility and non-transfer, contract frustration due to political events, and wrongful calling of on-demand contract guarantees and bonds.

According to the website for Chartis, a well-known subsidiary of AIG Global, in order to meet with recent company and business demands, Chartis has currently expanded its political risk insurance to include coverage in areas such as sovereign payment default, which includes the non-honoring of a promissory note or a sovereign guarantee and the failure of a sovereign entity to honor payment obligations under a promissory note.¹⁵ Chartis is also currently offering political risk insurance coverage in traditional areas such as political violence, confiscation, expropriation, nationalization, currency inconvertibility, and non-trans-



MANY PRIVATE INSURERS HAVE ALSO BEEN PAYING OUT CLAIMS BROUGHT BY BUSINESSES UNDER THEIR NEW PRODUCTS.

fer, contract frustration due to political events, and wrongful calling of on-demand contract guarantees and bonds.¹⁶

Similar to AIG Global, in order to meet recent demands, Meridian Finance Group (an international insurance provider) current political risk coverage includes “creeping” expropriation, where a series of individual government actions which, taken together, effectively result in expropriation, and political violence.¹⁷ While Meridian Finance Group does not currently offer political risk insurance coverage for sovereign defaults, Meridian Finance Group does include, like most other private insurers, risk insurance coverage for political violence.¹⁸ This kind of political risk insurance protects against “... non-payment, loss of income, business interruption, loss of equity investments, or damage/destruction of physical assets due to political violence. Covered political risks include war, revolution, civil unrest, rioting, public strikes, armed uprising, insurrection, terrorism, sabotage, acts of malice, or other political violence.” Such coverage in political risk insurance coverage meet the demands of current events.¹⁹ In addition to the newer products being offered, Meridian Finance Group is also still offering political risk insurance coverage in traditional insurance areas such as expropriation of assets, currency inconvertibility, contract repudiation, wrongful calling of guarantees, and non-delivery by foreign supplier.²⁰

Zurich Emerging Markets Solutions (‘Zurich’), a private Switzerland-based political risk insurance provider, like the private insurers already discussed and according to its website, has expanded its political risk insurance to include coverage in areas such as the non-honoring of sovereign guarantee insurance.²¹ Zurich also maintains political risk insurance coverage in traditional areas such as political violence, expropriation, and currency inconvertibility.

Aon, a private Taiwan-based political risk insurance provider—in order to meet more timely demands of businesses—has expanded its political risk insurance in the areas of war and political violence as well. However, like most

private political risk insurance providers, Aon still currently offers political risk insurance coverage in traditional areas such as non-payment products for financial institutions, expropriation, cancellation of operating licenses, exchange transfer problems, import and export embargoes, and non-repossession for global corporations.²²

Lastly, Sovereign Risk Insurance, Ltd (‘Sovereign’), an international, leading underwriter of political risk insurance (like the private insurers already discussed in this review) in order to meet recent demands, has expanded significantly its political risk insurance and includes coverage in areas such as sovereign and sub-sovereign non-payment and political violence.²³ According to a recent news article, Sovereign expects to face numerous claims because of the recent Egyptian upheaval and political violence taking place in Egypt.²⁴ Sovereign, like most private political risk insurance providers, also offers political risk insurance coverage in the traditional areas such as expropriation, currency inconvertibility/exchange transfer, unfair calling of bonds, non-repossession of aircraft or mobile equipment, and other customized coverage including embargoes and license cancellations.²⁵

In addition to offering new products for political risk insurance coverage, many private insurers have also been paying out claims brought by businesses under their new products.²⁶ While much of the information regarding private insurer claim history is not made public, some of the private insurers made such claim payments known on their websites.

For example, in 2009, Zurich Emerging Markets Solutions (‘Zurich’) paid a total of nine claims alone.²⁷ One claim, in the Ukraine, was for \$85,000,000 where “lenders financed the sale of commodities and other items to buyers supported by letters of credit from Ukrainian banks ... [and the] lenders suffered losses when the Ukrainian banks were unable to meet their obligations due to the effects of the global credit crisis.”²⁸

In another claim, Zurich paid a claim of \$3,000,000 where a “manufacturer

sold telecommunications equipment to a Bolivian customer who installed some of the equipment for a governmental entity in Ecuador. When the governmental entity failed, the Bolivian customer was unable to repay in accordance with the contract with the manufacturer.”²⁹

Between 1999 and 2005, Sovereign Risk Insurance Ltd. (‘Sovereign’) paid a total of five claims.³⁰ For one claim, Sovereign paid a claim to three European commercial banks for a defaulted scheduled payment on an export finance loan to the Government of the Dominican Republic.³¹

New products meeting market need

The developments in political risk insurance, as discussed by this review, remain significant. The changes in the demands for political risk insurance coverage not only reflect the market need for such products, but also reflect the demands of businesses and companies, who are reacting to current worldwide events and political turmoil.

THE NEW PRODUCTS OFFERED CAN HAVE SIGNIFICANT BENEFITS FOR BUSINESSES IN LIGHT OF WHAT IS GOING ON IN THE WORLD TODAY.

The new products offered can have significant benefits for businesses in light of what is going on in the world today. The new products also seem to be meeting the current market need and demand as well. For example, on March 10, 2011, the OPIC board approved \$250 million in insurance to provide medical equipment for hospitals in Ghana.³² Currently, throughout Africa, many countries are experiencing unrest from political instability.³³ Political Risk Insurance coverage, offered in both the public and private sectors, in areas such as political violence, or sovereign defaults can be especially helpful to projects in Africa to insure against the political instabilities.

As mentioned earlier in this review, OPIC has also recently been offering facilitating financing for renewable resource projects. For example, on March 10, 2011 the OPIC board approved \$58 million for a hydropower project in Georgia.³⁴ The new products being offered

in areas such as political violence, or sovereign defaults can also be especially helpful to insure such projects against instabilities in nations abroad and meet the needs of the market for renewable resource projects.

Businesses are currently purchasing political risk insurance to insure their projects against uncontrollable turmoil in countries abroad. China Gezhouba Group Co., Ltd. purchased political risk insurance to insure its house building project against any political instability in Libya, for example.³⁵ The ability of political risk insurers, in both the public and private sectors, to update, and expand coverage to meet business demands is very important in light of current worldwide events.

One timely point to consider in light of Japan’s recent natural disaster, is regulatory change in the wake of natural disasters. Certain regulatory changes instituted in response to such disasters—such as those involving energy or natural resources—can impair investments without constituting an expropriation. In such instances, entering into a bilateral investment treaty and actual treaty coverage may be more advantageous where the risk is less fluid. However, the developments in political risk insurance, as discussed by this review, remain significant, as the new products are working with both the demands of businesses and the needs of the market. ■

NOTES

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² *Turmoil in the MENA Region & Increased Risk Premium Support to Exporters and Investors*, African Trade Insurance Agency, 2011 Press Releases, <http://www.ati-aca.org/press.php?id=32&yid=2011&pid=86>; see also *The Return of Political Risk*, NewsTime, February 17, 2011, http://www.newstime.co.za/Business/The_return_of_political_risk/20988/.

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⁵ See Yan Pei, *China’s Libyan Projects on Hold Indefinitely*, China.org.cn, March 21, 2011,

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- ⁶ See Julia Kollwe, *Rich Rush for Insurance Cover Amid Middle East Turmoil*, Observer, March 6, 2011, <http://www.guardian.co.uk/business/2011/mar/06/insurance-middle-east-turmoil>
- ⁷ OPIC, <http://www.opic.gov/sites/default/files/OPICrenewableresourcesproducts.pdf>.
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- ¹² Julia Kollwe, *Rich Rush for Insurance Cover Amid Middle East Turmoil*, Observer, March 6, 2011, <http://www.guardian.co.uk/business/2011/mar/06/insurance-middle-east-turmoil>.
- ¹³ *Id.*
- ¹⁴ AIG Global, http://www.aig.com/aigweb/internet/en/files/mkt_WS_PoliticalRisk_tcm20-14776.pdf. Such acts of political violence mirror current situations in countries abroad, such as in Libya and Egypt.
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- ¹⁶ *Id.*
- ¹⁷ Meridian Finance Group, http://meridianfinance.com/political_risk.html.
- ¹⁸ *Id.*
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- ²⁰ *Id.*
- ²¹ Zurich Emerging Markets Solutions, <http://www.zurichna.com/internet/zna/SiteCollectionDocuments/en/Products/tradecredit/FinalClaimsOverview.pdf>.
- ²² Aon, <http://www.aon.com/risk-services/political-risk.jsp>.
- ²³ Sovereign Risk Insurance, Ltd, http://www.sovereignbermuda.com/claims_history/claims_history.html.
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- ²⁹ *Id.*
- ³⁰ Sovereign Risk Insurance, Ltd, http://www.sovereignbermuda.com/claims_history/claims_history.html.
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- ³² OPIC, <http://www.opic.gov/news/press-releases/2009/pr031011b>
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