The challenge of mitigating political risks for investments in MENA

Despite the risks associated with investing in the emerging markets, most companies still do not purchase political risk insurance when investing abroad, writes **Mr Jim Williams**, Director, Insurance for the Overseas Private Investment Corp.

As the global economy slowly recovers and FDI flows begin to increase, the level of political risk associated with investing, as perceived by investors, is also on the rise. According to the 2009 World Investment and Political Risk report by the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group, multinational enterprises investing in developing countries ranked political risk among their top three concerns, followed behind by macroeconomic stability and access to finance.

Nowhere are political risks more apparent than they are to US investors planning to make long-term investments in the Middle East and North Africa (MENA) region. The discussion should begin, however, with an overview of political risk insurance and how all foreign investors can take advantage of the protection such coverage offers against noncommercial risks such as the risk of loss due to political violence.

Figure 1: Government-sponsored insurers

Single government insurers:

- US: Overseas Private Investment Corporation (OPIC)
- Japan: Nippon Export & Investment Insurance (NEXI)
- UK: Export Credit Guarantee Department (ECGB)
- Canada: Export Development Corporation (EDC)

Multilateral insurers:

- The World Bank: Multilateral Investment Guarantee Agency (MIGA)
- Islamic Development Bank: Islamic Corporation for the Insurance of Investments and Export Credit (ICIEC)

What PRI covers

Political risk insurance (PRI) generally offers protection against three broad categories of risk: expropriation, inconvertibility, and political violence.

While politically motivated actions resulting in expropriation derive from actions of the host government and inconvertibility events arise when it is not possible to exchange and transfer local currency into hard currency, political violence typically results from violent acts to remove a government from power or which cause significant changes in the ways a country is governed.

Political violence coverage typically protects companies against a loss of assets or business income due to events such as terrorism, sabotage, revolution, insurrection, war, and civil war – essentially any politically motivated act of violence. This coverage is a much broader protection than is afforded under property and casualty insurance policies that routinely exclude perils like terrorism and war.

Since political violence coverage requires specialised knowledge and no prospect of salvage, private insurers are reluctant to offer the coverage, particularly on a stand-alone basis. However, political violence coverage is available from the Overseas Private Investment Corporation (OPIC) and other government-sponsored insurers because such public insurers have a different mission and a greater tolerance for taking political violence risk than might otherwise be

Figure 2: Eligibility requirements for OPIC insurance

Investor eligibility

- US citizens
- Corporations or associations in the US
  - Must be majority owned by US citizens or US corporations
  - Not-for-profit entities in the US provided majority of the Board of Directors are US citizens
- Entities established outside the US
  - Corporations must be more than 95% owned by US citizens or corporations
  - Other entities must be 100% owned by US citizens or corporations
- Insured investor must retain ownership and bear some risk of loss

Project eligibility

- "Greenfield" or new investment projects
- Privatisations, including expansion or rehabilitation of facilities
- Existing investment provided there will be new investment (25% of total to be insured)
- Developmental for the host country and not harmful to the US economy
- Not harmful to the environment, worker health, safety or rights

Country eligibility

- Available in over 150 countries worldwide; check OPIC website – www.opic.gov

available from the private insurers.

Government-sponsored programmes are offered by most countries with developed economies to encourage their citizens to invest in emerging markets. Such programmes include not only those sponsored by single governments, but also multilateral agencies which are funded and supported by multiple countries. There are 40 such PRI insurers, several of which are shown in Figure 1.

Mandate of OPIC

OPIC is a US government agency with a mandate to mobilise, facilitate, and support US private capital and skills to invest in emerging markets around the world through investment funds, project financing, and political risk insurance. OPIC and its predecessor agency have been offering protection against political events to US investors since the end of World War II (Figure 2 outlines the eligibility requirements for OPIC Insurance). OPIC alone has provided US$43 billion of political risk coverage to over 3,100 projects in more than 150 countries around the world since 1971 and has paid $970 million of compensation for 290 individual insurance claims.

OPIC has been and continues to be an active provider of PRI coverage in the MENA region as both an insurer of US companies and a reinsurer of private insurance companies. The MENA region currently represents 22% of OPIC's total PRI portfolio, second in size only to sub-Saharan Africa. Within the region, OPIC has provided coverage to projects in a range of industries, from energy and infrastructure to construction and manufacturing to financial services and tourism.

Among the three basic types of PRI coverages against inconvertibility, expropriation and political violence, more US companies in the MENA region are currently being insured by OPIC against political violence than the other two coverages combined.

While current statistics are hard to come by, the National Counterterrorism Center estimates that the vast majority of terrorist incidents directed against US targets from 2005-2009 took place in the MENA region. When data from Iraq are excluded, still a third of all reported incidents of terrorism against Americans occurred in the MENA region, claiming more than half of all American victims of terrorism during this same period. Considering the number of US companies operating in the MENA region, the percentages may not be high, but the numbers do suggest that US companies face a heightened risk of loss due to political violence when investing in this region compared to the rest of the world. So it is not surprising that US companies are more frequently seeking OPIC support to help mitigate their risk, particularly where their assets are highly concentrated or flammable. One such company looked to OPIC for $200 million of political violence coverage before building a new petrochemical plant in the Persian Gulf.

Low PRI penetration

Despite the political risks associated with investing in the emerging markets and the overall perception that risks to foreign investment are increasing, it is surprising that the majority of companies, US included, still do not purchase PRI coverage when investing abroad. The same MIGA report cited at the beginning of this article also noted that 67% of investors self-insure instead of purchasing PRI. When asked for other reasons why they did not make use of PRI, investors responded that they did not believe the level of risk warranted PRI, that the costs of coverage were too high or that they were simply unaware of PRI products. Part of OPIC's shared challenge with other insurers is the challenge of gaining the attention the large number of companies who are investing and to educate them about the very real benefits of having PRI.

In addition to serving as a direct insurer of PRI to US investors, OPIC also has the ability to offer reinsurance to local private insurance companies that would like to provide political violence coverage together with their property and casualty coverage. For example, OPIC recently provided reinsurance to a local insurance company in Iraq for political violence coverage for a multimillion dollar infrastructure project that includes US investment. Such an arrangement not only allows the local insurance company to cede a large proportion of the risk to OPIC, but also to develop the experience and skills to underwrite risks covered by PRI.

The world is becoming more dangerous and risky, not less so, according to the perceptions of foreign investors. Whether these investors need to or should consider PRI is largely a function of the risks associated with a particular host country and investment. Yet, for US companies in the MENA region, political violence is an all too real risk that can threaten not only investment but also lives. OPIC's experience and longstanding track record of providing political violence and other types of PRI coverage can serve as an important resource to help US companies understand how to substantially mitigate such risks.