World Bank Group
Multilateral Investment
Guarantee Agency

Political Risk Insurance
and Investment Promotion

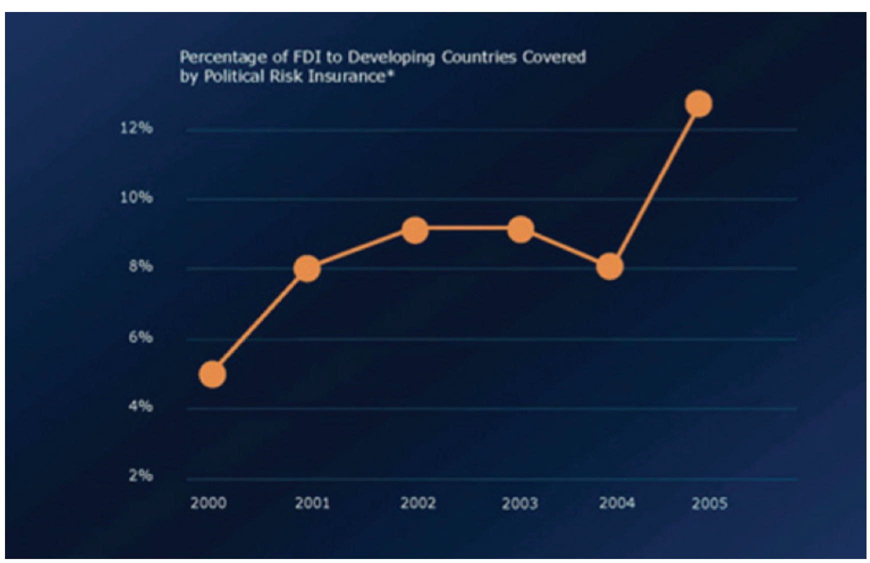
Against the backdrop of the global economic decline, investor perceptions of political risk are on the rise. Recent surveys and reports also show that most investors expect political risk to increase further over next five years. Coupled with the global economic recession, sharp declines in FDI flows and the re-emergence of "resource nationalism", investment promotion intermediaries (IPIs) face an uphill climb to attract foreign investors. However, powerful and innovative risk mitigation instruments in the form of political risk insurance (PRI) exist to help IPIs and their investor clients manage political risk in the calculus of investors and keep cross-border investment flowing. This article offers an overview of political risk and PRI, and suggests how IPIs can use risk mitigation instruments, such as PRI, to facilitate the investment process..

What is Political Risk Insurance?

Political risk insurance is a tool for businesses to mitigate and manage risks arising from adverse actions—or inactions—of governments. As a risk mitigation tool, PRI helps provide a more stable environment for investments into developing countries, as well as better access to finance. For investors, PRI helps reduce the risk profile of their envisaged projects, thereby increasing the probability of a better risk-weighted return. For lenders, PRI is often a prerequisite for investors to borrow money to fund projects in emerging markets. Purchasing PRI may also improve access to financing, increase the size of a loan, result in reduced interest rates, or lengthen the tenor of loans. As the chart below illustrated, increasingly larger percentages of FDI to developing countries are being covered by PRI which indicates a growing demand for non-commercial risk insurance.

Who Provides Political Risk Insurance?

The PRI industry is composed of private and public providers, as well as multinational entities, such as the World Bank's Multilateral Investment Guarantee Agency (MIGA). Private PRI providers, such as the Lloyd's syndicates, offer coverage for varying tenors and projects and are speedy in their project underwriting. Many public providers are national export credit agencies (ECAs), which cover both export credit/trade transactions,



as well as longer-term investments. They may offer particular programs to support investors based in their country in line with their priorities and objectives. Multilateral agencies providing PRI also offer special programs to investment projects that promote their strategic goals, e.g. investments by small and medium enterprises, FDI by multinationals based in developing countries etc.

Which Risks Are Covered by Political Risk Insurance?

Common political risks covered by PRI are expropriation; breach of contract; war and civil disturbance; and currency transfer restrictions. The PRI industry is constantly seeking to develop new and innovative products and services to suit emerging needs of investors. For example, prior to the 9/11 terrorist attacks in the United States, only a handful of PRI providers – MIGA being one of them -- provided terrorism insurance, but terrorism coverage is now more widely available.

Why is Political Risk Awareness Important for IPIs?

Political risk is becoming more prominent as a factor determining the location of a project, and IPIs need to be aware of the consequences of such risk in business and investment decisions of multinationals. Today, a variety of political risk ratings indicate that a number of developing countries are associated with relatively high political risk and such perceptions can hinder significantly IPIs' efforts to target new investment. This may be more so in countries seeking foreign investment in their extractive sectors, or looking to develop or upgrade their infrastructure in partnerships between foreign investors and national or provincial governments.

Rather than ignoring adverse investor perceptions regarding the presence of political risk, IPIs must be in a position to address directly such concerns. This means, first of all, building an awareness of investor political risk perceptions and candidly assessing the extent to which these are valid. Such awareness will enable IPIs to discuss openly specific political risks facing their country with potential investors and respond appropriately on how these can be mitigated. IPIs should be in a position to help potential investors distinguish between political risks, typically covered by PRI, and commercial risks, especially when there is a fuzzy demarcation line between the two. In this context IPIs must also recognize that there is a cost involved in purchasing PRI, and how that features in the location decision process of the investor.

How Can IPIs Address Investor Concerns about Political Risk?

There are several ways for IPIs to address investor concerns. First, IPIs need to be familiar with the types of risk mitigation products available, such as PRI, how these relate to their countries' risk profile, and how relevant these are in addressing the concerns of investors. Second, IPIs must be familiar with providers of PRI and their eligibility criteria so as to direct potential investors to the right provider. Investors should be encouraged to contact various providers to find the coverage most suited to their specific risks and the risk profile of the destination country. In this respect, it is important to be familiar with and draw upon the experiences of other investors in the country who have already purchased PRI. Third, IPIs must be familiar with their countries' PRI claims and investment arbitration record. This is also important for aftercare; foreign investors who have filed PRI claims would need a distinct approach to induce them to invest more in the country. Having an investor file a claim is not necessarily a bad thing since a satisfactory ending to a claim (or potential claim) can send positive signals to prospective investors about the proven ability of PRI to mitigate political risks in the country.

The PRI-Center: MIGA's Online Portal on Political Risk

IPIs first need to become familiar with how political risk factors into their countries' business environment. The Political Risk Insurance Center (PRI-Center.com) can serve as the starting point in learning about political risk and mitigation instruments in general, finding out who offers PRI and other services worldwide and access country pages containing risk ratings, news and relevant resources. IPIs can register to receive email alerts on new content, as well as the monthly PRI Briefing, an e-newsletter highlighting reports, news and events pertaining to political risk.

About MIGA

MIGA's mission is to encourage foreign direct investment into developing countries to support economic growth, reduce poverty, and improve people's lives. MIGA fulfills this mandate by offering political risk insurance (guarantees) to investors and lenders. For additional information on political risk insurance, contact MIGA at migainquiry@worldbank.org.

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