

Mitigation of political risks in PPP water investments in MENA: MIGA and the investment insurance market. Additional regional support mechanisms

Workshop on Risk and Insurance for Water Infrastructure

Athens: October 30-31, 2014

Bertrand Marchais, professor of finance, Audencia Nantes School of Management, former Lead Counsel and Business Development Advisor, MIGA

Political risks: Global and regional contexts

- **Political Risks 2nd most important constraint to FDI** (MIGA survey 2013)
- **Political risks a cyclical phenomenon.** Rising, rising PRI levels. Faster than FDIs
- Huge increase in Investor-state investment disputes in recent years. Close to 600 in 2012 (Unctad Investment Report 2013), including close to 400 ICSID. Rise in water-related disputes. **See next presentation**
- **Political Risks of most concern to investors** (MIGA survey 2013):
 - 1. Adverse regulatory changes
 - 2. Breach of contract (BoC) between investor and state
 - + Expropriation less of a concern, even with recent high profile, **except in MENA**
- **Increasing reluctance by commercial banks:** Aftermath of global financial crisis. Higher provisional requirements (Basle 2)
- **Large insurance capacity in market still available.** Lack of bankable/insurable projects
- **MENA Region:**
 - Arab Spring and political risks, real and perceived
 - Preexisting factors (regulatory environment) and low levels of FDI investments
 - Lower public financing capabilities
 - Retrenchment of banks with expertise in Project Finance and PPPs
 - Increase lack of refinancing opportunities in the context of long term infra. projects.....

1/ Investment insurance

- The investment insurance market
- MIGA and the coverage of water infrastructure investments against political risks
- Investment insurance and investment guarantee synonymous here

The investment insurance market: purpose and structure

- **Why get insurance?**
 - Balance sheet-cash flow protection protection/ Prudential rules and regulations
 - Impact on the value of the company on the stock market if major political risk not insured. Can be critical for SMEs
 - Facilitate access to finance: increase in loan tenor and lower financing costs
 - Management of counterparty limitations by banks
 - Competitiveness of the insured
- **What do we try to evaluate?**
 - Probability of occurrence of a guaranteed event (risk) of a political nature over the medium term (3 to 5 years) which will change the viability perspectives of an investment project
 - Guaranteed Event: Risk of detrimental intervention by a State, a sub national government or an entity controlled by the State. Element of sovereignty required. Also called country or political risk by opposition to a purely commercial event
 - Possibilities to recover amounts paid to insured if such event takes place

Fundamentals of investment insurance risk analysis

- Subject matter of risk analysis
 - + Probability of occurrence of a covered event (claim) of a political nature over the medium term (3 to 5 years)
 - + Potential for recovery and terms and conditions of guarantee contract
 - + Assessment per category of political risks
- Not an exact science. Limited information, growing. Claims by other PRI insurers. Investment disputes litigation
- Main factors
 - Host country *COUNTRY RISK*
 -
 - Investment
 - Project *PROJECT RISK*
 - Guarantee Holder

Political risks analysis: Main steps

- Done by risk category
- Identification of elements which could lead to risk and elements which could limit such risk (risk mitigants) at country level
- Identification of elements which could lead to risk and elements which could limit such risk (risk mitigants) at project level
- Integration of country and project risk elements and mitigants
- Determination of terms and conditions (contract and pricing)

ELEMENTS OF COUNTRY RISKS ANALYSIS

- Review of the country's economic situation
 - Quality of the economic team, capacity to react to economic crisis
 - Forex regulations. Foreign currency reserves.....
- Political system
 - Légitimitacy and stability, interventionnist or liberal...
- Legal system
 - Independance and integrity of judiciary
 - History of treatment of foreign investors and recovery of claims/losses sustained by other insurers and investors
- Probability of recovery and probable importance
 - Probability of happening
 - Recovery factors: existence of a bilateral investment treaty.....

Elements of project risks analysis

- Investor
 - Experience investing abroad
 - Claims/losses in the past
 - Financial strength. Capacity to absorb claim (sinistre).....

- Investment project
 - Economic and financial viability
 - Capacity to remunerate in convertible currencies
 - Agreements with host country (protection BIT, access to currencies)
 - Strategic importance of project for host country
 - Project location.....

Use of Comparators & Indicators.

Ex: Expropriation, Breach of Contract

Comparators

- WB Governance Indicators (WBGI): Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption
- WEF Global Competitiveness Index (Institutions)
- WB Country Policy Institutional Assessment (CPIA): corruption, private sector, property rights
- Transparency Int'l Corruption Perception Index
- IFC Doing Business
- Heritage Index of Economic Freedom
- ONDD Expropriation risk
- Alliant Expropriation risk
- ICSID # of cases
- Berne Union # of cases of expropriation/breach and latest claim

Methodology



- **Probability of a claim**
- **Salvage & recovery prospects**
- **Terms & conditions (contract and pricing)**

- **Combination of qualitative and quantitative analysis**
- **Assessment is per coverage (transfer restriction, expropriation, wcd, boc)**
- **Tenor is medium-term (3-5 years)**

The investment insurance market: Risk management and market participants

- **Political risks management strategies**
 - Avoid risks
 - Insurance/guarantee (public, private)
 - Risk transfer/sharing (sharing the project equity, recourse to loans)
 - Risk limitation and avoidance of claims (sinistres)
 - Insured takes risks on own balance sheet (self insurance)
- **Structure of the investment insurance market**
 - National Export Credit Agencies
 - Multilateral Institutions: MIGA
 - Private insurance market. Insurers and brokers
 - Cooperation

The investment insurance market: Market participants (cont'd)

- **Export Credit Agencies**

- ECAs can cover political and commercial risks
- Short term, and medium to long term activities (investment insurance)
- Main ECAs: COFACE (France), Office du Ducroire (Belgique), OPIC (US) ...
- Statutes: public entities or private companies with public mandate
- Advantages and constraints. Conditions (investment treaty)

- **Multilateral Institutions**

- MIGA and World Bank Group
- Regional development banks : Ex IsDB and ICIEC
- Specialized agencies (IAIGC/CIAGI et ACA/ATI)
- Advantages and constraints : Essential contra cyclical effect in current international context

The investment insurance market: Market participants and cooperation

- **The private political risk insurance market**
 - The Lloyd's of London market
 - Direct insurers: Unistrat, Zurich....
 - Reinsurers: ACE, XL..
 - Benefits: flexible, quick, project oriented
 - Constraints: Cyclical activities, tract record, confidentiality of policies
- **Cooperation among market participants**
 - Reinsurance: Advantages and constraints
 - Co insurance: Pros and Cons
 - Benefits and limitations to such cooperation for the insured and insurer
 - Role of multilaterals/IFIs
 - Berne and Prague Unions

About the Private Market

The Players

‘Corporates’

- About 10, including the “big three” :
AIG, Sovereign, Unistrat_Coface and Zurich

Lloyd’s

- About 35 Syndicates at Lloyd’s
Prominent Lloyd’s PRI insurers :
Ace, Beazley and Catlin

Main types of cooperation

➤ **Coinsurance**

- Advantages
- Constraints

➤ **Reinsurance (treaty and facultative)**

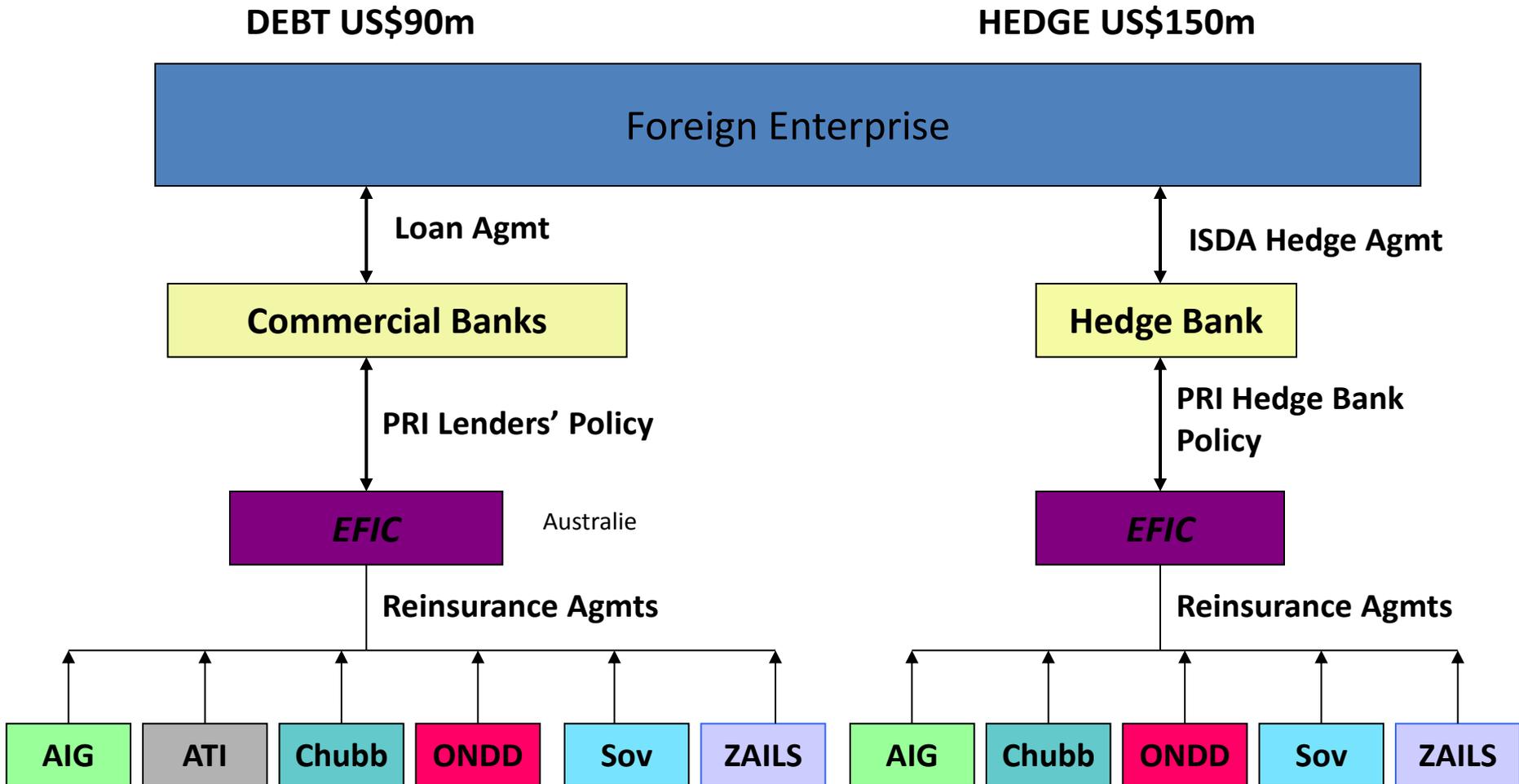
- Advantages
- Constraints

➤ **Risk sharing and increased capacity**

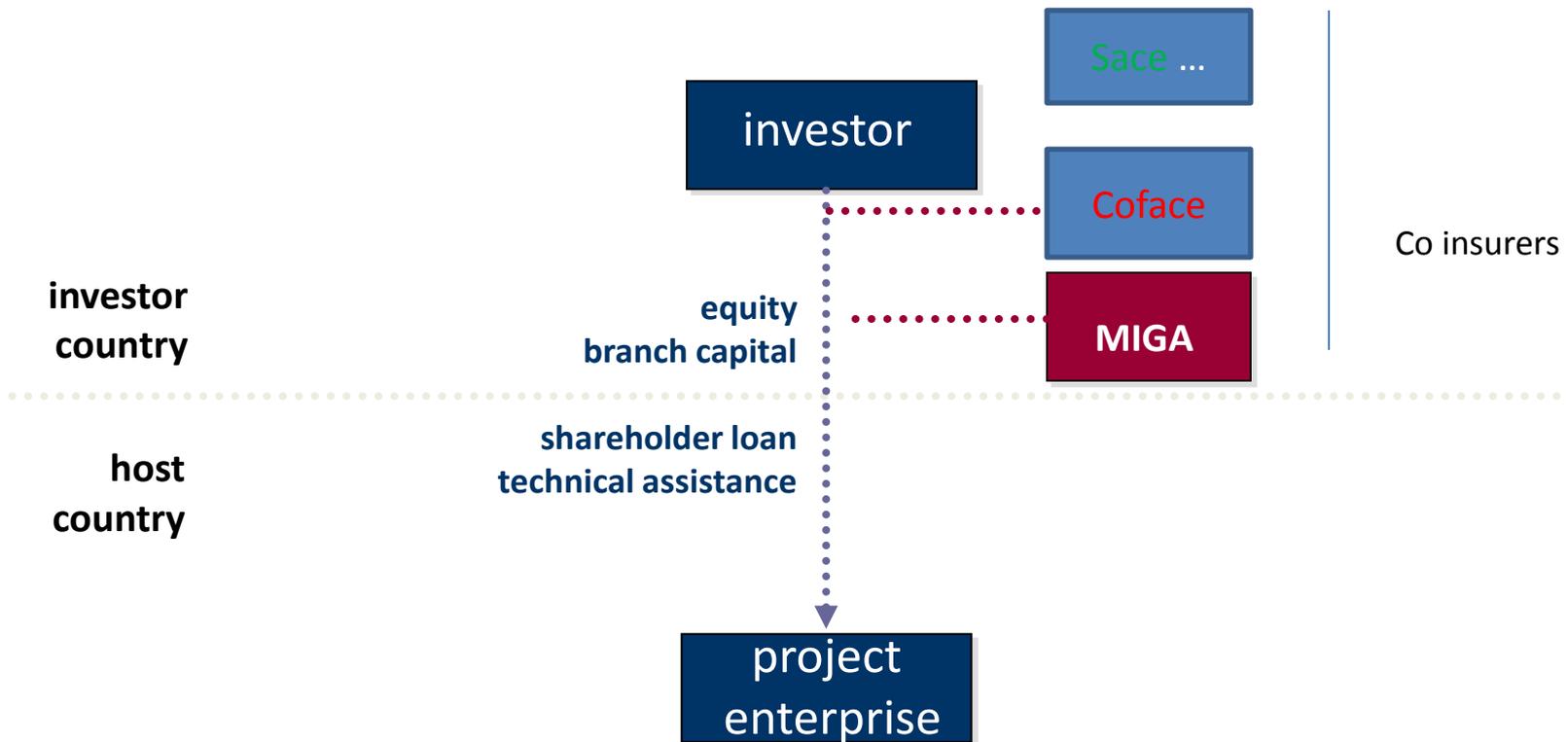
➤ **Berne Union:** Group of insurers (2 sub groups: Export Credit and Investment Insurers). Formed in 1934, provides guidelines and meetings for exchange of views

➤ **Prague Union:** for new and maturing insurers of export credit and investment

PRI Structure Reinsurance



Co-insurance structure



Multilateral Investment Guarantee Agency (MIGA)

World Bank Group

IBRD
International Bank
for Reconstruction
and Development

Est. 1945

Role: To promote institutional, legal and regulatory reform

Clients: Governments of member countries with per capita income between \$1,025 and \$6,055.

Products:

- Technical Assistance
- Loans
- Policy Advice

IDA
International
Development
Association

Est. 1960

To promote institutional, legal and regulatory reform

Governments of poorest countries with per capita income of less than \$1,025

- Technical Assistance
- Interest Free Loans
- Policy Advice

IFC
International
Finance
Corporation

Est. 1956

To promote private sector development

Private companies in member countries

- Equity/Quasi-Equity
- Long-term Loans
- Advisory Services

MIGA
Multilateral
Investment
Guarantee Agency

Est. 1988

To promote cross-border investments

Foreign investors in member countries

Credit Enhancement and Political Risk Insurance for Financial Institutions (loans) and Investors (equity & shareholders loans)

← Shared Mission: "End extreme poverty and build shared prosperity" →

What does MIGA do?

- **MIGA promotes foreign direct investment by providing:**
 - Non-commercial (political) risk insurance (guarantees) for investors and lenders. Commercial risks not eligible.
 - Dispute mediation services, to remove obstacles to current and future investments. Proven success in supporting resolution of investment disputes between states and investors
 - Technical assistance to help countries attract and retain FDI through FIAS (Foreign Investment Advisory Services), a joint department of World Bank Group Institutions
 - Online information on investment opportunities and operating conditions in developing countries

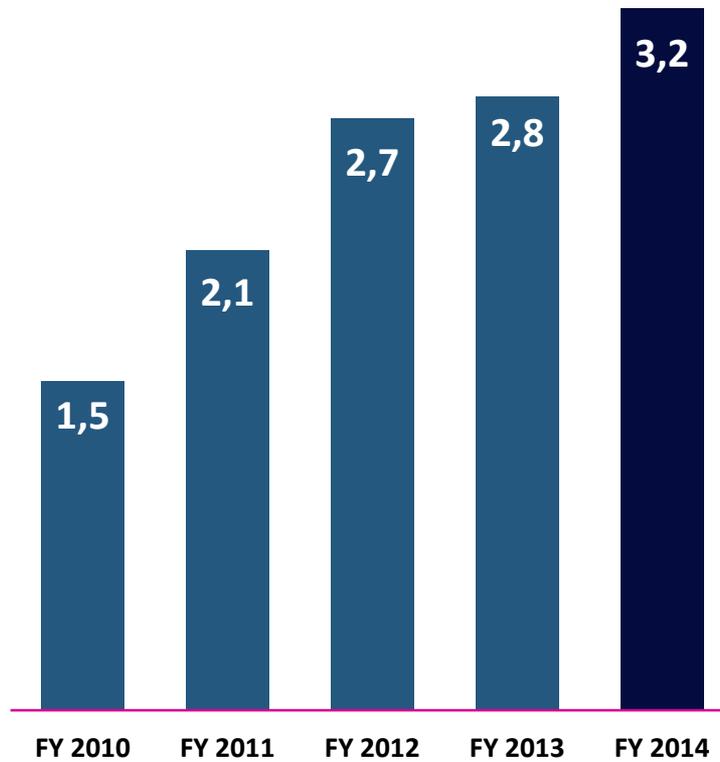
Eligibility/Terms of coverage

1. Investment must be cross border between member countries into developing member country (**North-South** and **South-South**)
2. Cannot participate in purely local deals
3. Eligible sectors: All except standard exclusions (tobacco, weapons, etc....)
4. MIGA can cover new investments, and existing projects, on a project-per-project, or portfolio, basis
5. Coverage of:
 - Equity, including shareholder loans, various profit sharing agreements (management contracts, leases...) capital market transactions.....
 - Loans, together with equity, or on a stand-alone basis
 - Loan guarantees (for the benefit of foreign or local banks)

Eligibility/Terms of coverage

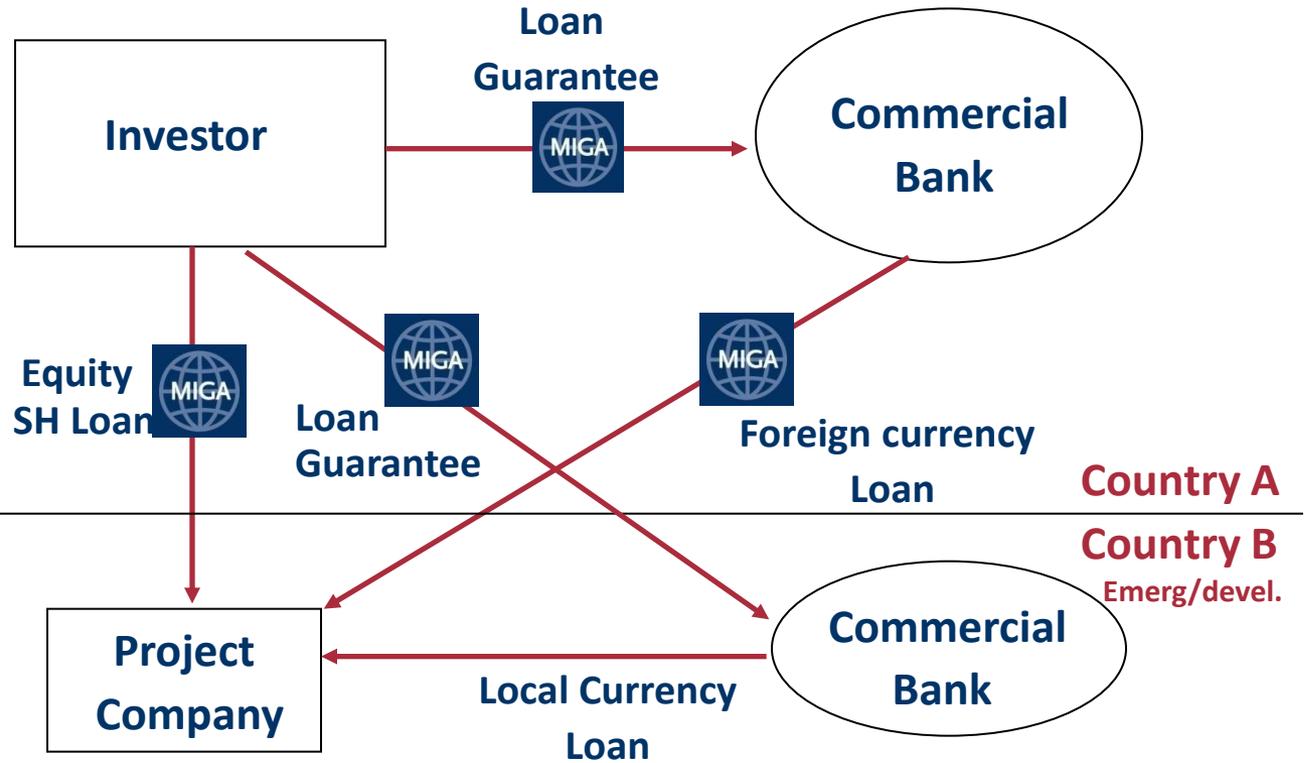
6. Standard minimum term 1 year; maximum of 15, up to 20 in some cases
7. Amounts, Coverage and Pricing
 - MIGA typically can arrange cover for all amounts, on its own books and through the PRI market (co/reinsurance). No minimum amount for guarantee or size of investment
 - Current max. country capacity: 720M USD
 - Equity typically covered up to 90% & debt up to 95%
 - Premiums are paid annually or semi-annually by the beneficiary of the guarantee and are calculated as a percentage rate applied to the amount of coverage. Premium rates are decided on a per project basis and vary by country, sector, transaction and the type of risk insured

MIGA's New Guarantee Issuance (US\$ Billion)



Eligible Structure. Standard MIGA cover

5 contracts
 Equity
 SH Loans
 NSH Loans
 Loan
 guarantee
 + Non
 Honoring



MIGA's PRI Products

- **Political risk insurance coverage**

—————→ 4 categories of covered political risks : *War, Expropriation, Non Transfer and Breach of Contract*

- **Credit enhancement products** (comprehensive risk coverage, political and commercial)

—————→ *Non Honoring of Financial Obligations*

A/ Current MIGA's political risk insurance coverage

Currency Transfer Restriction and Inconvertibility

- Protects against losses arising from:
 - Inability to convert local currency into foreign exchange
 - Inability to transfer funds
 - Excessive delays in acquiring funds
- Currency depreciation is not covered

Expropriation

- Protects against losses arising from:
 - Nationalization and confiscation
 - Creeping expropriation (e.g. through regulatory acts)
 - Partial expropriation (expropriation of funds)
- Non-discriminatory measures not covered, unless such measures have a confiscatory effect

MIGA's current Insurance Coverage (cont.)

War and Civil Disturbance(including revolution, insurrection, coups d'état, sabotage, and terrorism)

- Protects against:
 - Damage/disappearance of tangible assets
 - Business interruption (including short term).... Resulting from covered events
- Acts must have a primary intent of achieving a political objective

Breach of Contract

- Protects against losses arising from Breach or repudiation of a contract between the investor/project company and the host country authorities
 - Non-enforcement of an arbitration/judicial award, or no recourse to judicial/arbitral forum, or decision not rendered in reasonable time
 - In some cases MIGA may provide coverage without requirement of an award (Government unlawfully interferes with dispute settlement rights of investor)
- Waiting Period 180 days
- May cover sub-sovereign obligations and obligations from SOEs
- Payment of provisional indemnity at MIGA's option

Breach of Contract (cont.)

Examples

Host Government breaches its obligations under:

- ❖ **off-take agreement** (*e.g.*, power purchase agreement, water purchase contract)
- ❖ **Supply agreements**
- ❖ **concession** (*e.g.*, toll road, water/waste water concession)
- ❖ **sovereign guarantee** (*e.g.*, payment guarantee for SOE's obligations)
- ❖ **direct agreement** between Host Government and project lenders
- ❖ **Government letter of support/Comfort letter** between Government and investor

Reminder: NO counterguarantee from Government. Guarantee Holder and/or Project Enterprise can claim no more than what they are entitled to under the award/judgment, up to the Amount of Guarantee

Breach of Contract (cont.)

Examples

- Coverage of natural force majeure in exceptional cases. Allocation of FM event to Govt in concession agreement. Exhaust commercial insurance cover, such as ppty.
- Additional recent coverage: non compliance with award under a Bilateral Investment Treaty (BIT) when underlying contract investor-Govt is breached+ umbrella clause in BIT
- BoC coverage in the context of Islamic finance (Doraleh project Djibouti)

Breach of Contract (cont.)

Examples

- Covered contractual provisions
 - Tarif/Price payment clause
 - Termination provision
 - Penalties for delays/Poor performance
 - Force Majeure natural in some cases.....
- Approach:
 - List of items/provisions covered included in guarantee contract (standard)
 - List of exclusions

Darco Water Project (China): Project and Key Risks for Investor



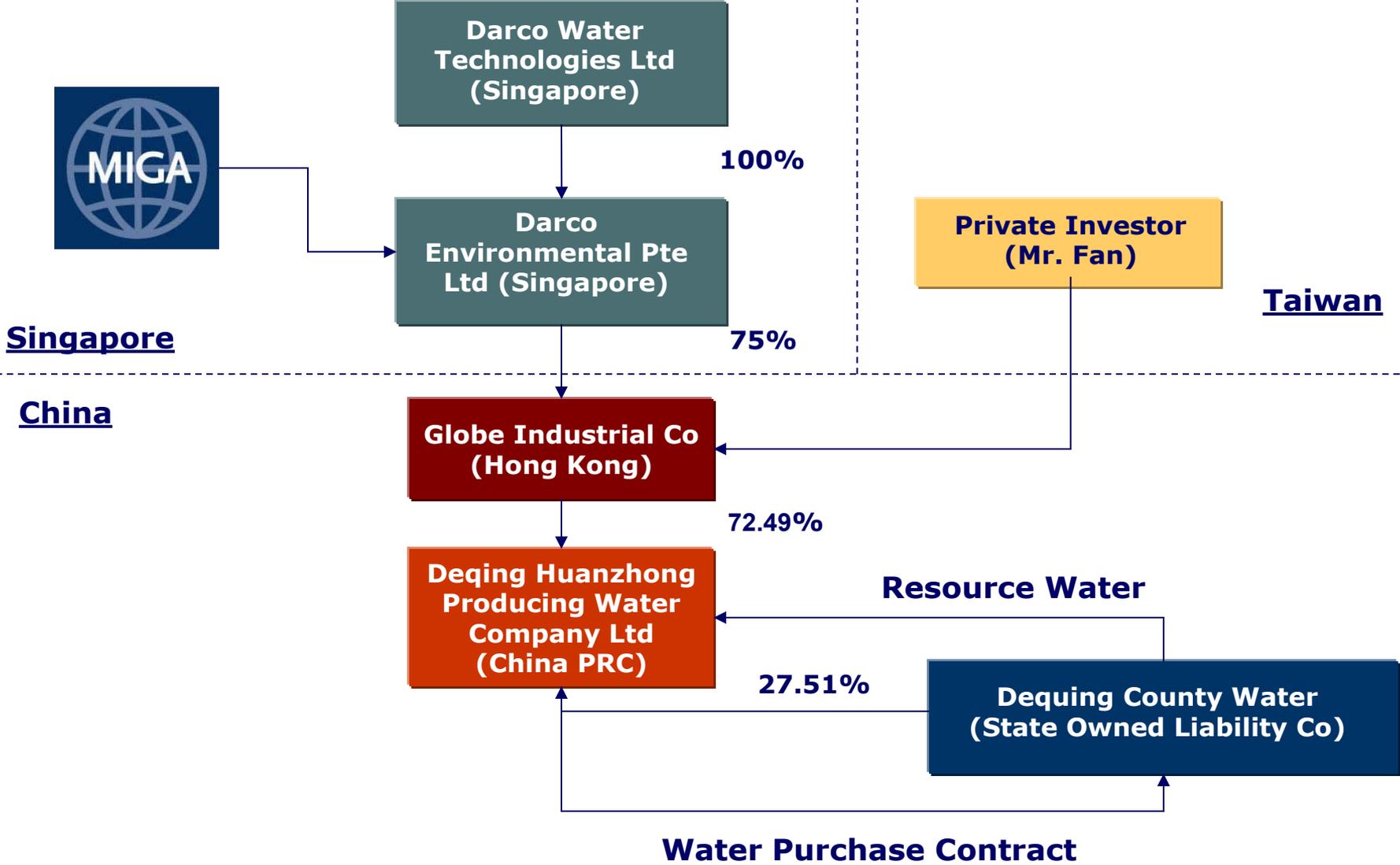
Project

- BOT Construction and operation of a water treatment plant in Zhejiang Province
- 15-year Water Purchase and Sale Contract
- MIGA partnership with Government of China resolved investment dispute

Key Risks for Investor

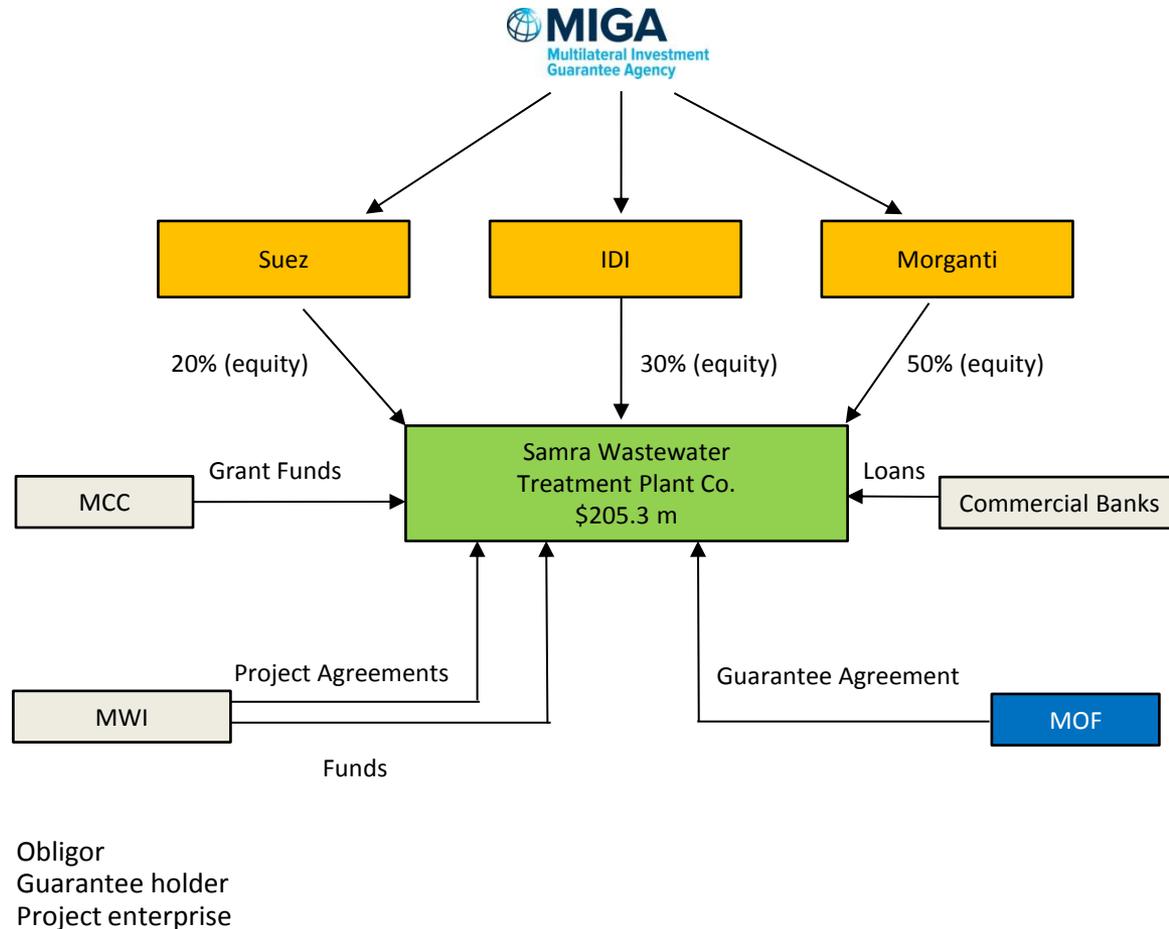
- Sub-sovereign (municipal) risk
- Breach of WPSC (especially tariff clause)
- Expropriation (creeping)
- Civil Disturbances leading to business interruption

Case Study: Darco Water Project (China)



Political Risk Insurance – Breach of Contract Cover

AS Samra Wastewater Treatment Expansion Project, Jordan



- ❖ **Project:** expansion of the existing wastewater treatment plant at AS-Samra, northeast of Amman by Samra Wastewater Treatment Plant Company, Ltd.,
- ❖ **MIGA cover**
 - Amount: \$13.1 million
 - Tenor: 20 years
 - Issued: June 2013

B/ Credit Enhancement Solutions/ Non-Honoring; Comprehensive coverage

- Financial Obligations of Sovereign, Sub-sovereigns and State-owned enterprises (SOEs) :
 - *Lower funding costs for sovereign and sub sovereign borrowers*
 - *Facilitates long term financing for sovereign and sub-sovereign borrowers*
 - *Lower funding costs and improve access to long term financing for public entities (SOEs)*
- Can be purchased separately or in combination with other coverages
- Does not require an arbitral award (unlike BoC)
- Well suited for PPP projects

Criteria for MIGA's Non-Honoring Products

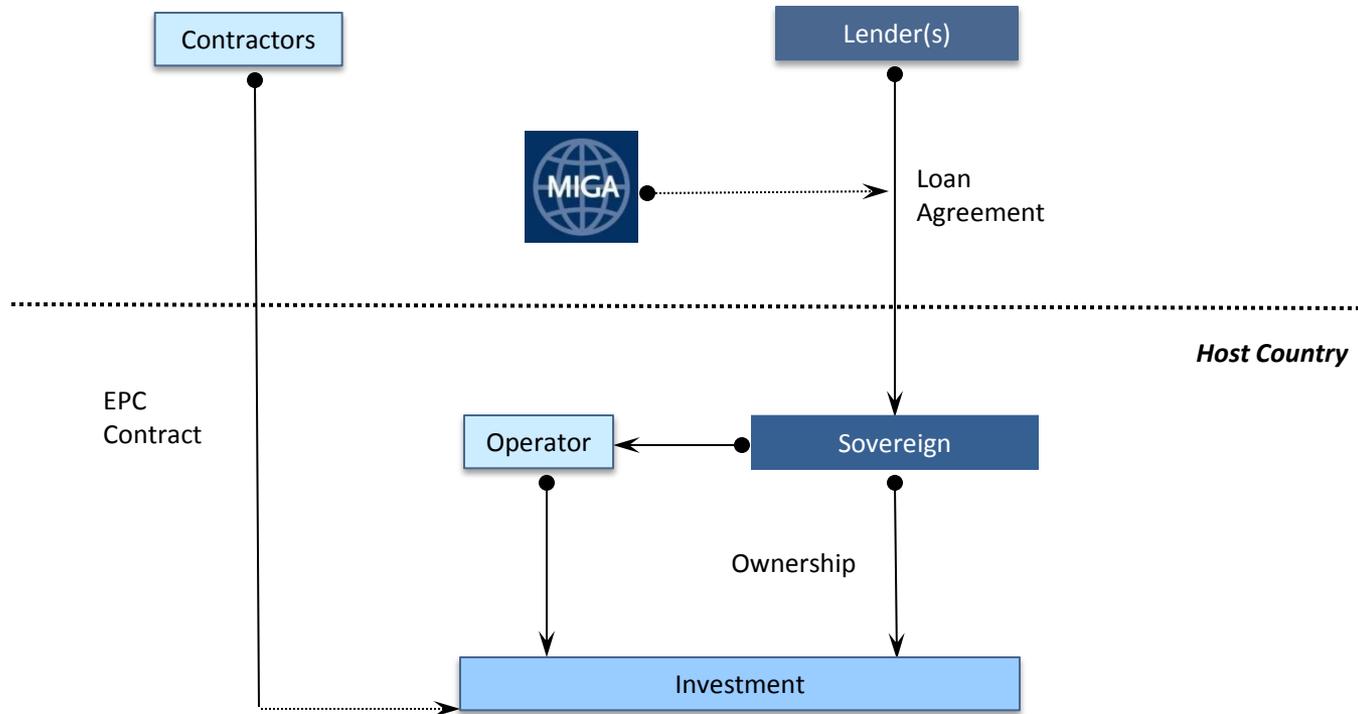
Non-Honoring of Sovereign and Sub-Sovereign Financial Obligations

- Satisfactory credit rating for country/project based on MIGA analysis and rating agency data
- Financial payment obligation is unconditional and not subject to defenses
- Must support an eligible underlying investment project with measurable developmental benefits

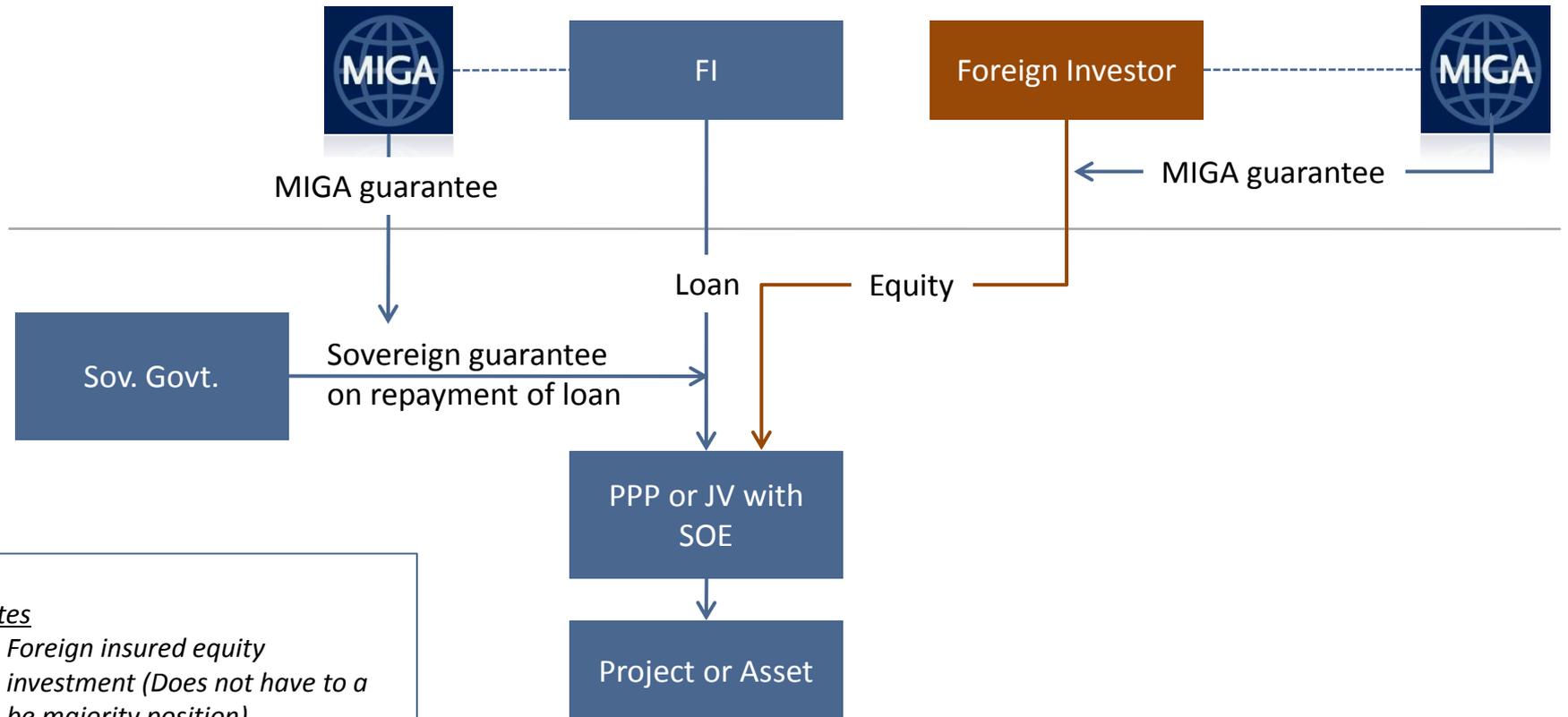
Non-Honoring for State-Owned Enterprises

- SOE must be creditworthy
- SOE must be under the supervision and control of government
- SOE must perform a public function
- Financial payment obligation is unconditional and not subject to defenses
- Must support an eligible underlying investment project or portfolio with measurable developmental benefits

NHFO Project Structure



Example of Structure for NHFO

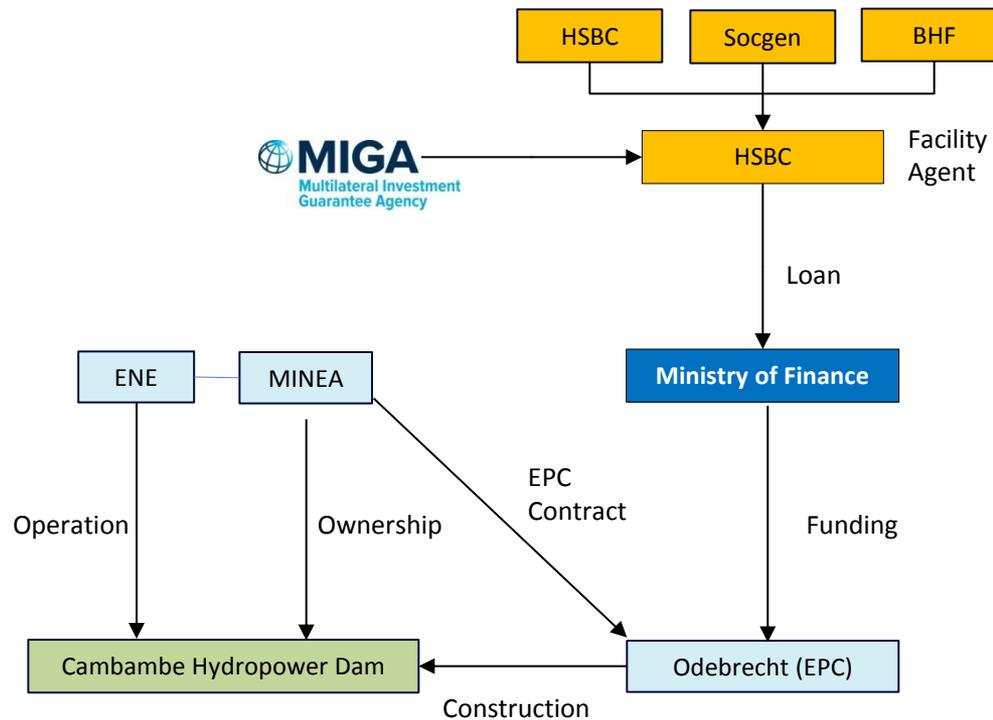


Notes

- Foreign insured equity investment (Does not have to be majority position)
- Identified project

Non-Honoring of Sovereign Financial Obligations

Cambambe Hydropower Plant, Angola



- Obligor
- Guarantee holder
- Project

❖ **Project:** Expansion of a hydropower dam in Angola

❖ Will add 700 megawatts to Angola's generation capacity.

❖ **MIGA Cover**

- Amount: \$512m
- Tenor: 13 years
- Issued: June 2013

COOPERATION AMONG MIGA AND PUBLIC AND PRIVATE POLITICAL RISK INSURERS

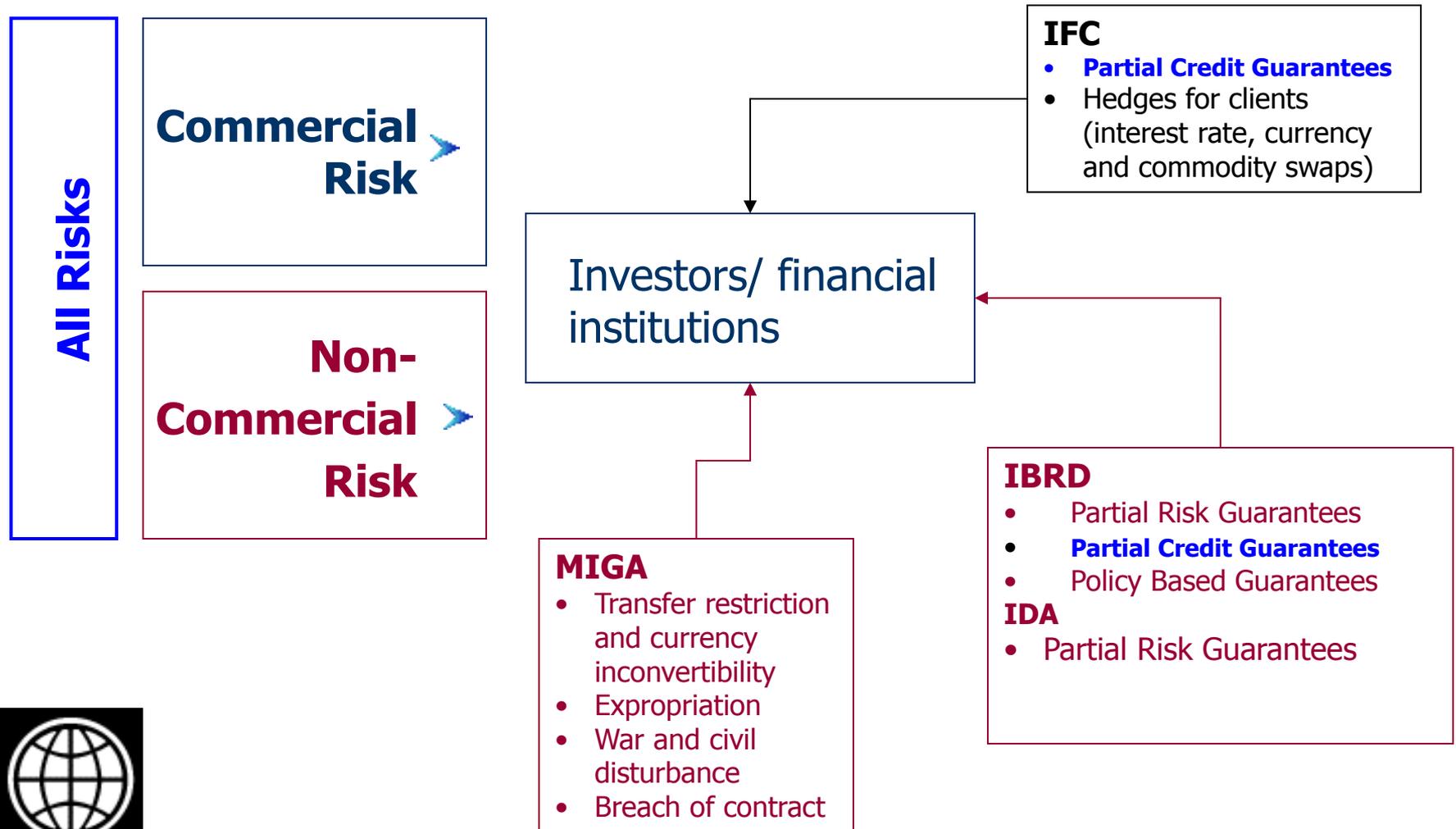
- **Specific mandate of MIGA's statutes**
- **Forms of cooperation**
 - Co-insurance(syndication) and re-insurance, with national, multilateral and private sector operators. Cooperative Underwriting Program
 - Cooperation with domestic ECAs/investment guarantee systems in emerging countries
 - When the national ECA does not have enough capacity
 - When the national ECA cannot intervene because of its own statutory limitations
 - Technical assistance (Cotunace.....)
 - Member of the **Berne Union**
- **As the only global multilateral insurance institution in its sector, MIGA is at the center of a network of private and public operators of the political risk investment insurance**

Cooperation with other World Bank Group 6 financial instruments

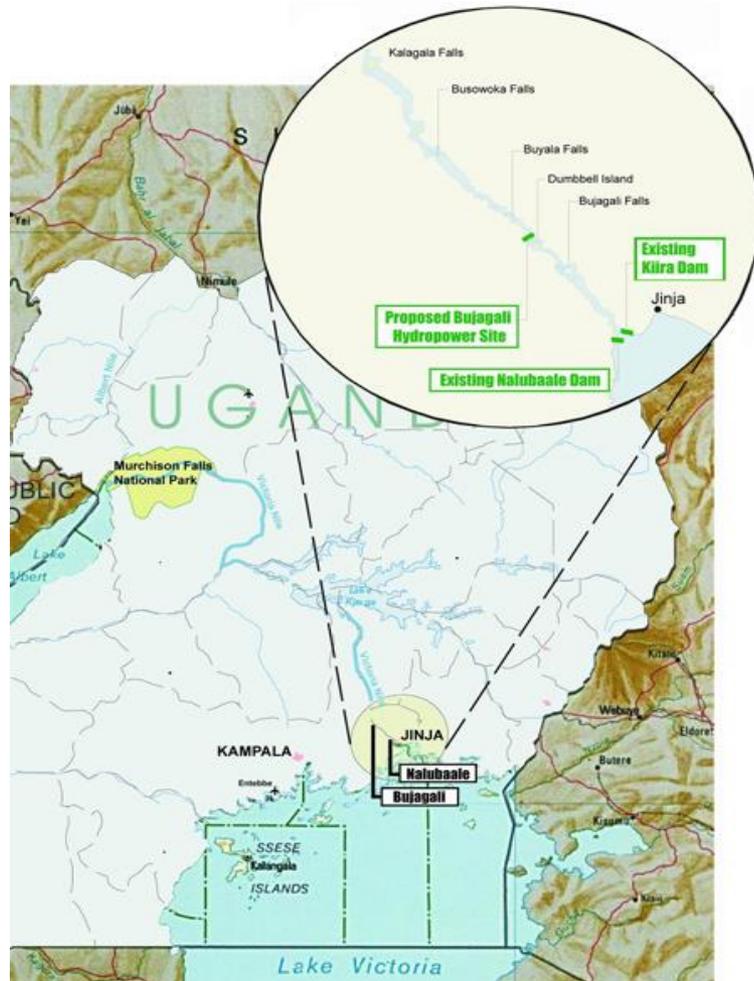
+ World Bank Group Financial Instruments are complementary

+ Flexible and coordinated deployment rules according to characteristics/profile of project and country

World Bank Group Guarantees Framework



Bujagali Power Generation Project (Uganda): Example of cooperation among World Bank Group institutions



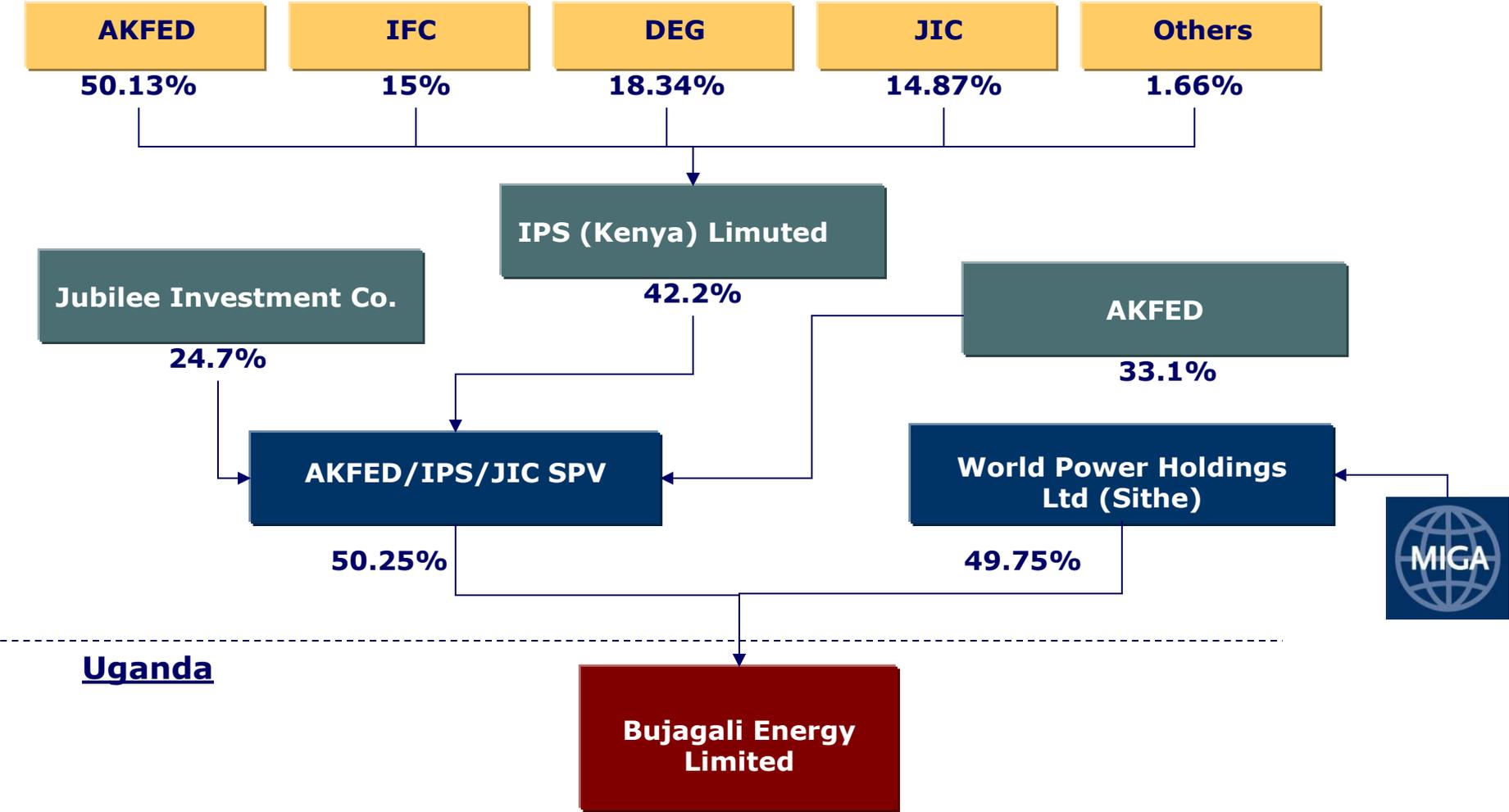
Project

- 250 MW run-of-river hydroelectric power plant in Uganda
- \$799 million
- Environmentally sustainable power generation
- Support from World Bank Group Agency (MIGA, IDA, IFC)

Key Risks for Investor

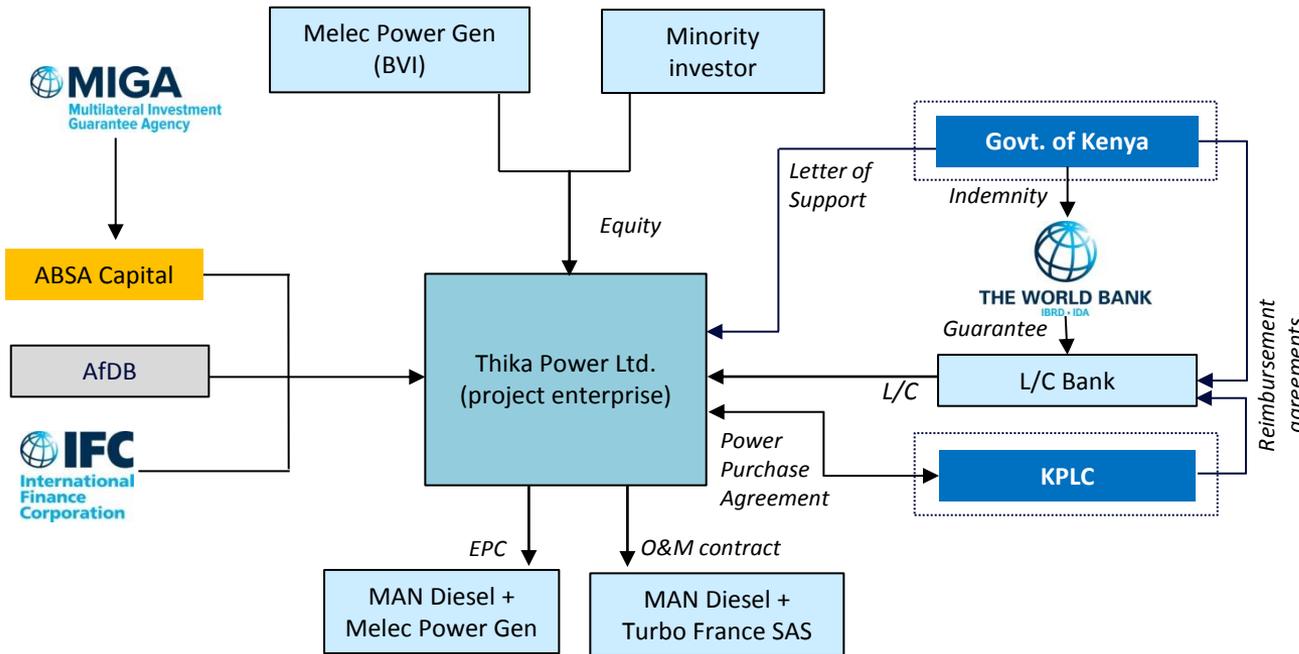
- Breach of Contract
- Interconnection (Umeme)
- Hydrology
- Force Majeure

Case Study: Bujagali Power Generation (Uganda)



WBG Cooperation. Political Risk Insurance – Breach of Contract Cover

Thika Power Ltd., Kenya



- Guarantee holder
- Project enterprise
- Obligor

- ❖ **Project:** Construction of a heavy fuel-oil plant near Nairobi (87 MW)
- ❖ 20-year power purchase agreement with Kenya Power and Lighting Co.
- ❖ MIGA cover on a loan from ABSA
 - Amount: \$62m
 - Tenor: 15 years
 - Issued: May 2012

Why MIGA and When?

WHY?

- Facilitate access to financing
 - Lower costs of borrowing
 - Longer tenor of loans
 - Access to capital markets and credit enhancement (mortgage securitization/ coverage of bond issues)....
- Stable premium pricing as compared to private sector.
Countercyclical effect
- Facilitation of settlement of disputes/umbrella of deterrence
 - Mediation role (**see next session**)
 - Deterrence effect (member of the World Bank Group)
 - *Very small number of claims*
- **Flexibility/accessibility:** new products (Islamic finance, currency swaps)
- No counter guarantee required from Host Government
- Capacity to mobilize large guarantee capacity in the market

WHEN MIGA?

- No obligation to have recourse to MIGA
- As soon as possible in project cycle
 - If late, may jeopardize recourse to loan finance since MIGA needs to participate in loan cooperation agreements (recovery and security, such as access to shares of project enterprises)
 - Ideally at tender stage since will determine if project is eligible and make project more bankable if at the margin. MIGA can provide indicative pricing conditions at this stage and commitment to cover if tender is won
- By whom?
 - Usually project sponsors (investor or Government)
 - Commercial banks in connection with participation in tenders
 - Their representatives (brokers, advisors.....)
- Underwriting process: Preliminary Application (response within 48 hours, determines eligibility) followed by Definitive Application as a basis for underwriting

2/ Additional Regional Support Mechanisms

- The Investment Security in the Mediterranean initiative (Ismed)
- The Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC).
Traditional PRI and Sukuk insurance policy
- Facility for Euro-Mediterranean Investment and Partnership (FEMIP)
- AfDB's Initiative for Risk Mitigation in Africa (IRMA).....

ISMED Initiative

- Establishment of a **support programme** (managed by the MENA-OECD Investment Programme)
- Establishment of a Joint **ISMED Working Group** to reflect on means to facilitate financing for infrastructure investments (on-going). 4 Task forces with 4 general topics:
 - Facilitate access to investment guarantee/insurance instruments, refinancing, and deployment of long term EU financial instruments
 - Develop arbitration in the Mediterranean region
 - Encourage Risk mitigation in PPPs
 - Encourage use of Islamic Finance

*The Investment Security in
the Mediterranean (ISMED)
Support Programme*



- Promoting infrastructure investment in the Southern Mediterranean through :
 - ▶ **Policy advice for governments** on designing sustained policy frameworks for reducing the legal and regulatory risks of private investment in specific infrastructure projects (ex RWE)
 - ▶ **Public-Private dialogue** to help ensure that project-specific recommendations lead to broader policy reforms
 - ▶ **Information-sharing for private investors** on available guarantee and financing instruments (via a guarantee database and quarterly newsletter)

The ISMED Support Programme is implemented by the MENA-OECD Investment Programme with funding by the European Union.

EIB FEMIP (Facility for Euro-Mediterranean Investment and Partnership)

Objectives and priorities

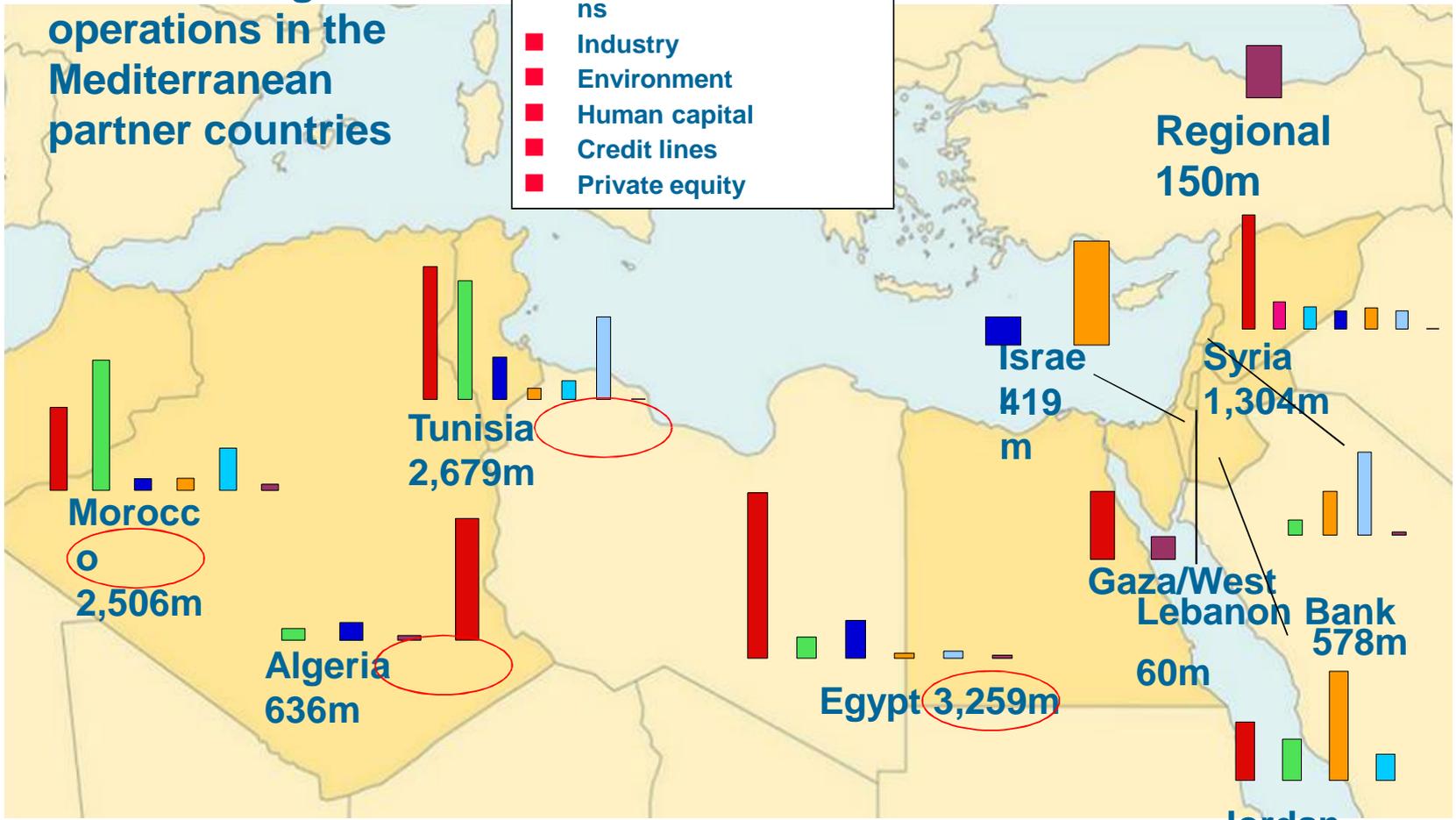
Bringing together the whole range of EIB instruments in the Mediterranean partner countries (MPCs)*.

- ▶ Objective: to support the modernisation and opening up of MPCs' economies. Finance granted under mandates conferred to the EIB by the
- ▶ Member States (finance from the EIB's own resources with an EU
- ▶ guarantee)
- ▶ Two priorities:
 - ▶ support for the private sector including via guarantee s
 - ▶ the creation of an investment-friendly environment.

* **Algeria, Egypt, Gaza/West Bank, Israel, Jordan, Lebanon, Morocco, Syria and Tunisia.**

EIB financing operations in the Mediterranean partner countries

- EUR**
- Energy
 - Transport
 - Telecommunications
 - Industry
 - Environment
 - Human capital
 - Credit lines
 - Private equity



From October 2002 to December 2010: almost EUR 12bn

IRMA initiative

African Development Bank

- Build information and knowledge capital on risk evaluation and coverage instruments, and provide risk mitigation brokerage services to African countries, ICA members and private investors.
- Enhance the platform of AfDB's RMIs and its capacity to leverage private investment for infrastructure financing, through public private partnerships, based on a dedicated technical assistance trust fund.