

# POLITICAL RISK

Willis



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When investing or undertaking contracts in emerging markets, companies are frequently exposed to political turmoil. However prudently a company researches counterparties and monitors events, adverse political circumstances can arise which put the balance sheet at risk.

In recent years, the scope and flexibility of insurance against political risk affecting foreign investments and trade transactions has grown dramatically. Political Risk Insurance can provide valuable protection to the foreign investor, exporter or importer.

### **ASSET RISKS**

Many companies undertake an increasingly wide array of investments abroad. These often take the form of manufacturing subsidiaries, build-own-operate-or transfer projects, mobile assets used in construction projects and joint ventures with foreign governments.

Foreign investment will prosper, however only as long as the host country tolerates it. The prudent investor needs to assess the specific political and economic risks which could – in the long run – undermine the viability of the investment.

Such risks could include:

- Confiscation, expropriation or nationalization of an investor’s permanent or mobile asset
- Deprivation or inability to export finished products from the foreign investment or to repatriate mobile assets
- Discriminatory governmental actions or acts of expropriation, which deprive an investor of its rights in the country or render the operation uneconomical
- Export or operating license cancellation/revocation
- Currency inconvertibility, or the inability to convert and/or freely transfer dividends or other scheduled payments from the host country
- Political violence and War: Physical damage to assets caused by military action, civil war, terrorism, etc.
- Forced abandonment/Forced divestiture of an investment or mobile assets
- Breach of a production, concession or government agreement

## CONTRACT RISKS

Many companies derive an increasing proportion of their income from overseas. Such companies typically include capital goods exporters, commodity traders and major corporations.

The uncertainties of foreign legal jurisdiction, political instability and acute hard currency shortages create considerable difficulties both for exporters and importers. Our team has considerable experience in developing solutions to these risks.

### CONTRACT REPUDIATION

Some risks are not directly related to payments due under a contract, but can still generate substantial losses. These include:

- Embargo, where the contract cannot be performed due to the cancellation of an import or export license
- War, revolution or hostilities within the foreign country which prevent performance of the contract
- The unilateral termination of a contract by a government buyer where the buyer has no contractual right to do so
- Failure or refusal of a government buyer or contractor to perform their contractual obligations
- Unfair rejection of goods by a government buyer on or prior to delivery
- Non-delivery of pre-financed goods by a foreign government exporter
- Non-performance of barter counter-trade contracts by a government entity

Many of these risks can sometimes be overlooked, particularly if a company possesses a confirmed irrevocable letter of credit. In the case of pre-financing of commodities, as well as barter and counter-trade transactions, the insurance of the non-delivery risk may well be a prerequisite to the transaction.

### PAYMENT RISKS

The risks of non-payment arise from many causes, including the simple inability or unwillingness of the buyer to pay. They may include the inability to enforce the contract locally, a lack of available hard currency, or indeed, the political will of the buyer to pay.

The extent of insurance coverage available typically depends on the status of the customer. For example, where the customer is a state-owned entity, insurance can cover the failure to pay. Where the customer is non-state-owned, cover is available against the inability of the customer to pay due to political reasons outside its control. That cover would insure against the inability to obtain hard currency or the failure by a state-owned entity to honor its guarantee.

### ON-DEMAND BOND COVERAGE

One of the prevalent features of commercial life today is the need to issue on-demand bank guarantees to satisfy advance payment, performance and warranty obligations imposed by the buyer. Our insurance solutions are designed to address arbitrary or unfair calls, and fair calls that arise where political cause has prevented the performance of contractual obligations.

## CASE STUDIES

### INSURING AGAINST ADVERSE IMPACT TO THE FINANCIAL STATEMENTS

Willis structured and placed a global insurance program for an energy client with numerous fixed asset investments worldwide. The Political Risk Insurance program protects this corporate entity's financial results and balance sheet from adverse changes in these investments due to Expropriation perils; Forced Divestiture; Forced Abandonment; Riots, Strikes, Civil Commotion and Malicious Damage; and Selective Discrimination.

### MINIMIZING RISK TO A FOREIGN STATE

Our client, a U.S. manufacturer of steel assembly equipment entered into a sales contract with a government-owned Chinese steel manufacturer. We structured cover to protect our client against loss of costs incurred during the pre-delivery period and post-delivery period. Perils that would trigger a loss during the pre-delivery period include: discriminatory host government laws, order and decrees; cancellation of export or import licenses; export or import embargoes; war; and arbitrary contract cancellation by the state-owned buyer.

The policy also protected the client against buyer non-payment. Our client used this insurance policy to enhance its bank financing of the contract.

### MANAGING GLOBAL ASSETS OF A CORPORATION

As with any worldwide manufacturer our client is subject to potential disruptions at any of its manufacturing facilities located on each continent. Our solution provides the company with a sense of security that it will be made whole in the event a situation arises that disrupts or destroys the manufacturing process. Perils covered include Confiscation; Political Violence including War; Selective Discrimination; Currency Inconvertibility; and Business Interruption.

## FINANCIAL INSTITUTIONS

Prior to 1990, financial institutions were unable to secure insurance for their trade-related receivables within the private political risk market. This position has changed, and institutions directly financing the contracts of exporters, importers or lessors through the provision of loans, or by the discounting/forfeiting of debt instruments, are now able to secure insurance for themselves.

Our Political Risk team can advise, arrange and syndicate policies to protect financial institutions against country risk events, such as:

- Expropriation
- Political Violence
- License cancellation
- Exchange transfer controls

And state sector obligor risk events, such as:

- Sovereign borrower default
- State sector corporate default

Our financial institution clients are typically banks involved in project finance, trade finance or export finance in emerging markets, who require insurance as part of their country risk management techniques.

For these institutions, our solutions can be used to protect short and medium term trade-backed loans and guarantees, and to protect letter of credit confirmations. They can also be used to protect loans from defaults arising from risks such as currency inconvertibility, expropriation, political violence, or non payment.

### CASE STUDY

#### PROTECTING A LENDER AGAINST OVERSEAS BORROWER DEFAULT

Our client, a bank, made a loan to a construction company that had been contracted to build a water treatment plant overseas. The Ministry of Finance in the country where the plant was being built guaranteed the repayment obligations for the loan. We arranged a specialized cover to protect the bank against possible default by the Ministry of Finance in meeting its obligations under the guarantee.

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## MEET THE TEAM

Willis has operated a full Political Risks capability since 1979 and has over 40 people specializing in this area in Europe, Asia, and the USA. We are the market leader in this type of insurance and are renowned for our creative solutions to risks inherent in dealing with emerging markets.

### WHAT WILLIS CAN DO FOR YOU

- We work closely with multinational corporations and financial institutions with assets and interests in many territories around the globe. We have an in-depth understanding of the key risks involved in international trade and investment, tailoring solutions that draw on our knowledge of global and country-specific economic and political issues.
- We are market-leading specialists in addressing exposures related to emerging markets and developing countries.
- Drawing on our extensive network of global underwriting markets and alternative capital powers, we can spread risk and achieve optimal risk transfer for our clients. Our knowledge and leverage in these markets enable us to provide independent risk benchmarking and comparison services for clients, offering a greater degree of price benefit transparency than is the case with off-the-shelf products.

Willis' Political Risks team is a recognized leader in designing single risk policies and portfolio programs to address these risks, thereby providing balance sheet protection against unpredictable and potentially damaging losses.

### WHY WILLIS

- Willis is the largest political risk broker in the world with 45 specialists in New York, London, Los Angeles, and Singapore.
- We have over 25 years of experience working with clients in a variety of industry and service sectors, including banking, project finance, energy, utilities, mining, manufacturing and retailing.
- Our global team regularly places over \$150 million of premiums per year – roughly 20 percent of the world market. The team has unrivaled experience in placing complex risks with the North American, European and Bermudian underwriting markets.
- We have a reputation for innovative solutions built on a wide range of specialist knowledge across the entire risk spectrum. As we develop these solutions, the breadth and depth of what we can offer our clients grows. Our solutions are backed up by stringent servicing and quality assurance systems.

### WHAT NEXT

With so much uncertainty in the emerging markets today, a customized political risk program can help protect investors', financial institutions', project developers' and contractors' financial stability against untimely negative events in developing markets and emerging economies.

For more information, please contact your Willis Retail Broker or a member of the Willis Political Risk team.



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