Political Risk Insurance--OPIC

Captive Insurance Council of the District of Colombia

OPIC

What is OPIC?

- A self-sustaining, wholly-owned USG corporation
  - a federal agency reporting directly to the President of the US
  - An arm of US foreign policy
- **Developmental Mission**
  - To facilitate & mobilize US investment & skills in emerging markets to help them move toward free-market economies.
- The primary USG agency supporting private **investment** (assets & income) in emerging markets by providing U.S. businesses with:
  - Long term financing
  - Political Risk Insurance
  - Equity capital to private equity Investment Funds

OPIC Activity since 1971

Mobilized $177 billion worth of investments

In 150 countries created 800,000 host country jobs

Generated $71 billion in U.S. exports
&
Supported over 271,000 U.S. jobs

OPIC Political Risk Insurance

- The most experienced, creative and transparent Political Risk Insurer in the US if not the world
- Supported over 3100 projects
- Paid almost 300 claims for nearly $1 Billion
  - 90% Recovery Rate
  - 1960s: mix of types of loss across all 3 coverages
  - 1970s: expropriation—particularly Chile & Jamaica
  - 1980s: Inconvertibility
  - Early ’90s: Political Violence & Civil Strife
- Current Claims: Predominately Creeping Expropriation
- Concern of the future: Political Violence & Expropriation

OPIC Political Risk Insurance

- What is Political Risk?
  - More than just “politics”
  - The threat that political or judicial instability, social upheaval & violence or the resulting economic factors in a foreign country may affect the viability and profitability of your operations in that environment.
- Political Risk Insurance mitigates those risks with various products and coverages.
- The Basic Coverages of Political Risk Insurance
  - ***Inconvertibility (T&C)***
  - ***Expropriation (CEN) &***
  - ***Political Violence (PV)***

Political Risk Insurance (PRI)

Coverages

Inconvertibility or T&C (Transfer & Convertibility)

Inability to convert local currency into hard currency or inability to get earnings, remittances, technical assistance fees, etc. out of the country

- 62% of total claims but only 4% since the ’90’s because of greater government recognition of & openness to market mechanisms and foreign investment.
- Devaluation is not covered but is becoming the greater problem for investors.

Political Risk Insurance

Coverage

Expropriation or CEN (Confiscation, Expropriation & Nationalization

The wrongful taking of or interference with your investment--a denial of your rights to the proceeds from that investment.

- Could be a discrete event or a series of events or actions ("creeping expropriation")
- Could even be a *"Denial of Justice"* (a governmental barring, blocking, refusing to take to court, arbitration or refusal to honor their awards)
- 23% of all claims but 37% since the '90's and about 90% of all paid out dollars.
- MidAmerican—largest claim at $217m; government abrogated power contracts and thwarted the dispute resolution.

Countries in market transition find it difficult to juggle the balls and manage crises.

Political Risk Insurance

Coverage

Political Violence

Any violence with a political motivation including:

terrorism,

war,

civil war,

riots,

civil commotion,

sabotage, etc.

even if the weapons used are nuclear, biological, chemical or radiological (OPIC only)

– 16% of all claims but 59% since the ’90’s. Only 7% of dollars.

Other Products & Risks

- **Non-Honoring of a Sovereign Guarantee**
  - A particularly beneficial product for infrastructure programs with a government guarantee of payment. If the government renegs on its obligations, we pay.
  - The product is often rated by the rating agencies and, because of the backing of the US Treasury, financing through banks and capital markets is appreciably cheaper.
- **Business or Trade Disruption Within the Entire Supply Chain**
  - In a global, inter-dependent economy goods, services and equipment essential to operations could be disrupted, confiscated, destroyed outside of the host country in a variety of ways in a variety of countries.

- All PRI carriers have similar programs to all of the basic coverages and products.
  - But there are distinctions between carriers.

Institutional Distinctions

- **Mission**—Developmental rather than profit motivation
- **Financial Strength**—Full Faith & Credit of USG
- **Claim History—**Fair & transparent
- **Advocacy**—Intervention on behalf of investors by OPIC, the US embassy, State Department and other US agencies when necessary (Commerce, TDA, USAID, etc.).
- **Product Development**
  - Innovators in the market willing to lead by example
- **Reputation & Experience**—Oldest and, outside of Lloyds, perhaps, the most flexible PRI carrier.

Operational Distinctions

- **Underwriting & Legal Review**
  - Every project team includes an attorney to assure the best possible product for a well-designed project that will meet foreign government requirements as well as portect their rights.
- **No Deal Too Small—or Large**
  - Accept projects of any size—from $30k bid bond to a $400m pipeline!
- **Appetite & Capability**
  - Our mission requires us to go where no one else will go—where the private market has little or no interest and yet OPIC will cooperate with, facilitate, and assist the private insurers in developing comfort and appetite in riskier situations.
  - Other PRI carriers include:
    - AIG & Chubb –US
    - Zurich & Lloyds—Worldwide
    - MIGA—World Bank Member countries
    - Numerous public sector entities like OPIC in developed countries

Transactional Distinctions

- **Term:** up to 20 years; Other insurers normally 7-10 yrs
- **Limits:** up to $250 million per project; others generally $50-80 million a couple up to $100 million.
- **Pricing:** customary pricing ranges published on our web page
  - **Rate Stability:** rates change only because of risk rather than market conditions or profit motivations
  - **Rates are guaranteed for life of contract—up to 20 years**
  - OPIC is comparatively higher rates in low risk situations and lower in high risk.
- **Flexibility**
  - Each contract is individually customized and negotiated to accommodate investor needs.
- **Clarity of Coverage**
  - Fully vetted and debated contract language.

OPIC Reinsurance

- All PRI carriers offer both direct and reinsurance capabilities.
- OPIC can assume business from any carrier (**including captives**) that is either eligible or has eligible insureds.
  - 15-25% US ownership depending on foreign policy interests
- Private & Local insurers in especially difficult markets (e.g. Afghanistan, Iraq, Palestine, Pakistan…) with wraps or drop downs, etc. that allow them to package PRI with P&C or Title Insurance (Expro & PV), or, perhaps, even Surety….
- If we can handle these insurers in these environments, we can handle anything your captive can throw at us.

Reinsurance Opportunities

- OPIC will reinsure the US private market INCLUDING CAPTIVES for individual risks or portfolios.
- We reinsure/wrap Property & Casualty or specialty carriers, either US or foreign, for comprehensive and seamless protection.
  - Specialty Carriers such as: Title Insurers (e.g. Stewart Title & Fidelity Ins.), Surety (e.g. Zurich), Monoline Bond Insurers (e.g. MBIA & Ambac)
  - Foreign Insurers such as the National Insurance Co. of Palestine for trade disruption & political violence (note prior comment that a guarantee would be a better vehicle for the coverage intended for this product); IGI of Pakistan for PRI; ICA of Afghanistan for PRI, African Trade Insurance for PRI.
- We will employ all reinsurance pricing, product and structure options including: Facultative; Treaty; Quota Share; Excess; Following Form and Non-Following Form; quota share for specific coverages and excess for others in the same contract; retrospective rating or profit sharing; diminishing quota share over time until entity is self-insured & OPIC is out entirely or becomes excess.

Political Risk Insurance

- The Multilateral Investment Guarantee Agency (MIGA) of the World Bank commissioned *PwC* in 2008 to study investor use of PRI:
  - **50% of surveyed investors said they had refrained from or withdrawn from potential investments because of the inadequacy of risk mitigation (PRI) products.**
- MIGA also engaged the *Economist Intelligence Unit* in 2008 to research the demand for PRI:
  - Investors see **political risk as the greatest impediment** to investments in emerging markets.
  - Breach of contract is the greatest concern followed in descending order by transfer/currency restrictions, war/civil disturbance, non-honoring of sovereign guarantees and regulatory changes.
- **Only 5% of *EIU* surveyed investors purchase PRI and less than 15% purchase mitigation instruments of any type (PRI, credit default swaps, hedges).**
- Why? Minimal & mistaken knowledge of the products; a belief that a claim will result in years of arbitration & expense with little likelihood of recovery; fear of the cost.
- Despite these numbers, private market insurers have been growing dramatically over the last 10 years—although less so since the recent financial crisis.

Political Risk Insurance

- We conducted a survey of some captive domiciles: Vermont, DC, South Carolina, Hawaii, Bermuda, Barbados, Cayman, Guernsey, and BVI to determine if any captives had been licensed to include Political Risk Insurance.
- All but two domiciles indicated that they have captives with some form of PRI **within a broader insurance program.**
  - Logical but, apparently, it is almost always only Terrorism coverage.

Potential Problems With Commercial PRI

- Contract language can be confusing, legalistic and leave gaps between commercial coverage & PRI or unintended holes in protection.
  - The products and their history are very different from the controlled and regulated forms of insurance you are accustomed to.
- Inconvertibility and PV are relatively straightforward but Expropriation can be very murky and unpredictable in claim situations.
  - The capacity of politicians & bureaucrats for creating mischief is infinite.
- Most carriers are very conservative about their coverage but the actual situations giving rise to claims are very, very different and not at all clear cut.
  - Denials, then, are relatively common and may have to be determined in arbitration--an expensive process that can take years with unpredictable outcomes.
- Great resistance to setting new coverage or claim precedents
- It is expensive coverage—especially if it is unpredictable after a claim arises

The Captive Alternative

- If you have risks outside of the US, you have political risks in varying degrees.
- Political Risk insurance is a valuable & important product that deserves serious consideration by CEOs, Risk Managers, and brokers doing business in foreign locations.
- The risk exists whether it's funded or not.
- You can fund the loss through formal public or private insurance mechanisms or you can self-insure through programs like captives.
- The captive structure has advantages &, of course, disadvantages but virtually all of the problems or impediments with commercial PRI carriers are eliminated with a captive structure.
  - Difficult and lengthy claims processes can be eliminated
  - The potential for denial of a claim is virtually eliminated especially when the contract language may not be clear in its intent. You settle disputes in your favor.
  - Rates are whatever you determine as reasonable to set aside for funding.
  - Brokerage fees can be managed more successfully
  - You can tailor the coverage for precisely what you need rather than be locked into what the carrier wants to give you.
  - Loanbacks if Pure
- Reinsure with a PRI carrier that will structure around your appetite for risk.