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Protecting investments: 10 questions, 10 answers from a specialised broker

1- What is political risk and how is it different from country risk?

The analysis of *country* risk is one of the first tasks done by an investor, and it deals with evaluating the advantages and disadvantages a country presents to investors. It's a crucial element in deciding whether to invest or not, because it determines the profitability of a venture in that country.

***Political* risk** forms part of that evaluation but deals with the governing authority – state action -- which can generate losses for private operators as much in terms of investments as expected profit.

This risk can emerge in various forms:

- Confiscation, expropriation, nationalization
- Destruction of current assets, sabotage of assets during riots, civil war or international conflict.
- Deprivation of the company's dividends and benefits outside the host country caused by currency shortfalls or inconvertibility.
- Lack of respect by the State of contractual commitments.

For example, Poland, even though it is on its way to joining the European Union soon, has had many confiscatory legal disputes with investors (Pernod-Ricard, Eureko, Béghin-Say); and insecurity in the Solomon Islands prompted a mining development company to abandon a mine there.

Political risk does exist; it has occurred over past years in all its forms, even the most conventional, and in all the main regions in the world, causing often serious prejudice to investors.

2- Besides cases of brutal nationalisation or expropriation, what kind of political risks are investors exposed to?

Confiscation pure and simple still exists but is changing into more pernicious forms that could be called "creeeping nationalisation": unplanned power cuts, the non-attribution of export or import licences which are essential to a company's activity.... difficulty in exercising an activity because of persistent public disturbance or outright insecurity. China, though looking to join the WTO, requires electronic products made locally by foreign investors, even those operating in joint ventures, to be sold under admnistrative authorizations that are hard to obtain.

Beyond the classic risk of confiscation, different impediments to functioning can be taken into account by the private insurance market ranging from outright insecurity to changes in local rules.

3- What can be the consequences for investors?

Impediments to functioning under the original terms for profitability leads to operating losses and obviously a cessation of activity: it's a real risk! Coverage against it is a difficult product to come up with, and it requires a broker who thoroughly understands the operations of the local company and the way its real profits are raised. It's all about the technical caracteristics of the product in a way that, if a crisis arises, the indemnity can be quickly calculated without the prospect of a legal dispute with the insurer.
The private insurance market is able to adapt to the perception investors have of their risks; policy clauses are changing under the influence of specialized brokers.

4- What bodies can provide investment insurance coverage against political risk (public procedures, private market)?

The political risk market was strictly public at first, run by well-known state operators (Coface in France, Hermès in Germany, Opic in the USA, Ducroire in Belgium) and complemented by a multilateral tool of the World Bank Group, the MIGA. Those players work with public funds.
A private market emerged in the 1980's. The resources available on the private market have exploded in the last two years and stood at more than two trillion dollars in 2001. The market insured risks over longer and longer periods and makes payouts. Its recent dynamism can also be seen in its inventiveness in terms of its products and its flexibility in calculating premiums, all of which allow investors to eschew the public establishments and thus save public funds.
Further, the private market upholds the confidentiality ofits policies, which provides protection to both the investor and the insurer. That is not the case with public insurers whether they are nationals or multilaterals (Miga), which think to the contrary that going public to local authorities might have a dissuasive effect on illegal or illicit appropriation. It's up to the investor to decide what is best, on a case-by-case basis.

5- What are the other advantages to being covered for political risk?

Insuring political risk allows better financial deals because it lifts regulatory constraints that weigh on banks, thus reducing the global cost of financing and possibly even securing funding that would not otherwise be available.
It also improves the credit worthiness of a company in the eyes of bankers and financial analysts when it is publicly listed.

6- Is an investor required to get full coverage or are personalized policies available?

Most insurers offer this option because specialized brokers do not promote a standard product. propose personalized coverage and not a standard product. They undertake an identification of risks for each client and source tailored coverage from insurers.

7- Are there countries that cannot be insured?

No. If an investor decides to invest in a country, it's inconceivable that he won't find an insurer willing to follow him under reasonable financial terms. Insurers may temporarily

refuse to cover one specific country if they are in direct legal conflict with it, but it is really rare that a whole market is closed.

8- Apart from the investment itself, can private insurers provide a guarantee against a t drop in turnover and under what conditions?

The market can cover a downturn in revenue due to a political risk manifesting itself. For example, the private part of Coface has recently developed a product that protects against a drop in turnover as a result of a big devaluation (40%).

9- Are their any means of reducing the cost of an investment guarantees?

There are several ways of doing that. First of all, through an evaluation of a project's specific risks we can avoid redundant or useless coverage.
You then have to avoid the case-by-case aproach (as practised by public insurers), because it is always costly. It doesn't systematically cover latent risks and hence leads an investor to look for protection against only the most visible risks, which are also the most expensive to insure against.
In contrast, the systematic approach of global coverage of a portfolio allows considerable savings on premiums thanks to the flexibility of calculating premiums on the private market, which explains why most multinationial companies are today insured in this way, leaving behind the dangerous practice of self-insuring.

10- Is it necessary to deal with a broker?

In France, the public insurer doen't work with brokers, but this is not true everywhere else, ECGD in London or Miga appreciate the broker's role as do the biggest private insurers (like AIG for instance). This improves transparency and market creativity and therefore the service provided to investors.
The brokers' role is to encourage insurers to propose products that are more and more tailored to the needs of clients. Brokers, as long as they are specialized, bring significant added value to the whole process of launching an investment (optimizing financial backing, securing the invested capital and the anticipated profits). Their knowledge of the operations carried out allows them to push innovation ever further.

It is a very specialized market in which the talent of the brokers can change everything. To be effective, brokers need financial and legal knowledge as well as an intimate understanding of a company's operating environment. To a good broker, nothing is impossible because there is always a solution to any kind of risk, so long as one knows how to invent it and present it.

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