

# A COMPARATIVE ANALYSIS OF PUBLIC AND PRIVATE POLITICAL RISK INSURANCE POLICIES WITH STRATEGIC APPLICATIONS FOR RISK MITIGATION

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## INTRODUCTION

Any business with global operations is bound to have considered the purchase of a political risk insurance (PRI) policy. A PRI policy insures a beneficiary's property in the country specified in the policy against three primary risks—expropriation, currency inconvertibility, and political violence<sup>1</sup>—providing enormous value to the beneficiary. A beneficiary can insure almost anything, tangible (e.g. production facilities) or intangible (e.g. future cash flows), if it understands the availability and variety of

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1. See *infra* Part I.

public and private PRI options. And it's not only global business powerhouses that participate in the PRI market. An ever-increasing number of small and medium sized businesses are quickly seeing the value of PRI policies to their global operations.

Take, for example, the American International School of Bamako, Mali. On March 24, 2012, the BBC News reported that a group of mutinous soldiers were "in complete control" of Mali's government after having overthrown the country's elected leader.<sup>2</sup> With the whereabouts of the elected president unknown, Bamako, the capital of Mali, descended into a scene of widespread pillaging, looting, and vandalism.<sup>3</sup> But the American International School of Bamako did not need to see news reports to grasp the magnitude of the coup. The school had a total of 206 students enrolled on March 20, 2012, but the number of students actually attending class dwindled to 117 by April 2.<sup>4</sup> Two days later, on April 4, there were just 88 students present.<sup>5</sup> Unable to operate, the school closed its doors, evacuated its teachers and their families, and decided to try to re-open in August for the new academic year.<sup>6</sup> When the school re-opened its doors in August of 2012, only 95 students enrolled.<sup>7</sup> As a result of the military coup, the American International School lost over \$1.5 million in tuition income,<sup>8</sup> and incurred over \$26,000 in evacuation expenses.<sup>9</sup>

Fortunately, the American International School had insured its investment with political risk insurance through the Overseas Private Investment Corporation (OPIC). Knowing that doing business in Mali contained inherent political risks that could jeopardize the business, the school had purchased PRI covering losses of business income up to \$2 million as well as evacuation expenses caused by political violence.<sup>10</sup> Under this policy, the school recovered over \$1.3 million from OPIC for its loss of business income and evacuation expenses,<sup>11</sup> demonstrating the

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2. *Mali Coup Leader Amadou Sanogo "in complete control,"* BBC WORLD NEWS (Mar. 24, 2012), <http://www.bbc.co.uk/news/world-africa-17498739>.

3. *Id.*

4. OVERSEAS PRIVATE INV. CORP., MEMORANDUM OF DETERMINATIONS, POLITICAL VIOLENCE CLAIM OF THE AMERICAN INTERNATIONAL SCHOOL OF BAMAKO FOUNDATION, INC. 2 (2013), available at <http://www.opic.gov/sites/default/files/files/mali-claims-02052013.pdf> [hereinafter OPIC AIS MEMORANDUM OF DETERMINATIONS]

5. *Id.*

6. *Id.* at 2–3.

7. *Id.* at 3.

8. *Id.* at 9.

9. *Id.* at 6–9.

10. *Id.* at 3.

11. *Id.* at 10.

prudence of purchasing a PRI policy in regions with elevated levels of instability.

Unsurprisingly, then, the importance of PRI policies—like those purchased by the American International School—is rising among foreign investors. The number of policies issued increased by 13% in 2011, hitting a record number, with more records forecast in the coming years.<sup>12</sup> The use of PRI among investors, however, still has plenty of room to grow; only 18% of firms use PRI as a risk mitigation tool.<sup>13</sup> This also implies that any analysis of the use of PRI in mitigating risk must also consider its compatibility with other tools for managing risk.<sup>14</sup> Additionally, the growth in PRI policy issuance has been outpacing the growth of foreign direct investment (FDI), indicating that the importance of PRI is only likely to grow.<sup>15</sup> And as the American International School's experience demonstrates, PRI is not only for gigantic corporations but also for relatively small investors as well.<sup>16</sup> In fact, agencies such as OPIC have “no minimum investment size requirement,” making PRI available to even the smallest of investors.<sup>17</sup>

Both public and private entities offer PRI policies. Some national governments have established agencies to provide PRI policies to their constituent businesses. Japan, for example, has established the Nippon Export and Investment Insurance Agency (NEXI) to offer PRI policies to Japanese businesses.<sup>18</sup> The United States established OPIC in 1971 to offer a variety of risk mitigation tools to U.S. businesses and individuals, as well as advance social and economic development in developing countries.<sup>19</sup> Multilateral agencies, too, such as the World Bank Group's Multilateral Investment Guarantee Agency (MIGA), offer PRI policies to investors of member countries that invest in other developing member countries.<sup>20</sup>

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12. MULTILATERAL INV. GUAR. AGENCY, THE WORLD BANK GROUP, *2012 World Investment and Political Risk* 9, available at <http://www.miga.org/documents/WIPR12.pdf> [hereinafter MIGA 2012 Political Risk Report].

13. *Id.*

14. Among the other tools of risk mitigation that are more popular with foreign investors than PRI include forming joint ventures with local partners, keeping “informal relationships with political leaders” warm, promoting engagement with local communities, and conducting scenario planning. *Id.* at 10, fig.3.

15. *Id.* at 41.

16. OPIC AIS MEMORANDUM OF DETERMINATIONS, *supra* note 4, at 3 (noting that The American International School's investment was only roughly \$4.4 million).

17. OVERSEAS PRIVATE INV. CORP. HANDBOOK 37 (2015), available at [http://www.opic.gov/sites/default/files/docs/OPIC\\_Handbook.pdf](http://www.opic.gov/sites/default/files/docs/OPIC_Handbook.pdf) [hereinafter OPIC HANDBOOK]

18. *See infra* Part I.B.

19. OPIC HANDBOOK, *supra* note 17, at 4.

20. *Id.*

This Article chooses depth over breadth by focusing particularly on the relative utilities of public and private PRI. To help an investor-company select a PRI policy that is tailored to its particular investment projects, this Article comparatively analyzes public and private PRI policies and the advantages and disadvantages of each type of policy. An awareness of the relative utilities of public and private PRI is particularly important because multinational enterprises plan to boost their investments in developing countries over the next three years.<sup>21</sup> The Article then uses its comparative analysis to make recommendations for how investors can mitigate their exposure to political risk.

The analysis proceeds in three Parts. Part I introduces the market for PRI with a focus on what is most important for investors choosing insurance policies. Part I.A acquaints readers with the types of political risks that insurance policies typically cover. Part I.B gives an overview of the market for public PRI, focusing on the important market insurers, eligibility requirements for receiving a public PRI policy, and the substantive provisions of those insurance policies. Part I.C does the same for the private market.

Part II then moves from the descriptive to the normative, arguing that both advantages and disadvantages exist to both public and private PRI policies that investors must consider before making a decision. In particular, Part II.A argues that the advantages of low public insurance premiums must be weighed against increased monitoring and reporting obligations of beneficiaries, while Part II.B argues that the benefits of speed and more personalized policies in the private PRI market must be weighed against the diminished political clout that private insurance companies carry with host governments when compared to their public counterparts.

Part III then sets forth two recommendations for investors. Part III.A argues that public PRI, when available, is preferable to private PRI. Part III.B then argues that investors can likely lower their PRI premiums by strategically engaging with host communities and host governments. A conclusion follows.

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21. See MIGA 2012 Political Risk Report, *supra* note 12, at 17 (“The share of [multinational enterprises] that intend to expand into developing countries in the following three years jumps to 70 percent compared with 52 percent in the short term . . .”); see *id.* (indicating that investors are prioritizing investment in developing countries due to “large and growing consumer markets”).

## I. A PRIMER ON POLITICAL RISK INSURANCE

### A. The role of PRI for foreign investors

To clearly distinguish PRI from commercial risk insurance (CRI), it is important to note that PRI covers risks that are generally separate from those insured by CRI. Risks covered by CRI include construction and operational risks, such as the delayed completion of a project, excessive maintenance costs, and insufficient sales to pay interest on a debt.<sup>22</sup> PRI, by contrast, covers non-commercial risks associated with a host government's actions that result in an investment loss.<sup>23</sup> PRI generally covers the risks of expropriation, currency inconvertibility, and political violence.<sup>24</sup> Some risks, however, are non-insurable by the major public insurers, including currency devaluation risk, risks from inflation, and non-discriminatory regulation.<sup>25</sup> Each of the three insurable risks will be addressed in turn.

Expropriation risk includes both the risk of direct expropriation through seizure or nationalization of a business, as well as indirect expropriation through adverse regulatory changes that "deprive the owner of its ability to manage, use, or control its property in a meaningful way."<sup>26</sup> In addition, a series of increasingly encroaching government regulations can compound over time to constitute a "creeping expropriation."<sup>27</sup> The risks of expropriation are becoming "more prevalent,"<sup>28</sup> and the number of direct expropriations in particular has been increasing over the past decade,<sup>29</sup> underscoring the potential benefits of PRI. While there is "no

22. HOSSEIN RAZAVI, FINANCING ENERGY PROJECTS IN EMERGING ECONOMIES 128 (1996).

23. *Id.*; see also Pieter Bekker & Akiko Ogawa, *The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the 'BIT Bang'*, 28 ICSID REVIEW 314, 316–317 (2013) (noting elements of PRI policies as "length of coverage, the amount of compensation, and . . . the standards required to find State liability").

24. Bekker & Ogawa, *supra* note 23, at 318; KAUSAR HAMDANI, ELISE LIEBERS & GEORGE ZANJANI, FED. RESERVE BANK OF N.Y., AN OVERVIEW OF POLITICAL RISK INSURANCE 2 (2005), available at <http://www.bis.org/publ/cgfs22fedny3.pdf>.

25. Bekker & Ogawa, *supra* note 23, at 323.

26. UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS II, EXPROPRIATION 6 (2012), available at [www.unctad.org/en/Docs/unctaddiaa2011d7\\_en.pdf](http://www.unctad.org/en/Docs/unctaddiaa2011d7_en.pdf) [hereinafter UNCTAD].

27. *Id.* at 11.

28. MIGA 2012 Political Risk Report, *supra* note 12, at 20.

29. MULTILATERAL INV. GUAR. AGENCY, 2011 REPORT ON WORLD INVESTMENT AND POLITICAL RISK 30, fig. 2.1, available at <http://www.miga.org/documents/WIPR11.pdf> (demonstrating that expropriations have risen since the early 2000s, albeit being far below the peak of expropriations in the 1960s and 1970s) [hereinafter MIGA 2011 Political Risk Report].

uniform definition” of indirect expropriation,<sup>30</sup> it is important to note that at least one public insurer, OPIC, has been more willing than arbitral tribunals operating under a bilateral investment treaty (BIT) to find that an indirect expropriation took place,<sup>31</sup> suggesting that PRI may provide more favorable substantive protection than investment treaties with respect to expropriation claims.<sup>32</sup>

The second category of insurable risk—currency inconvertibility—is the “risk of losses arising from an investor’s inability to convert local currency into foreign exchange for transfer outside the host country.”<sup>33</sup> Host governments could trigger an insurance payment for this risk if it prohibits, for example, currency conversions or remittances,<sup>34</sup> thereby “freez[ing] the investor’s income derived from investment.”<sup>35</sup> A host government’s motivation for prohibiting currency conversions could be to protect its balance-of-payments or conserve foreign currency.<sup>36</sup>

OPIC regularly pays claims of currency inconvertibility in the form of paying the beneficiary an amount of U.S. dollars that the beneficiary would have had absent the government regulations.<sup>37</sup> Successful claims for currency inconvertibility only require that (1) the investor took all reasonable steps to transfer currency, (2) the investor could not do so because of government regulations, and (3) that the host government promulgated those regulations after the issuance of the PRI policy.<sup>38</sup> PRI is especially useful for investors facing substantial currency risks because no international arbitral tribunal has ever addressed an inconvertibility claim, adding uncertainty to the law and making the relative certainty of PRI policies attractive.<sup>39</sup> This is especially important given that over 20% of firms responding to the MIGA-EIU Political Risk Survey either

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30. UNCTAD, *supra* note 26, at 57.

31. Bekker & Ogawa, *supra* note 23, at 330.

32. The fact that PRI providers may be more liberal with finding indirect expropriation, however, does not necessarily mean a higher level of overall protection, as protections such as the fair and equitable treatment standard take may only be available in BITs and not in PRI policies.

33. MIGA 2011 Political Risk Report, *supra* note 29, at 21, available at <http://www.miga.org/documents/WIPR11.pdf>.

34. *What We Offer: Currency Inconvertibility*, OVERSEAS PRIVATE INV. CORP., <http://www.opic.gov/what-we-offer/political-risk-insurance/types-of-coverage/currency-inconvertibility> (last visited May 17, 2015).

35. Bekker & Ogawa, *supra* note 23, at 319.

36. *See id.* at 335 (“Developing countries often face balance-of-payments difficulties and must conserve foreign currency to pay for essential goods and services.”).

37. *See Currency Inconvertibility*, *supra* note 34.

38. Bekker & Ogawa, *supra* note 23, at 335. An additional regulation is that the currency held by the beneficiary was obtained within the last 18 months. *See id.* at 335, n.141.

39. *Id.* at 335.

withdrew or cancelled investments from 2011–2012 on account of currency convertibility risks.<sup>40</sup>

Lastly, PRI policies insure against losses arising from political violence, which can include civil wars, domestic unrest, and revolutions, among other types of civil strife. Publicly available claim determinations from OPIC demonstrate that the agency regularly pays political violence claims. Illustrative examples include the payment of \$68,202 to the International Rescue Committee in the Democratic Republic of the Congo for property damaged during firefights between the Congolese Army and rebel groups,<sup>41</sup> the payment of \$1,384,871 to the American International School in Mali to cover evacuation expenses and lost tuition income resulting from the military's overthrow of the elected government,<sup>42</sup> and the payment of \$38,027 to a company in Zambia after political protests resulted in damage to its physical property.<sup>43</sup>

Given the rise in expropriation and political violence, it is unsurprising, then, that “investors continue to rank political risk as a key obstacle to investing in developing countries.”<sup>44</sup> In fact, investors label political risk—particularly risks from regulatory changes or breaches of contracts—as “the most significant constraint to investing in developing countries.”<sup>45</sup> According to Lloyd's Risk Index, high taxation and excessively strict regulation are two of the top five risks that investors face globally, but especially in developing countries.<sup>46</sup> That 97% of senior executives labeled managing political risk as important to their business strategy only begins to show PRI's importance.<sup>47</sup> A full 42% of surveyed executives stated that their risk management process was “not integrated as

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40. See MULTILATERAL INV. GUAR. AGENCY, The World Bank Group, *2012 MIGA-EU Political Risk Survey* 58–79 (2013), available at <http://www.miga.org/documents/WIPR12.pdf>.

41. See OVERSEAS PRIVATE INV. CORP., MEMORANDUM OF DETERMINATIONS, POLITICAL VIOLENCE CLAIM OF THE INTERNATIONAL RESCUE COMMITTEE 1 (Jan. 14, 2009), available at [http://www.opic.gov/sites/default/files/docs/international\\_rescue\\_committee\\_droc\\_2009.PDF](http://www.opic.gov/sites/default/files/docs/international_rescue_committee_droc_2009.PDF).

42. See OPIC AIS MEMORANDUM OF DETERMINATIONS, *supra* note 4, at 1.

43. OVERSEAS PRIVATE INV. CORP., MEMORANDUM OF DETERMINATIONS, POLITICAL VIOLENCE CLAIM OF SEABOARD OVERSEAS LTD. 1 (Apr. 2, 2012), available at <http://www.opic.gov/sites/default/files/files/seaboard-overseas-limited-zambia.pdf>.

44. MIGA 2012 Political Risk Report, *supra* note 12, at 1.

45. *Id.* at 7.

46. LLOYD'S, LLOYD'S RISK INDEX 2013 7 (2013), available at <http://www.lloyds.com/~media/Files/News%20and%20Insight/Risk%20Index%202013/Report/Lloyds%20Risk%20Index%202013report100713.pdf>.

47. PRICEWATERHOUSE COOPERS ADVISORY AND EURASIA GROUP, HOW MANAGING POLITICAL RISK IMPROVES GLOBAL BUSINESS PERFORMANCE 34 (2006), available at [http://www.pwc.com/us/en/risk-compliance/assets/PwC\\_PoliticalRisk\\_052006.pdf](http://www.pwc.com/us/en/risk-compliance/assets/PwC_PoliticalRisk_052006.pdf).

effectively as it could be,”<sup>48</sup> further demonstrating the need to develop risk mitigation strategies using PRI.

The supply of PRI is also increasing.<sup>49</sup> The supply of private PRI in particular is currently experiencing an uptick because chronically low interest rates have pushed insurance companies to seek higher rates of return elsewhere, in part by expanding their PRI offerings.<sup>50</sup> In addition, private PRI issuance continues to increase as the private sector develops the expertise necessary to compete with its more seasoned public counterparts.<sup>51</sup>

In sum, PRI policies play a vital role by covering increasingly important risks associated with doing business globally. Though public issuers have traditionally dominated the PRI industry, the increased expertise of private players and their heightened willingness to compete in the industry indicates that investors now have multiple options when purchasing PRI.

## B. Public PRI

The market for public PRI is comprised of national actors, such as OPIC in the United States and NEXI in Japan, as well as multilateral agencies such as MIGA, the African Trade Insurance Agency, the Inter-American Development Bank, and the Asian Development Bank.<sup>52</sup> While governments can delegate their public insurance programs to private entities, as Germany and France have done, this is not the norm.<sup>53</sup> This Section discusses the role of a few public PRI actors, including their eligibility requirements as well as their policies’ substantive provisions.

National insurance agencies focus on providing insurance products to their constituent entities. NEXI, for example, only provides overseas investment insurance to Japanese companies.<sup>54</sup> NEXI has typically catered

48. *Id.*

49. See MIGA 2012 Political Risk Report, *supra* note 12, at 40 (“The growth in PRI has involved both public and private providers . . . . [C]apacity has increased 19 percent in the first half of 2012, with new providers entering the market and existing providers increasing their capacity.”).

50. *Id.* at 11.

51. See Bekker & Ogawa, *supra* note 23, at 349 (noting the increased sophistication of private PRI providers due to “the enhanced . . . ability of private political risk insurers to sort risks and to do business in a competitive way.”).

52. See *id.* at 320, n.32.

53. *Opening Trade and Investment to the Private Sector*, INST. FOR INT’L STUDIES AND TRAINING (Mar. 15, 2005), [http://www.iist.or.jp/wf/magazine/0330/0330\\_E.html](http://www.iist.or.jp/wf/magazine/0330/0330_E.html).

54. See *Overseas Investment Insurance*, NIPPON EXPORT AND INV. INS., <http://www.nexi.go.jp/en/products/types/investment/> (last visited May 17, 2015) (“This insurance covers losses suffered by a Japanese company with a subsidiary or a joint venture in a foreign country.”).



to large businesses, but it recently began initiatives to open investment insurance to small- and medium-sized enterprises by forming partnerships with twenty-nine Asian regional banks.<sup>55</sup> NEXI is not pressured to make a profit; rather, it must only operate on a break-even basis,<sup>56</sup> allowing it to reduce its premium rates for insurance, particularly for small and medium-sized enterprises (SMEs).<sup>57</sup> Australia's Export Finance and Insurance Corporation (EFIC) also restricts its insurance to domestic companies and has the added requirement of restricting its insurance to investors making *new* investments, forcing the investor to decide whether to purchase PRI before embarking on a new investment or project.<sup>58</sup> The EFIC does, however, allow for insurance purchases for new *expansions* of existing investments.<sup>59</sup>

OPIC restricts its services to only "U.S. investors, contractors, exporters and financial institutions involved in international transactions."<sup>60</sup> Congress mandated that OPIC work to promote the development goals of the United States, stating that its goal in creating OPIC was "[t]o mobilize and facilitate the participation of United States private capital and skills in the economic and social development of less developed countries . . . thereby complementing the development assistance objectives of the United States."<sup>61</sup> To that end, Congress set forth various criteria that OPIC's managers must consider when deciding whether to provide PRI to a company or project. Among these criteria are the "economic and social development impact" of the project, whether the project will benefit an especially poor country, and whether the project will comport with environmental standards.<sup>62</sup>

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55. See *Message from the Chairman*, NIPPON EXPORT AND INV. INS., <http://www.nexi.go.jp/en/corporate/message/> (last visited May 17, 2015) ("NEXI is supporting overseas business of regional SMEs by using a support network between NEXI and 29 regional banks based on service agreement to diffuse the use of NEXI insurance.").

56. *About Trade Insurance*, NIPPON EXPORT AND INV. INS., <http://www.nexi.go.jp/en/products/> (last visited May 17, 2015). NEXI does not have to make profit under the Trade and Investment Law and the Trade Reinsurance Special Account Law. *Id.*

57. See *Message from the Chairman*, *supra* note 55.

58. See *Political Risk Insurance for Investors*, EXPORT FIN. & INS. CORP., <http://www.efic.gov.au/client-solutions/individual-solution-pages/political-risk-insurance/> (last visited May 17, 2015).

59. *Id.*

60. OPIC HANDBOOK, *supra* note 17, at 17.

61. 22 U.S.C. § 2191 (2006).

62. See 22 U.S.C. § 2191(1)–(3) (2006). The statute stipulates that "preferential consideration" shall be given to countries with per capita income of less than \$984 in 1986 U.S. dollars, and that OPIC should limit its assistance to projects in countries with per capita incomes above \$4,269 in 1986 U.S. dollars. 22 U.S.C. § 2191(2) (2006). Congress expresses its desire in the statute to have OPIC grant at least thirty percent of its insurance policies to small businesses. 22 U.S.C. § 2191(2).

OPIC's policies also contain other limitations that are typical of public insurers. It sets upper limits, for example, on the amount of investment insured. OPIC insures investments only up to \$250 million, but special treatment is given to oil and gas projects, which can receive up to \$400 million.<sup>63</sup> There is not, however, a minimum investment size, which opens up OPIC insurance to even the smallest of investors. OPIC will also only cover up to 90% of the investment loss.<sup>64</sup> This limitation makes sense. Insuring the investment for only 90% of its value will give the investor an incentive to protect its investment despite having PRI, as the investor would still presumably lose 10% of the investment if it were, for instance, expropriated.

Multilateral agencies such as MIGA serve many of the same purposes as national agencies but are available to all its member countries. MIGA offers PRI to 179 World Bank members.<sup>65</sup> Given its broad membership, it is unsurprising that it insured a total of \$2.8 billion against political risk in 2013 alone,<sup>66</sup> in many cases "mak[ing] the difference between a go and a no-go decision" for the investors.<sup>67</sup> MIGA insures up to \$220 million per project, and can insure up to \$720 million per country, thus capping its risk exposure in any single country.<sup>68</sup> In contrast to OPIC, MIGA does insure *existing* investments if the investor demonstrates a long-term commitment to the project.<sup>69</sup>

MIGA also has more restrictive eligibility requirements than many national public agencies. MIGA has three main eligibility requirements: (1) investors must be citizens or entities of a MIGA member making an investment in a *developing* MIGA member,<sup>70</sup> (2) the host country must have a bilateral investment treaty, protection for the investment through local laws, or a protection agreement with MIGA,<sup>71</sup> and (3) the investment

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63. OPIC HANDBOOK, *supra* note 17, at 16. The preference for oil and gas projects may be because these projects likely have the potential to generate substantial income, thereby reducing the risk in the project and allowing OPIC to therefore invest more money in it. *See id.*

64. *Id.* at 28.

65. MULTILATERAL INV. GUAR. AGENCY, ANNUAL REPORT 2013 7 (2013), available at [http://www.miga.org/documents/Annual\\_Report13.pdf](http://www.miga.org/documents/Annual_Report13.pdf).

66. *Id.* at 2.

67. *Id.* at 14.

68. *Frequently Asked Questions, Project and Country Limits*, MULTILATERAL INV. GUAR. AGENCY, <http://www.miga.org/whoweare/index.cfm?stid=1792#con4> (last visited May 17, 2015).

69. *Investment Guarantees: Eligibility*, MULTILATERAL INV. GUAR. AGENCY, <http://www.miga.org/investmentguarantees/index.cfm?stid=1798> (last visited May 17, 2015).

70. *See id.* ("MIGA insures cross-border investments made by investors in a MIGA member country into a developing member country.")

71. Bekker & Ogawa, *supra* note 23, at 322.

must meet a variety of social and environmental development goals.<sup>72</sup> The requirement to have a BIT or some other form of local statutory or contractual protection is a requirement not found in many national agencies and provides a benefit to countries with BITs.

MIGA's social and environmental standards naturally bring the investor together with the World Bank's goal of reducing poverty. One requirement for PRI through MIGA, for instance, requires the investor to consult with local communities when they "may be affected by risks or adverse impacts from a project,"<sup>73</sup> thus helping ensure positive community relations as well as potentially reducing the risk of expropriation by strengthening the investor's community ties.

The publicly available model insurance contract of MIGA provides a window into the substantive insurance policies of public actors. MIGA defines an expropriation event as an act or series of acts which "deprives or prevents the Guarantee Holder from exercising its ownership rights in, or effective control of, all or a substantial portion of the Guaranteed Investment," or that deprives the Guarantee Holder of a "substantial benefit . . . constituting a fundamental right essential to the [investment's] overall financial viability."<sup>74</sup> Given that the broad language of only requiring a loss of a "substantial portion" of the investment or losing a "substantial benefit" from it, it is unsurprising that some scholars have argued that MIGA is more likely than arbitral tribunals to deem expropriation claims valid.<sup>75</sup> Expropriation losses, however, do not translate into expropriation claims immediately; rather, MIGA mandates a waiting period of 180 days before recognizing claims for expropriation of investment.<sup>76</sup> This waiting period is likely a time when the investor and MIGA make all possible efforts to recover the loss from the host government in accordance with Article 12.5 of the insurance contract.<sup>77</sup>

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72. *Performance Standards*, MULTILATERAL INV. GUAR. AGENCY, <http://www.miga.org/projects/index.cfm?stdid=1828> (last visited May 17, 2015). The substance of the International Finance Corporation's Guidance Notes on meeting these performance standards gives a detailed explanation of how companies can achieve them. *Performance Standards and Guidance Notes*, INT'L FIN. CORP. (Apr. 30, 2006), available at [http://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes#2012](http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes#2012) [hereinafter IFC Notes].

73. IFC Notes, *supra* note 72, ¶ 19.

74. MULTILATERAL INV. GUAR. AGENCY, CONTRACT FOR GUARANTEE OF EQUITY INVESTMENTS art. 4.1(a) (Aug. 5, 2013), available at <http://www.miga.org/documents/disclosure/Contract%20of%20Guarantee%20for%20Equity%20Investments.pdf> [hereinafter MIGA Model Contract].

75. See Bekker & Ogawa, *supra* note 23, at 328–330.

76. MIGA Model Contract, *supra* note 74, art. 2 (defining waiting period).

77. *Id.* art. 12.5 (mandating that the investor work with MIGA to "(a) pursue available administrative and judicial remedies arising from the Loss, in cooperation with or on behalf of MIGA,

If MIGA does pay compensation to the insured investor, the investor might be disappointed with the value MIGA provides when compared against that of arbitral tribunals. This is because MIGA calculates compensation based on the “book value” of the investment,<sup>78</sup> which explicitly excludes the goodwill of the company and is calculated strictly on a basis of assets minus liabilities.<sup>79</sup> Thus, if an investor is building a company which requires developing substantial goodwill before harvesting a loyal consumer base over time, or if an investor expects the company’s profits to grow exponentially in future years, an expropriation followed by a MIGA payout at book value might be very unsatisfactory. The discounted cash flow method of valuation employed by most arbitral tribunals would likely compensate investors more fully.<sup>80</sup>

The Berne Union, a club of 79 public and private insurance agencies, dedicates itself to promoting and providing a forum for establishing industry-wide best practices.<sup>81</sup> The public and private players “meet on a regular basis to discuss industry trends and challenges.”<sup>82</sup> The Union also nurtures newly-established insurance companies by providing support through the Prague Club,<sup>83</sup> which contributes to the Berne Union’s goal of “actively facilitate[ing] cross-border trade by supporting international acceptance of sound principles in . . . foreign investment.”<sup>84</sup>

### C. Private PRI

This Section discusses the role of private players in the PRI market. Private insurers play a vital role in supplementing the capacity of public insurers to offer PRI to clients. Private insurers can offer attractive policies in the private market or collaborate with public insurers in the reinsurance market. Because the quality of private PRI is stimulating demand for it “across all political risks,”<sup>85</sup> it is necessary for investors to understand the

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against the Host Government; (b) negotiate in good faith with the Host Government, in cooperation with or on behalf of MIGA; and (c) pursue other potential sources of recovery for the Loss.”).

78. *Id.* art. 4.4 (“[C]ompensation payable under Expropriation shall be the Percentage of Cover of . . . the Net Book Value of the Project Enterprise . . .”).

79. *Id.* art. 2 (defining net book value).

80. The discounted cash flow method would compensate investors for future incomes lost, not simply the net book value.

81. *About the Berne Union*, BERNE UNION (2015), <http://www.berneunion.org/about-the-berne-union/>.

82. MIGA 2012 Political Risk Report, *supra* note 12, at 80.

83. BERNE UNION, *supra* note 81.

84. *Id.*

85. See MIGA 2012 Political Risk Report, *supra* note 12, at 43 (“In a July 2012 roundtable of private insurers and brokers from the London insurance market . . . participants noted an increase in demand for PRI across all political risks.”).

landscape of the private PRI market before formulating a risk mitigation strategy.

The company of Arthur J. Gallagher & Co., for example, is a typical private insurer. It does business in over 110 countries and offers the “most competitive and appropriate terms” for its insurance policies.<sup>86</sup> It ranks countries numerically on a risk scale with nine categories ranging from insignificant and low risk (e.g. Poland) to very high or extreme risk (e.g. Yemen).<sup>87</sup> The premiums for its policies are then based on a country’s ranking. It offers policies covering every major type of political risk.<sup>88</sup> It prides itself on not being bound by any insurance template; instead, it is committed to going beyond the traditional transactional brokering and offering “innovative insurance solutions” to its clients.<sup>89</sup>

In general, the private insurance market offers policies for shorter terms and for smaller amounts than their public counterparts. In Arthur J. Gallagher’s market capacity report, it indicates that the majority of PRI available is for terms of three to five years totaling just over \$3 billion in capacity while having only barely \$1 billion in capacity for terms of ten to fifteen years,<sup>90</sup> perhaps indicating less of an appetite for long-term risk. Additionally, most private players only insure an investment for less than \$100 million,<sup>91</sup> though larger players such as the American Insurance Group (AIG) offers PRI for investments up to \$120 million.<sup>92</sup> Whereas public insurers such as OPIC are backed by the full faith and credit of the United States, and thus are likely able to withstand substantial losses for investments-gone-bad, private insurers must compete with one another in the private marketplace, where any ratings downgrades may potentially impede their ability to attract clients.<sup>93</sup>

Despite the apparent diminished appetite of private insurers in terms of amount of coverage and policy term lengths, insurance claims have increased over the past two years and have “tended to be paid out *more* by private than by public providers.”<sup>94</sup> The track record of recovering money from host governments has been poor by both public and private insurers,

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86. GALLAGHER LONDON, PRI REPORT AND MARKET UPDATE 15 (2013), *available at* <http://www.ajginternational.com/assets/Uploads/Publications/Gallagher-London-PRI-Report-Market-Update-Jan-2013.pdf>.

87. *Id.* at 12–14.

88. *See id.* at 15 (offering policies covering political violence, war, currency transfer, etc.).

89. *Id.*

90. *Id.* at 8.

91. Many insurers only cover up to \$20 million of investment. *Id.* at 4–6.

92. *Id.* at 4.

93. *Id.* at 3 (publicizing the downgrades of two major insurance companies)

94. MIGA 2012 Political Risk Report, *supra* note 12, at 40 (emphasis added).

though it is “unpredictable” if or when an insurance company will recover.<sup>95</sup> The higher payout rates of private insurers could be for several reasons. It could, for instance, indicate that the private market is willing to cover riskier investments than MIGA, albeit covering those risky investments for short timeframes and for lower amounts.

The private and public markets are also interconnected in the reinsurance markets. In this way, the public and private insurers should not be seen so much as competitors but as complements. MIGA, for example, received reinsurance coverage through twenty-seven public and private providers as of 2012.<sup>96</sup> MIGA itself provided reinsurance coverage to two investment insurers in Belgium and Slovenia in 2012 alone.<sup>97</sup> NEXI also has reinsurance agreements with the export credit agencies of Hong Kong, Canada, and Indonesia.<sup>98</sup> The result, then, is that the PRI markets are not as focused on cutthroat competition as they are on providing insurance and reinsurance for clients that are investing ever-greater sums in risky countries. The collaborative spirit in the PRI market allows public and private players to reinsure one another to diversify their risks across different geographic regions and industries.

## II. A COMPARATIVE ANALYSIS OF PUBLIC AND PRIVATE POLITICAL RISK INSURANCE POLICIES

### A. The advantages and disadvantages of public PRI

From an actuarial perspective, when deciding to issue an insurance policy, the issuer should, in theory, consider the following equation representing the expected payout of the insurance policy over time, where  $p_i$  represents the probability of a payout event occurring in year  $i$ ,  $a_i$  represents the expected value of a payout in year  $i$ , and  $r$  is the discount rate. Over the lifetime of a project with a duration of  $n$  years, the insurer's expected payout<sup>99</sup> is:

$$\text{Net present value of expected payout at time of policy issuance} = \sum_{i=0}^n \frac{p_i a_i}{(1+r)^i}$$

It is important to note that the expected payout is not the actual payout

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95. *Id.*

96. MULTILATERAL INV. GUAR. AGENCY, ANNUAL REPORT 2012 115 (2012), *available at* [http://www.miga.org/documents/AR2012\\_English.pdf](http://www.miga.org/documents/AR2012_English.pdf).

97. *Id.*

98. *See Message from the Chairman, supra* note 55.

99. The formulas in this paper are the author's own. They are not intended to be a comprehensive representation of insurance pricing policy, but rather simplified formulas to illustrate key concepts useful in distinguishing public and private policies.

of the insurer. The formula encapsulates the insurer's overall exposure to risk over the life of a project. The actual payout could be much higher or lower, depending on the claim. It should be an uncontroversial assertion that risk profiles may vary widely for different countries, thus influencing the  $p_i$  for the calculation. It is thus logical that insurance premiums vary "depending on the particular risk profile of the project" and that any public rates "could be adjusted" to account for certain circumstances.<sup>100</sup>

The insurer should charge a premium that at least suffices to cover both the expected payout and a profit load. Hence, the premium charged to the investor can be represented as:

$$NPV \text{ of premiums charged over project's life} = \sum_{i=0}^n \frac{p_i a_i}{(1+r)^i} + \text{profit load}$$

The above theoretical formula only instructs the policy issuer on the total amount of premiums that should be charged to adequately cover its risk exposure and earn a profit. Exactly how the premiums should be *distributed* over the lifetime of a project is a matter of contract and the risks expected by the insurer. If an insurer anticipates the highest risk of expropriation to occur within the first five years of a project's life, it could and should frontload the premiums to adequately cover its risk. If the risk will remain relatively constant over the project's lifetime, a greater inclination exists to spread the premiums evenly over time.

It is not difficult to see why public insurers have two primary cost advantages over private insurers: (1) greater access to information to better predict  $p_i$ ,<sup>101</sup> and (2) no pressure to make profit, which could potentially push the profit load to zero for a policyholder. First, public insurers such as OPIC are guided by the U.S. State Department, receiving assistance in forming its policy objectives<sup>102</sup> and broader intelligence about the actions of host-state actors and their intent.<sup>103</sup> The intelligence that the State

100. *Indicative Rates*, OVERSEAS PRIVATE INV. CORP., <http://www.opic.gov/what-we-offer/political-risk-insurance/indicative-rates> (last visited May 17, 2015).

101. For purposes of discussion, this paper assumes that  $p_i$  can be foreseen with some measure of certainty. There is, however, "a growing realization that political risk events are not easily predictable." MIGA 2012 Political Risk Report, *supra* note 12, at 42.

102. 22 U.S.C. § 2191 (describing that OPIC "shall be an agency of the United States under the policy guidance of the Secretary of State").

103. See Jennifer M. DeLeonardo, Note, *Are Public and Private Political Risk Insurance Two of A Kind? Suggestions for A New Direction for Government Coverage*, 45 VA. J. INT'L L. 737, 752 (2005) ("Part of OPIC's purpose was to capitalize on the U.S. government's substantial investment in gaining less readily available information about foreign parties by using it to effectively grade risk."). The U.S. government can, for instance, know when "in negotiations between states, a government might indicate its intent to encourage a business environment favorable to private investment." *Id.* at 751–52. However, there has been a rise in private consulting firms that help to counteract the information asymmetry. *Id.* at 753–54. Nonetheless, private consultants may not have ready access to confidential

Department shares with OPIC based on its leadership analysts, political analysts, and economic analysts all contribute to give it a distinct advantage over private actors in determining  $p_i$ . In fact, OPIC works “in close consultation” with the State Department before making a final commitment.<sup>104</sup> It is true that the signing of BITs by host governments acts as a signal in lessening the information gap between the public and private sector,<sup>105</sup> but it still remains that OPIC can rely on its worldwide support network of U.S. embassy staffers in assessing risk. This intelligence helps OPIC set premiums high when necessary to cover its risk and lower premiums when possible to be the low-cost provider. The evidence confirms that public insurance premiums are generally lower than those in the private sector.<sup>106</sup>

Second, public entities often have a statutory mandate to operate on at least a break-even basis with no pressure to make profit, which has the ability to reduce the profit load on a contract to almost zero. This policy contrasts with publicly-traded insurance companies offering PRI that have fiduciary duties to their shareholders to pursue profits. Furthermore, the focus of public entities like OPIC on promoting small businesses makes PRI available to small entities that might be forced out of the market for private PRI by the transaction costs of brokering insurance for a small investment. Public entities, therefore, offer major advantages to investors, especially to small investors.

Public insurers may also be able to factor in a lower  $p_i$  in calculating premiums because they can use the force of government backing. If the host government, for example, fears negative repercussions from the U.S. government, it may not expropriate an OPIC-insured investment. There may also be private discussions with the host government at the first sign of an expropriation in which the insuring government or multilateral agency attempts to stiff-arm the host government into foregoing expropriation. Skeptics of this effect are likely to argue that publicly documented examples of a host government’s negotiation with PRI insurers are few and far between,<sup>107</sup> and thus that public insurers maintain no advantage over the

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interactions between public actors.

104. *Worker & Human Rights*, OVERSEAS PRIVATE INV. CORP., <http://www.opic.gov/doing-business-us/OPIC-policies/worker-human-rights> (last visited May 17, 2015).

105. Bekker & Ogawa, *supra* note 23, at 339 (“[A] host state’s willingness to conclude a BIT and join an international arbitration convention publicly demonstrates that it has committed to fostering a positive business environment.”).

106. *Id.* at 323 n.73.

107. The lack of publicly available information is unsurprising, as the majority of PRI claims and the negotiation processes behind them are confidential. See Robert Ginsburg, *Political Risk Insurance and Bilateral Investment Treaties: Making the Connection*, THE JOURNAL OF WORLD INVESTMENT AND



private sector in negotiating with host governments. But this argument fails to address the inherent *deterrent effect* that comes from being insured by the U.S. government or the World Bank, resulting in expropriations that never even materialize.

Indeed, an analysis of the MIGA model contract reveals that it is structured to allow MIGA to use its political clout to potentially prevent or minimize an investment loss. Article 12.1(g) requires the policyholder to “immediately notify MIGA in writing upon learning of any event or circumstance that could cause, or materially increase the likelihood of, a Loss.”<sup>108</sup> This article essentially allows MIGA to preemptively try to prevent a host government action, such as a piece of legislation, that could result in a loss to the investor. Article 12.1(i) mandates that the investor, too, take all reasonable steps necessary to prevent an investment loss.<sup>109</sup> Article 11 also subrogates MIGA to the claims of the investor once MIGA has paid the investor for its loss, allowing MIGA to attempt to recover at least part of the loss from the host government.<sup>110</sup>

Investors must weigh the advantages of being publicly insured, however, with the potential disadvantages of public insurance. Investors taking out an OPIC insurance policy must comply, for example, with a laundry list of social and environmental conditions. Investors must explicitly guarantee a right to collective bargaining and a right to association for workers in every contract they sign.<sup>111</sup> Investors in certain projects must submit an Environmental Impact Assessment to demonstrate their compliance with OPIC standards as well as conduct a variety of analyses to ensure compliance.<sup>112</sup>

MIGA imposes similar conditions. Article 12.1(m) of the model contract gives MIGA free reign to monitor an investment’s compliance with environmental and social development standards,<sup>113</sup> and it imposes a burden on the investor to provide MIGA with a comprehensive set of Development Effectiveness Indicators three years after the initial

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TRADE, 943, 950 n.19 (2013) (“While the majority of PRI claims processes are confidential, host government’s decisions to settle a claim or honor an arbitral award are often made available to the public. For this reason, host governments will consider political consequences as well as the merits of the investors’ claims.”).

108. MIGA Model Contract, *supra* note 74, art. 12.1(g).

109. *Id.* art. 12.1(i).

110. *Id.* art. 11.

111. OVERSEAS PRIVATE INV. CORP., ENVIRONMENTAL AND SOCIAL POLICY STATEMENT ¶ 6.3 (2010), available at [http://www.opic.gov/sites/default/files/consolidated\\_esps.pdf](http://www.opic.gov/sites/default/files/consolidated_esps.pdf).

112. OVERSEAS PRIVATE INV. CORP., ENVIRONMENTAL HANDBOOK 5 (2004), available at [http://www.opic.gov/sites/default/files/docs/opic\\_env\\_handbook.pdf](http://www.opic.gov/sites/default/files/docs/opic_env_handbook.pdf).

113. MIGA Model Contract, *supra* note 74, art. 12.1(m).

investment.<sup>114</sup> If the investor fails to comply with any environmental guidelines, and this failure can be linked to the investment loss, MIGA will not pay a claim by the investor.<sup>115</sup> Hence, a situation could arise in which a host government claims that it must pass strong environmental legislation to combat unacceptable levels of pollution by the investor, resulting in what the investor sees as an indirect expropriation. If MIGA discovers evidence on non-compliance with its environmental guidelines, the investor will not be able to recover under its insurance policy. MIGA also has information-gathering powers over the investor; the model contract mandates that the investor give MIGA free reign to examine the investment,<sup>116</sup> as well as furnish MIGA with any information it reasonably requests.<sup>117</sup>

Perhaps due in part to these requirements, a full 48% of investors seeking PRI choose to purchase it through the private sector.<sup>118</sup> An opposing point of view could be that social and environmental regulations actually help investors by helping them maintain a positive rapport with the local community. Even assuming the correctness of this assertion, however, does nothing to diminish the burdensome costs associated with actually proving compliance,<sup>119</sup> which can be a time-consuming, resource-intensive process. Investors receiving OPIC insurance must endure an analysis by OPIC's Office of Investment Policy to ensure compliance with all relevant standards,<sup>120</sup> and withstand onerous monitoring. Purchasing insurance through the private sector would thus allow an investor to gain the benefits of compliance with social and environmental standards while eliminating, or at least potentially reducing, the costs of proving that compliance to a third party.

## B. The advantages and disadvantages of private PRI

The first inherent advantage of private PRI is that it is available to *every investor* looking to purchase it. While some investments may be especially risky, such as those invested in countries without BITs or with countries that would refuse to sign an investment protection agreement

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114. *Id.* art. 12.1(n).

115. *Id.* art. 9.1.

116. *Id.* art. 12.1(j).

117. *Id.* art. 12.1(b).

118. Bekker & Ogawa, *supra* note 23, at 337.

119. Investors purchasing PRI through the private sector could obtain the benefits of compliance with the regulations without having to invest the resources to prove their compliance to a third party.

120. *See generally* *Project Monitoring*, OVERSEAS PRIVATE INV. CORP., <http://www.opic.gov/doing-business-us/OPIC-policies/project-monitoring> (last visited May 17, 2015).

with an insurer (thus eliminating eligibility to obtain MIGA insurance, for example), private insurance companies do not categorically prohibit offering PRI policies to these risky investments, though they may be subject to higher premiums. Private insurance thus provides a fallback for high-risk investments that nonetheless possess a reasonable risk-reward ratio, especially if the private sector can reduce premiums as much as possible by strategically obtaining reinsurance from a variety of actors to reduce its risk exposure.

Perhaps more importantly, an analysis of the policies of national agencies such as OPIC reveals that private PRI fills important gaps in the industry as a result of national governments' imposition of social and environmental conditions. OPIC's economic policies, for example, prohibit it from providing insurance to a project that eliminates U.S. employment and moves production overseas.<sup>121</sup> OPIC's environmental guidelines also prohibit it from assisting projects that "require resettlement" of more than 5,000 inhabitants.<sup>122</sup> Similarly prohibited are infrastructure investments that disrupt rainforests.<sup>123</sup> Although these investments may not garner the emotional salience that more compassionate investments garner, it is nonetheless true that they could have long-term economic benefits for host countries. Private PRI policies allow investors that want coverage to rest assured they will not be subject to a categorical prohibition. For instance, a small-town textile company in Asheboro, North Carolina, that moves some of its operations to the Dominican Republic and El Salvador to increase its competitive advantage would have to rely on the private PRI market to purchase insurance.<sup>124</sup> Similarly, a company building a highway that displaces more than 5,000 people, or an airport that impacts a rainforest habitat, would also likely have to resort to the private market for insurance. Plus, for those investors with *existing* investments that they want to insure, private PRI may be the best option, and in some cases the only option.<sup>125</sup>

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121. See *Economic Analysis*, OVERSEAS PRIVATE INV. CORP., [www.opic.gov/doing-business-us/OPIC-policies/economic-analysis](http://www.opic.gov/doing-business-us/OPIC-policies/economic-analysis) (last visited May 17, 2015) ("The main prohibition covers any project that intends to reduce or eliminate U.S. operations by moving production overseas."). All categorical prohibitions apply to *lenders* as well as investors. See also ENVIRONMENTAL AND SOCIAL POLICY STATEMENT, *supra* note 111, ¶ 3.32 ("No Financial Intermediary may use proceeds from any loan made or guaranteed by OPIC for the purpose of investing in or lending to an entity engaged in a Categorically Prohibited Project.").

122. OPIC ENVIRONMENTAL HANDBOOK, *supra* note 112, at 44.

123. *Id.* at 7.

124. See *Our Plants*, ASHEBORO ELASTICS CORP., <http://www.aecnarowfabrics.com/about-aec/our-plants> (last visited Mar. 12, 2015) (indicating that Asheboro Elastics Corporation, a family-owned business in rural North Carolina, has now grown to have production facilities in El Salvador and Honduras, with distribution centers across the Dominican Republic, Mexico, and Nicaragua).

125. Private insurers have more interest in covering existing investments than public insurers. See

Private PRI, therefore, may offer insurance to projects left out in the cold by OPIC.

In addition to filling gaps in the PRI market, a second advantage of private PRI is that it can be more quickly and efficiently tailored to an investor's specifications. Private PRI providers can generally procure policies more quickly than their public counterparts, resulting in time savings to an investor.<sup>126</sup> Investors can also negotiate more favorable, albeit more costly, coverage. If an investor, for example, desires to insure an investment based on the more favorable discounted cash flow method instead of book value, it can negotiate a contract to do so with a set discount rate and established metrics with which to estimate future cash flows. Similarly, if an investor does not want to absorb a full 10% of any loss, he could potentially purchase a policy with higher coverage in the private market, or supplement his public PRI policy with a private policy for the remaining 10%.

Private PRI providers are also better positioned to offer global risk policies. Piracy, war, and terrorism are becoming ever-more global, and an inability to know where the next coup or terror attack will occur has prompted interest amongst investors for global insurance policies.<sup>127</sup> Of course, globalized policies would be more costly as a result of covering more geographic risk, but there could be substantial transaction cost savings from such a policy relative to an individual policy negotiated for each specific country. The private PRI market could be the launching pad for such a policy because it is not constrained by social and environmental evaluation requirements, or by a requirement that a country have a BIT or some other form of legal protection agreement for the investor.

Despite the advantages of private PRI, it faces at least two drawbacks. First, the private PRI market is more subject to capacity fluctuations than public entities. Periods in which credit markets are tight lead to increased difficulty in obtaining insurance from private providers. During the heart of the financial crisis in 2008 and 2009, the growth in total coverage provided by public providers increased much faster than that of private providers.<sup>128</sup> Laws governing cash reserve requirements for insurance companies can

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MIGA 2012 Political Risk Report, *supra* note 12, at 46 (“For example, the events in the Middle East and North Africa region have engendered an interest for coverage of existing investments, despite the historical requirement of many public providers to cover only new investments.”).

126. See Bekker & Ogawa, *supra* note 23, at 323 (noting that private insurers are often “speedier” and can offer “more tailored” policies).

127. See MIGA 2012 Political Risk Report, *supra* note 12, at 47 (“[T]here has also been an increase in demand for global policies that encompass all risks. With uncertainty as to where the next political risk ‘event’ will occur, there seems to be an increased interest in global PRI coverage.”).

128. *Id.* at 43.

also impact PRI availability.<sup>129</sup>

Second, an investor purchasing a private PRI policy loses the deterrent effect that public insurers carry. This deterrent effect would presumably be less important, however, for investors concerned with political violence rather than expropriation. Expropriation—an intentional act by a host government—might be deterred by the prospect of engendering hostility with the World Bank or the U.S. government. By contrast, independent, uncontrollable bands of rebels causing political violence are not likely influenced or even aware of such indirect repercussions of their actions.

### III. TOWARD A COST-EFFECTIVE RISK MITIGATION STRATEGY FOR INVESTORS

#### A. Purchasing public insurance is favorable to private insurance

Despite the advantages of private insurance,<sup>130</sup> investors should prefer public insurance. National agencies such as OPIC have spent decades building goodwill with developing-country communities.<sup>131</sup> American investors, for example, should highly value the reputation that OPIC holds in developing countries, as governments are oftentimes concerned with their reputations when engaging in activity that could be considered expropriation.<sup>132</sup> The backing of OPIC and the pressure that OPIC can potentially put on host governments not to expropriate should be of high value to investors, especially investors that might be prone to expropriation risk, such as oil companies, canal operators, or mining companies.

One may reasonably argue that investors should purchase private PRI because the net book value valuation method used by public insurers will not adequately compensate them for the investment loss. While this is true, nothing appears to prevent the investor from seeking additional compensation from an arbitral tribunal in the amount of the difference

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129. See *id.* at 40 (“[T]he PRI market is influenced by developments in the general (property/casualty) and life insurance industry . . . . [N]ew capital requirements contemplated by [new regulations] are expected to be met easily.”).

130. See *supra* Part II.B.

131. See, e.g., OVERSEAS PRIVATE INV. CORP., OPIC-SUPPORTED U.S. INVESTMENT IN CENTRAL AMERICA HELPS REGION MEET DEVELOPMENTAL NEEDS (2007), available at [http://permanent.access.gpo.gov/lps81122/central\\_america0307.pdf](http://permanent.access.gpo.gov/lps81122/central_america0307.pdf) (noting remarkable achievements by OPIC and OPIC-supported businesses to contribute to societal development in Central America).

132. See Roderick Duncan, *Costs and Consequences of the Expropriation of FDI by Host Governments*, COLLECTION OF THE AUSTRALIAN AGRIC. & RES. ECON. SOC’Y tbl. 2 (2006), available at <http://ageconsearch.umn.edu/handle/139524> (providing empirical evidence supporting the assertion and expropriations lower the reputations of governments amongst investors, though it can be regained through de-expropriation).

between the discounted cash flow valuation and the net book value. In fact, investors that possess the support of agencies such as OPIC could have a greater chance of succeeding in arbitration.

Even if investors are intimidated by the public insurers' social and environmental requirements, they should still strongly consider purchasing insurance for their investment. Whatever costs investors incur meeting their social obligations could be recouped through intangible benefits from improved community relations and increased shareholder confidence necessary to pursue their investment objectives aggressively. As for tangible benefits, investors paying PRI premiums could be able to recoup some of the cost in the form of lower interest rates from lenders due to the fact that major political risks are shifted out of the company and onto the insurer.<sup>133</sup> In sum, the intangible and tangible benefits of public insurance, as well as the potential deterrent effect against host governments, should cause investors to think twice before foregoing a public PRI policy.

#### B. Lowering insurance premiums through strategic engagement with host communities and host governments

As previously discussed, an investor can lower the amount of its insurance premiums primarily by either reducing (1) the amount of an investment loss in the event of a claim ( $a_i$ ), or (2) the probability of an investment loss ( $p_i$ ).<sup>134</sup> Strategic engagement with host communities and host governments can potentially lower both of these variables.

First, engaging host governments could lower the amount of an investment loss in the event of a covered host-government action. Investors could enter into agreements with host governments to set aside host-government funds into an escrow account to be released to the investor in the event of expropriation or other damages from political violence. Some scholars have recommended escrow accounts as risk mitigation tools.<sup>135</sup> The exact amount in escrow, as well as the period of time it would be held in escrow, would be negotiated by the investors and governments. The amount could be large, such as enough to cover a portion of an investment loss, or the amount could be just small enough to cover arbitration costs in the event of arbitration in which the host state loses. Oftentimes, no single tool can cover all risks,<sup>136</sup> so investors should

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133. This benefit would also be present with a private PRI policy.

134. See *supra* Part II.A.

135. RAZAVI, *supra* note 22, at 132.

136. *Id.* at 131 ("Often, project sponsors combine several guarantees to ensure sufficient protection against political risks.").

consider a variety of ways in which they can combine PRI policies with other contractual solutions to reduce risk. The availability of escrow accounts may be limited to investors performing critical services for a country, such as infrastructure projects, as they would be the only investors with enough leverage to potentially extract such a concession.

Investors can also reduce  $p_i$  by forming healthy working relationships with host governments. Investors currently rank engagement with host governments and contributions supporting “well-connected political figure[s]” as among some of their top risk mitigation strategies.<sup>137</sup> This seems intuitive, as open channels of communication between government leaders and investors would allow investors to address any host-government concerns sooner rather than later. Investors might also consider quarterly or semiannual meetings with host government leaders to keep them apprised of the company’s activities.

Second, investors can strategically engage their host communities to reduce  $p_i$ . Popular risk mitigation strategies include forming an “alliance with [a] local company” and “invest[ing] gradually while developing familiarity with the local environment.”<sup>138</sup> In addition, investors can build goodwill in their host communities by engaging in innovative social programs with host governments and local workers.<sup>139</sup> Building support among local businesses and populations can thus be an effective mechanism for controlling risk and lowering insurance premiums.<sup>140</sup>

## CONCLUSION

No investor-company can completely immunize itself from the potential political risks inherent in investing in developing countries. As such, investors are increasingly turning to PRI to protect their investments. While public entities have traditionally filled this need, private players are increasingly participating in the PRI industry.

Investors tasked with selecting a PRI option face wide-ranging

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137. MIGA 2012 Political Risk Report, *supra* note 12, at 10, fig.3.

138. *Id.*

139. See, e.g., “Food for the People” Program for Workers at Free Zones, COMISIÓN NACIONAL DE ZONAS FRANCAS, <http://www.cnzf.gob.ni/?q=en/news/food-people%E2%80%9D-program-workers-free-zones> (last visited Mar. 12, 2015) (describing the provision of subsidized food, among other benefits, to local workers by foreign investors in Nicaragua in collaboration with the Nicaraguan government).

140. PRI purchases are generally made *before* an investment is made, making it difficult for the investor to predict that it will be able to achieve goodwill in the host communities and thus should be charged lower premiums. However, a strong track record of host community and business cooperation could be persuasive in negotiating premiums for new investments in the same country, or expansions of existing investments.

options, each with distinct advantages and disadvantages. Which PRI option best fits an investor's needs depends on various circumstances. An investor that values speed and does not wish to be monitored for compliance with social and environmental standards would likely prefer a private PRI policy, whereas an investor concerned particularly with expropriation risk who values the deterrent effect of the World Bank's backing would likely opt for a MIGA PRI policy. Furthermore, there may be some investors for whom the decision of which policy to purchase is pre-determined, since those investors face categorical prohibitions from national agencies.

Despite the advantages and disadvantages of each type of PRI policy, investors should attempt, if possible, to purchase a public PRI policy to reap the benefits of lower premiums and increased leverage when negotiating with host governments. Investors can also safeguard their investment and potentially lower their PRI premiums by engaging strategically with host communities and host governments to reduce the probability of an investment loss. With these risk mitigation tools, the upward trend of foreign investment in developing countries will hopefully continue to increase, perhaps even at a more rapid rate—as will the corresponding societal benefits that accrue to host communities.