POLITICAL RISK INSURANCE - BRIEF EXPLANATION ON WHAT'S COVERED

In the following few pages, we define the specific issues that a company may face when considering an overseas investment.

Perhaps the most important first step is the identification of political risks and how they can affect the way a company considers an investment - or if it should proceed with it at all.

The brief review of the various types of political risks will help in that process.

Political Risk Insurance policy will pay on the behalf of the Insured for losses resulting directly from those risks associated with cross border transactions primarily in developing countries. This can include actions or inaction by the "foreign" host Government in the form of contract default, expropriation, license cancellation or non-honouring of a sovereign guarantee. Because of the exposure to a foreign currency, it can cover the inability to convert local currency to a hard currency such as the US dollar and transfer offshore. As a supplement to property coverage it protects against physical damage to assets as a result of political violence. This includes coverage for War and Civil War.

In addition to coverage for acts which occur within the host country, Political Risk Insurance will protect against acts by the Insured's country directed at the host country of the investment including embargo, license cancellation, forced abandonment or forced divestiture.

Political Risk Insurance is designed to protect the financial exposure of the Insured and can be designed to protect the interest of an Insured as a seller or buyer of goods or services, as an equity investor, or as a lender to a foreign project. In contrast to other lines of coverage, the Insured can protect its interest only, even where there are other investors or parties to the contract. The local partner(s) portion of investment in the country of domicile cannot be insured. It must be cross-borders.

PREMIUM RATES FOR POLITICAL RISKS INSURANCE (PRI)

The pricing for buying PRI protection is usually around 1 to 3% per year. It's only for Equity Investment across borders, meaning available only for investment overseas.

The premium rate dependant on type of investment and country and also the amount. The bigger the amount lower the rate, can go as low as 0.5% per year.

BRIEF DEFINITIONS OF POLITICAL RISK COVERAGE

RISK: Confiscation, Expropriation, Nationalization.

Selective and discriminatory acts by the host government causing permanent loss of economic benefit of a venture without fair compensation.

Example: A gold mine is taken over or "nationalized" by the host government in the public's interest. Compensation to the owner(s) is $1.00.

RISK: Deprivation

Loss of use of personal property (generally mobile equipment) outside the host country due to;

a) the inability to obtain an export license where export licenses were previously obtainable

b) cancellation of the export license or

c) other restrictions by the host government to prevent export.

d) Deprivation is generally grouped with Confiscation, Expropriation, Nationalization to form the abbreviation CEND.

Example: A construction company brings equipment in country to complete road construction. Upon conclusion, the host government refuses to issue export licenses. Equipment becomes a non-performing asset.

RISK: Selective Discrimination

The imposition of any law, order, decree, regulation or import/export restriction by the government of the host country, applied selectively against a foreign enterprise, which;

a) expressly and selectively prevents or restricts the operation of the foreign enterprise, or

b) legally prevents the Insured from participating in the benefits of the foreign enterprise rendering continued operation of the foreign enterprise(s) economically unviable for a continuous period of time.

Example: Host country increases taxes to an effective rate, which is prohibitive and makes project economically unviable. The tax

increase is targeted only to projects majority owned by foreign corporations.

RISK: Forced Divestiture

The imposition of any law, order, decree, or regulation by a party's own government that expressly:

a) requires permanent divestiture of all or part of a shareholding in the foreign enterprise, or

b) prevents or restricts the operation of the foreign enterprise or the possession of the assets of the foreign enterprise so as to cause the permanent and total cessation of activities.

Example: U.S. government prohibits U.S. companies from investing in a country and also forces the sale of existing investments in the same country. The forced sale results in less than adequate compensation.

RISK: Forced Abandonment

Abandonment of a foreign enterprise for a continuous period of six (6) months arising in circumstances beyond the control of the equity holder or lender. Abandonment is a result of a requirement or advice by the home government to evacuate key operations personnel from the host country or a relevant region. This is subject to the requirement or advice being generally applicable to all nationals of the home country.

Example: The U.K. government requires all U.K. nationals to leave a specific country during a period of war. An investor must therefore abandon a wastewater treatment plant as the plant cannot be maintained without U.K. engineers and management.

RISK: Arbitration Award Default

The risk of default or non-payment of an arbitration award obtained under the terms and conditions of a project agreement or under International Law (if there are no provisions for dispute resolution) where the proximate cause is breach or unfair termination of the project agreement by the host government.

Example: Telecom project has a licensing agreement with the host government. The government unilaterally amends the agreement increasing significantly the percentage share to be paid to the government, resulting in an economically unviable project. Project disagreement is taken to arbitration and is awarded in favor of the non-government investors. The government defaults on the obligation to pay the arbitration award.

RISK: Import/Export License Cancellation, Embargo

The prevention of import or export of goods or technology from any country due to the cancellation of previously obtained import/export licenses or prohibition due to embargo.

Example: A company must default on a major construction contract when an embargo is put in place with the host country after contract signature and construction had begun. The company is not compensated for work completed nor advances paid to equipment manufacturers.

RISK: Currency Inconvertibility

The inability of the host country/central bank to exchange deposits of local currency representing principal, interest, earnings, dividends, management fees, etc., deposited by a foreign enterprise for exchange to a designated foreign currency.

Example: Payments of loan principal and interest are delayed for an extended period due to insufficient hard currency reserves in the host country.

RISK: Transfer Risk

The risk that the host government/central bank blocks or refuses to transfer deposited funds in the host country to a designated foreign location.

Example: Earnings and dividend remittances are frozen in the designated depository of the host country due to newly implemented regulations to protect dwindling hard currency reserves.

RISK: Political Violence

Physical damage to the assets of a foreign operation or inability to continue debt service due to strikes, riots, civil commotion, malicious damage, war, civil war or terrorism.

Example:

1) A terrorist attack damages the retaining wall of a hydro-electric plant.

2) Civil war in the territory shuts down a manufacturing location. Sufficient revenue cannot be generated to continue debt service.

RISK: Business Interruption

Interruption of a foreign operation resulting in lost earnings and additional expenses due to either (a) confiscation, expropriation, nationalization or related perils, or (b) political violence.

Example: A chemical processing plant is damaged during a civil war. Income is lost and ongoing expenses must be paid during the rebuilding phase, while no revenue is generated.

RISK: Contract Frustration

The non-fulfillment of a contract due to "political events" including: import/export license cancellation, embargo, government buyer non-payment or repudiation, expropriation (CEND), currency inconvertibility, war, or non-honoring of a letter of credit.

Example: A construction project is successfully completed for a host government. The host government defaults on their payment obligation to the contractor.

RISK: Unfair Calling of Guarantee / Wrongful Calling of Guarantee

(A) The unfair drawing down of an on-demand, standby letter of credit posted as a bid, advance payment, warranty or performance guarantee by a government entity or

(B) a fair drawing where the contract terms are unfulfilled due to a political risk.

Example: Bid bond posted with a bid for privatization of a utility is called "on demand" by the government. The call is unfair, as all the terms of the bid were fulfilled.

Credit risks inherent in international trade transactions

In addition to the risks that fall under the category of Political, there are also Credit risks inherent in international trade transactions.

RISK: Default or Insolvency

Protracted default or insolvency of a private buyer or seller.

Example: A medical equipment manufacturer sells equipment to a private hospital on two year terms. Six months later, the hospital defaults on a payment due to insolvency.

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